CHAPTER

08

The Changing Dynamics of Urban Economies

QUICK FACTS

1. Megacities and metropolitan regions have benefited more from globalization than secondary cities.
2. Inadequate urban infrastructure and services hamper economic growth and activities that depend on the optimal allocation of resources.
3. The benefits of agglomeration tend to outweigh the drawbacks, providing the resources needed for proper management of any diseconomies.
4. Formal employment has not grown in tandem with the rapid urbanization of cities, thus exacerbating urban social and economic inequality.

POLICY POINTS

1. The link between planning and economic development policies for cities must be integrated across all levels of government.
2. Strengthening city finances through public-private partnerships, land taxes and user charges and the development of more equitable fiscal arrangements between national and city governments is essential for sustainable development.
3. Providing a legal framework for the decentralization of responsibilities is essential to improving city governance structures.
4. Linking urban policy to economic development is critical to improving the competitiveness and performance of local economies.

Changes impacting cities' economies since Habitat II include:

- global economic conditions
- ageing and (mainly in developing countries) rapidly growing populations
- technological innovations particularly in transport, communications and data processing
- sharper policy focus on environmental sustainability and climate change

In various cities in developing countries, the **informal economy** is the main area of **production, employment** and **income generation.** It ranges from

25-40%

of GDP in developing economies in Asia and Africa, with the share in non-agricultural employment between **20-80%**

1990 — **2013**

The United Nations Human Development Index increased globally by almost **18%**

37%

Reduction in the global population of people living in extreme poverty from **1,959 million** in 1990 to around **900 million** in 2012.

10%

Estimated decline to **702 million** expected in 2015, largely due to massive efforts by China and India.

Urban populations in **low-income** countries are projected almost to triple, increasing by over **500 million.**

Property tax, as an efficient source of local revenues, represents less than

3-4%

of local revenues in most developing countries, compared with

40-50%

in cities in Australia, Canada, France, UK and US.

Lessons learned from technological change in cities:

1 > can **leapfrog** conventional barriers to deliver what vast majority of consumers need and at affordable cost

2 > **not confined** to high-income economies

3 > **not dependent** on foreign direct investment

4 > it is for national and municipal authorities to **provide well-adapted** legal, regulatory and tax environments, together with skills training and proper infrastructure if innovation is to be nurtured locally, instead of moving to more favourable locations

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New forms of partnership, such as that proposed by Asia-Pacific Economic Cooperation (APEC), are necessary to link the economic systems of cities, to encourage informal trading relationships, cross-industry and cross-cluster collaboration, innovation- and knowledge-sharing, as well as identification of new opportunities for linkages among cities. Mobilizing domestic capital has a crucial role to play.

8.1

Urban Economies, Prosperity and Competitiveness

Urban economies are primarily people-centred. Individual capital in all its forms — social, physical, technical, cultural, scientific, etc.— converges and combines in a variety of innovative ways and this productivity benefits all, spreading prosperity beyond city limits. This perennial dynamics is for cities to nurture through adequate healthcare, education, services, environments and institutions. Now, as governments and civil society prepare for the Habitat III conference, the "emerging futures" of many cities around the world seem elusive for their inhabitants due to persistent poverty and increased inequality and the emergence of new threats such as climate change and insecurity as highlighted in the preceding chapters.

Cities have been rapidly changing since Habitat II, so are their economies. These changes include: global economic conditions; ageing and (mainly in developing countries) rapidly growing populations; technological innovations particularly in transport, communications and data processing; as well as sharper policy focus on environmental sustainability and climate change.

Whereas one of the Millenium Development Goals targeted the slums (MDG 7,Target 11), the innovative feature of their "sustainable" successors is SDG 11, "Make cities and human settlements inclusive, safe, resilient and sustainable."[1] It will be for participants in the Habitat III conference to identify a number of specific indicators to measure progress toward this goal between now and 2030.

Focusing on the vital issue of cities' "emerging futures" does not mean that local specificities go overlooked

Focusing on the vital issue of cities' "emerging futures" does not mean that local specificities go overlooked. Every city has its own environment. The 2008 world financial crisis burst the speculative urban housing bubbles in Madrid and Dublin whilst the construction boom continued unabated in Mumbai, immune from external shocks and providing jobs to thousands of rural young people.[2] Today, massive multi-billion dollar urban re-development projects are transforming the economies and forms of inner cities from Singapore to London, from Buenos Aires to Vancouver to Guayaquil.

The dynamics of change are now increasingly determined by the interlinked nature of the global economy and markets, capital flows and information networks

Cities have always had to face issues of change.[3] The dynamics of change are now increasingly determined by the interlinked nature of the global economy and markets, capital flows and information networks. Transitioning to new opportunities is creating problems and opportunities for urban governance, the business sector, individuals and communities. Inflexibility and inefficiency are ruthlessly exposed by poverty, slums and the predominance of the informal economy.

Although urban areas around the world are becoming more and more interrelated, cities have their local dynamics and specificities—which include social structures, way of life, production, the environment and infrastructure.[4] As they interact, these dynamics transform one another and it is upon the socio-political institutions to make sure that they do so in a beneficial way for all involved. Even "way of life" can destroy urban and national prosperity; weak, corrupt autocracies have historically been seen to support themselves through "suppression of entrepreneurship" with "arbitrary taxation, confiscations and favouritism."[5] These basic realities are well recognized in the 2030 Agenda for Sustainable Development through calls for "people-centred economies," "wealth sharing," "strong economic foundations," "strengthening productive capacities" and "structural transformation." Productivity results from economies of agglomeration and scale in a concentrated area, which is increasingly interlinked to regional, national and international economies. The efficiency, productivity and liveability of cities are a foundation of society.

As noted in previous chapters, cities produce a significant share of all goods and services in the world. Urban-based markets facilitate trade and reallocation of resources (labour, capital, land) from less to more productive sectors, industries, and occupations. Efficient resource allocation depends on complex linkages and information flows among consumers and producers involving inputs, intermediate and final products. These linkages and flows are dependent on the quality, reliability and costs of a city's infrastructure and services, the legal and regulatory environment, educational standards and entrepreneurial spirits.

Ideally, urban policies and infrastructures keep in step with, if not anticipate on, growing populations—although lead times in the planning, financing and con-

Traders at work along the tracks in Kibera, Nairobi, Kenya.

Source: John Wollwerth / Shutterstock.com

struction timeframes of infrastructure and service provision can be protracted, and the same holds with reforms in education and health services. The reality has more to do with "creative chaos" as a result of poor planning, mismanagement and inadequate municipal finances including tax collection.

Informality is an instance of the "creative chaos" which typically comes with spontaneous urbanization, as cities fail to provide for newcomers, leaving them to their own devices for shelter and livelihoods.[6] Most of these migrants only have their poverty and low skills to bring to town; this disqualifies them from access to the formal, tax-paying business sphere, whereas the industrial and public sectors are too poorly developed to provide regular employment. The alternatives are self-employment, casual work and petty trading along with small-scale, low-productivity, informal enterprises devoid of any legal, social or labour protection. The conditions are especially difficult for youth and women, and there is a high risk of child labour exploitation.

Estimates of the overall size of the informal economy range from 25 to 40 per cent of GDP in developing economies in Asia and Africa, with the share in non-agricultural employment between 20 and 80 per cent.[7] In many cities in developing countries, the informal economy is the main area of production, employment and income generation. Moreover, informal settlements with thriving and diverse activities play vital roles, providing a wide range of labour, goods and services to cities. For instance, Kibera — one of the largest slums and informal economies in Africa— plays a vital role in the economy of Nairobi. The vibrant and dynamic economy Kibera is illustrated by the following observation: "*It is a thriving economic machine. Residents provide most of the goods and services. Tailors are hunched over pedal-powered sewing machines. Accountants and lawyers share trestle tables in open-air offices. Carpenters carve frames for double beds along a railway line.*"[8]

In addition to labour market and welfare issues, the informal economy poses a major policy challenge to urban governance in financing and providing urban infrastructure and services.

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8.2 Urban Economic Growth and the New Economic Geography

The ongoing spatial concentration of people in urban areas has spawned a new economic geography— as illustrated by Figure 1.2 and Figure 1.3 in Chapter 1—which Habitat II could not fully anticipate. The dynamics of urban economics feed on higher productivity and returns on investment, together with a rising

Box 8.1: The Delhi–Mumbai Industrial Corridor (DMIC)

Following the slowdown induced by the global financial crisis, the Indian economy responded strongly to domestic fiscal and monetary stimuli and achieved a growth rate of 9.3 per cent in 2010–2011; but due to both external and domestic factors, the economy decelerated, growing at an estimated 5 per cent in 2012–2013. To address this downturn, one of India's strategic initiatives was to transform the Delhi-Mumbai highway into an industrial corridor.

The Delhi-Mumbai Industrial Corridor (DMIC) involves industry and infrastructure in a 150-200 km band on either side of a 1,500 km dedicated railway freight line (DMIC, 2010). Approximately 180 million people, or 14 per cent of the population of India, will live there. The idea is to developian industrial zone, with eco-cities spanning across six States, together with industrial clusters and rail, road, sea and air connectivity. Plans include 24 "market-driven" cities comprising regions with special investment regimes and industrial zones. The scheme places a whole new meaning on the scope and scale of urban economic corridors.

Source: Delhi Mumbai Industrial Corridor (DMIC),2010.

middle class. On the whole, the benefits of agglomeration have tended to outweigh the drawbacks, providing the resources needed for proper management of any diseconomies (such as competition for resources, including space, driving costs up).

Urban areas account for as much as 55 per cent of national GDP in low-income countries, 73 per cent in middle-income countries, and 85 per cent in high-income countries. Indeed, it is anticipated that 80 per cent of future economic growth will be in urban areas.[9] However, Specific urban GDP data is hard to come by and interpretation requires caution. This is because estimates can vary significantly across research organizations for lack of generally accepted international accounting standards; if anything, they provide broad directions rather than precise magnitudes.

The McKinsey Global Institute (MGI) has compiled a database of the world's top 600 cities by contribution to total GDP growth until 2025. [10] Like the World Bank, MGI estimates that more than 80 per cent of global GDP is generated in cities. Of the 600 cities, the 100 largest generated an estimated 38 per cent of global GDP in 2007, or around US$21 trillion. The remaining 500 generated an estimated US$30 trillion.

Some general conclusions can be drawn from MGI and other data about urban economic dynamics since Habitat II:

- Mega- and larger cities are playing increasingly dominant roles as the drivers of economic wealth and employment. The world's economically strongest urban centres host 25 per cent of the global population and produce 60 per cent of global GDP.
- There is a clear trend of concentration in megacities, urban corridors and urban regions.
- Due to higher productivity and better infrastructure, rankings by GDP are dominated by developed country cities and will remain so for the foreseeable future.
- City GDPs and growth rates differ significantly across regions, and are highest in developing countries, mainly in the Asia-Pacific region.
- The fastest overall urban economic growth is found in mid-sized cities (with populations between two and five million).
- Economic growth continues in megacities although the pace is slowing down.
- In developing countries, seaports and other trade hubs are associated with relatively higher per capita GDP. In developed countries, extensive nationwide transport infrastructure significantly dilutes this effect.

- In some countries, the economy of a single city can account for a significant share of national wealth creation. For example, Seoul, Budapest and Brussels respectively account for more than 45 per cent of the GDPs of the Republic of Korea, Hungary and Belgium. In other countries, a group of cities contribute a significant share of GDP–For example, in South Africa, six major cities collectively account for 55 per cent of GDP.[11]
- As cities tend to concentrate more of productive resources, economic inequality with the rest of the country tends to become steeper. In MGI data, the most significant differences are found in Russia, China and Indonesia where urban GDP per capita is 2.5 times or more of the national equivalent.

8.3

Urban Development: An Economic Transformation

To date, the growth of cities and their economies has been positive in terms of aggregate income, though with different effects across locations, industries and people. Overall, productivity has improved and resulted in improved standards of living. Between 1990 and 2013, the United Nations Human Development Index increased globally by almost 18 per cent.[12] A significant, encouraging reduction in the number of people living in extreme poverty (i.e. on less than US$1.90 a day (2011 PPP)) has also been recorded: from 1,959 million (37 per cent of the global population) in 1990 to around 900 million in 2012, with a decline to 702 million (below 10 per cent of the global population) expected in 2015,[13] largely due to massive efforts by China and India.

The degrees of urbanization and economic development are closely interrelated. High-income countries and more developed regions have largely completed their urban transitions. Over the next 35 years to 2050, urbanization will centre on other countries. The urban population of lower middle-income countries is projected to more than double in size, increasing by around one billion. Urban populations in low-income countries are projected almost to triple, increasing by over 500 million. Management of this scale of urban transition will be particularly difficult as timeframes are short, and these countries have the least resources to accommodate change.

Since urban areas are where national economic dynamics take shape, the aggregate figures in Table 8.1 give a notion of what the “emerging futures” of cities might look like for various income brackets and regions. The strength of services and marginal contributions of manufacturing and agriculture will remain in high-income countries, where cities are faced with de-industrialization and its social consequences. At the other end of the spectrum, agriculture remains strong in middle- and low-income countries, compared with weak manufacturing and industry (the latter including the construction sector), with the relatively

Table 8.1: Structure of output :Income and regions, 2012

Source: Based on http://databank.worldbank.org/, last accessed 25 November 2014.

	GDP	Agriculture	Industry	Manufacturing	Services
	$ billion	% of GDP	% of GDP	% of GDP	% of GDP
Low income	527.0	27	23	12	49
Middle income	22,516.2	10	36	21	54
Lower middle income	5,031.4	17	31	16	52
Upper middle income	17,481.2	8	38	23	54
Low and Middle Income	23,057.2	10	36	21	54
East Asia and Pacific	10,331.0	11	44	30	45
Europe and Central Asia	1,867.7	9	31	17	60
Latin America and Caribbean	5,467.5	5	32	16	63
The Middle East and North Africa	1,595.2	..	..	..	..
South Asia	2,302.7	18	26	14	56
Sub-Saharan Africa	1,503.5	14	29	10	57
High income	49,886.8	1	25	15	74

strong share of services likely pointing to significant retail, import-export and transport more than higher-productivity services (banking and finance, insurance, consulting, etc.). This pattern suggests that cities in the countries within this income bracket need more private productive investment and public capital expenditure in areas such as manufacturing, utilities, and welfare.

Cities in countries that are part of the income brackets that are in between show economic transformation at different stages, with the notable persistent weakness of manufacturing in Latin America regardless of huge actual and potential consumer markets. The challenge for Africa is to transform more of abundant commodity resources— often, over-reliance on exports holds the region hostage to the vagaries of world markets. On the whole, Table 8.1 points to the increased scale and complexity of challenges that cities have faced since Habitat II. Ahead of the Habitat III conference, this reading of Table 8.1(combined with data on informal economies) also suggests how public policies, laws and regulations (including tax) can steer and support ongoing urban dynamic changes for smooth transitions to shared prosperity, along with public and private capital expenditure. Political will and appropriate policies are in order, with support from decentralized public finance, fostering social capital and socio-political stability.

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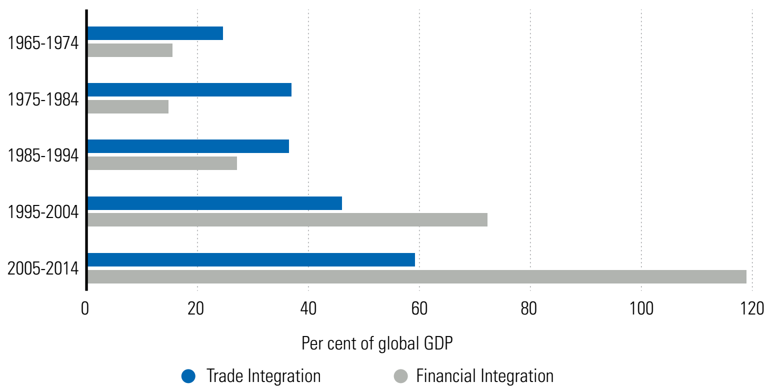
Figure 8.1: Global trade and financial links increased dramatically in the past 50 years

Source: M. Ayhan Kose and Ezgi O. Ozturk, 'A World of Change - Taking stock of the past half century', in IMF, Finance and Development, September 2014 p 7.



Note: Trade integration is measured by the ratio of total imports and exports to global GDP. Financial integration is the ratio of total financial inflows and outflows (including bank loans, direct investment, bonds, and equities) to global GDP. Financial integration data are through 2011. Trade integration data for 2014 are forecasts.

Looking ahead, a concern for some cities– in the light of continued urbanization—is slow global economic growth, smaller capital flows and limited local productive investment by domestic capital might exacerbate shortfalls in infrastructure and services, leaving large numbers of urban residents in inadequate housing and informal livelihoods for the long term.

8.4 The Dynamics of Urban Economies

The new economic geography is the outcome of a complex interplay of factors that have fundamentally changed the dynamics of urban economies. These factors are discussed below.

Global economic growth

A significant change since Habitat II is that cities are increasingly interconnected regionally, nationally and globally, and they operate in global markets for goods, services, finance and, increasingly, labour. In this new, more interconnected world, this is probably the most important factor determining the ability of cities to provide infrastructure and services, to ensure employment opportunities, and to improve standards of living is global ,economic growth and the capacity of cities to participate and compete in the global economy.

It is incumbent on national and municipal authorities to ensure that, at the city level, any such linkages nurture "strong economic foundations," "wealth sharing," "people-centred economies," "strengthened productive capacities" and "structural transformation"[14] with due regard for transparent, participatory governance involving local communities, as mandated by SDGs, and for the sake of urban prosperity as envisioned by UN-Habitat.

Economic policy and globalization

Since the early 1990s, policy changes encouraging liberalization and globalization have strengthened the economic development of cities with tradeable goods and services. Tariffs and other protection measures have declined, with global trade in goods and services, and capital flows, rising sharply (Figure 8.1).

The paradox with too many cities around the world today is that they seem more ready to cater to the needs and requirements of overseas investors than to those of the poor living in their midst or on the margins. Foreign direct investment in current conditions cannot adequately benefit the poor. Still, cities seem keener to provide land, infrastructure and well-adapted rules and regulations to the foreign denizens of central business districts than to local, poor, slum-dwelling informal entrepreneurs. Admittedly, this is a major factor behind ever-steeper urban inequality, in both statistical and anecdotal forms.[15] The problem is that serious doubts can be cast on the reality of the celebrated "trickle down" effect whereby riches naturally if gradually ends up benefiting the poor when the fact of the matter is that, especially in Africa, rent-seeking local elites make sure that most such benefits only accrue to them. As noted by a former World Bank chief economist,[16] liberalization is a factor behind inequality, creating new elites in developing countries; in advanced economies, de-industrialization leaves workers underpaid or jobless while the profits go to corporate managers and shareholders. Liberalization also deprives governments of the revenues they need to redress inequalities, as firms and capital evade taxation.

For many, particularly secondary cities, globalization has eroded the industrial base as businesses and jobs have moved to more attractive locations—leaving cities with low growth prospects, struggling to attract investment and create jobs in the formal economy. Many secondary cities in developing countries have failed to tie up global or even national linkages and are struggling to accommodate growing populations.

Agglomeration economies

Businesses tend to be more productive and profitable when located in cities because they benefit from agglomeration economies, knowledge spillovers (both within the same sector and across industries and sectors), a large labour market (including for specialist trades and scientific and commercial expertise), and sharing intermediate inputs (legal and accounting services). The impact in developed and developing countries is different but enhanced by "good urbanization policies."

With an increasingly global marketplace, the importance of agglomeration economies to the profitability and success of businesses has increased. A spatial outcome is that economic activity and industries increasingly tend to cluster together— research hubs, information processing or logistics clusters, etc. —both within cities and across multiple city regions, in the drive for profitability.

That is why some governments have encouraged agglomeration economies, employment and trade through incentives for businesses to locate in designated clusters or Special Economic Zones (SEZ). Incentives have usually included a combination of tax and tariff relief, land and infrastructure provision and a simplified regulatory environment for specifically designated areas (i.e. no need for sweeping nationwide reforms). As illustrated in Figure 8.2, the number of special economic zones has risen sharply over the past two decades. The Shenzhen SEZ in China is a remarkable success (built on location advantages and already incipient trends), but overall results have been very mixed especially when compared with the high costs (in terms of tax and infrastructure).

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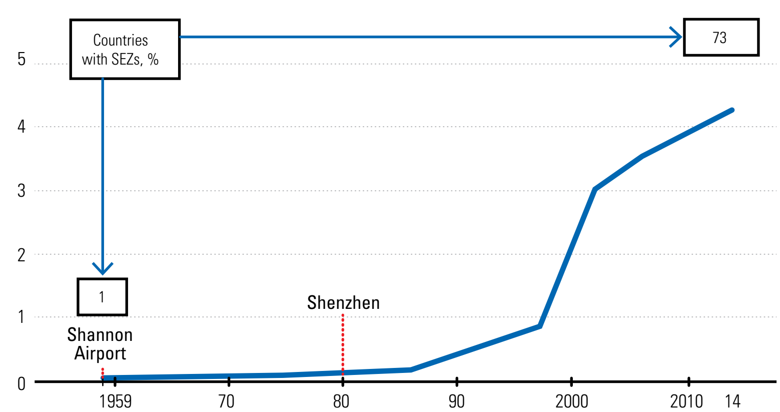
Technological change

Technological change affects how and where income and growth are generated. This flows through directly to the spatial structure and performance of cities and their economies. Most new businesses start in cities; most research and development is undertaken in cities. Over the last few decades, rapid technological change has revolutionized production processes, transport modes and costs, and ICT (Chapter 2). Where the profitability of commercial operations often benefitted from vertical integration –where inputs and production of the final product

Technological change affects how and where income and growth are generated

Figure 8.2: Special economic zones: Number worldwide (000s)

Source: The Economist, 2015a.



centred on a single location— more distant locations can now exploit their comparative advantage as they become part of global supply chains. Today, the economic success of cities remains dependent on the efficiency of their transport, communication and information linkages and systems. Technologies also revolutionize consumer behaviour and conventional services. Online networks such as Uber and AirBnB offer services which pose a challenge to existing business regulations and practices. Kenyans can transfer money via mobile phones, and even (pending government authorization) invest in government bonds.

The Kenyan example holds four lessons for cities: (1) the irrepressible drive of technology can leapfrog conventional barriers to deliver what vast majority of consumers need and at affordable cost; (2) technological innovation is not necessarily confined to higher-income, advanced economies; (3) it is not necessarily dependent on foreign direct investment, either; and; (4) it is for national and municipal authorities to provide well-adapted legal, regulatory and tax environments, together with skills training and proper infrastructure if innovation is to be nurtured locally, instead of moving to more favourable locations. Industrial clusters have a role to play and can attract foreign investment if needed.

Thanks to Internet, the range of service activities that can be digitized and globalized is expanding, from the processing of insurance claims and tax payments, to the transcription of medical records, to the provision of education via online courses. India and the Philippines are two countries that have rapidly expanded their export of services.

Mobile money transfer has created an efficient way of doing business in Kenya.

Source: Julius Mwelu / UN-Habitat

Technological change may well constrict the traditional development pathway of economies using cheap labour as an incentive to attract industries, moving over time into the production of more sophisticated products and onto services. As in China, the skills and experience gained in export-oriented production might be put at the service of national consumer markets which regional customs unions can only make larger.

Global supply chains

Since around the time of Habitat II, supply chain trade has accelerated export-oriented growth in much of Asia. However, it is not adapted to the geographical and other circumstances of many countries, especially in Africa, much of Latin America or the Middle East. This partially accounts for the slower rates of economic growth in these regions. The past few years' marked slowdown in world trade reflects the dismantling of many supply chains, together with the vagaries of foreign direct investment.

Today, the supply chain model is in decline on account of decreasing economic benefits[17] and rising logistics costs, on top of this, any country can only liberalize so much. Moreover, natural disasters (earthquakes, flooding, etc.) interfere with the "just in time" logic of the model and climate change is only portending some more. Manufacturers in advanced economies are also repatriating outsourced operations owing to poor workmanship standards in low-cost locations and the high costs of long-distance management and quality control, not to mention civil society campaigns over labour exploitation. The latter factor, coupled with apparently insurmountable cultural divides, has also prompted some large enterprises to close down overseas call centres.

Industry clusters

Globalization has brought about greater industry agglomeration and specialization as national and multinational companies move to locations that offer competitive advantages in the production of goods and services and access to markets. In many cases, large agglomerations of firms, such as ICT developers in Bangalore or chip manufacturers in Bangkok, have become spatially concentrated in highly specialized clusters.

Clusters are the sector-specific manifestations of agglomeration economies: firms compete for business but are brought together by common user infrastructure or available skilled labour, together with similar supply chains and synergies stimulating innovation, new product

Box 8.2: Building connectivity: The electronic cluster of Santa Rita Do Sapucaí, Minas Gerais – Brazil

Globalization is forcing companies and institutions to be creative and innovative, but city size is not decisive. This is the case in Santa Rita do Sapucaí, a small town (population: 34,000) in the south of the State of Minas Gerais, Brazil. It is now known as the country's own Electronic or Silicon Valley on account of its technological skills and innovation.

In the 1970s, graduates set up the first companies in Santa Rita, and the success was promptly emulated. Today, the Electronic Valley is home to 141 technology-based companies, ranking among the main electronic clusters in Brazil and even Latin America.

Santa Rita can show other clusters how better strategic positioning can enhance competitiveness. Rather than continue to work on general, non-sophisticated products, the companies and their institutional partners developed a strategy and solutions for more complex products and services. Entrepreneurs attended dedicated conferences, the university launched a research programme, and the government and institutions looked to improve policies and funding. It took familiarity with a new market, as well as trust and courage, to implement this long-term strategy, which strengthened Electronic Valley firms' hand in negotiations with clients and increased market share.

Source: SEBRAE.

development, pooling of resources and sales to gain access to new markets. In the US, 18 sets of industry clusters generate more than 50 per cent of employment and contribute an even higher proportion of GDP.[18] In India, 49 metropolitan clusters are likely to account for 77 per cent of incremental GDP from 2012 to 2025.[19]

Many city governments recognize industry cluster support as an important way of stimulating investment, job creation and value-adding,[20] including research and development facilities, technology and innovation parks, streamlined import-export approval and clearance, co-investing with business in the development of high-quality training facilities, and provision of common user facilities (warehousing, infrastructure).

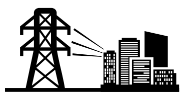
Infrastructure provision

Infrastructure is the backbone of any urban economy. One report estimates annual demand at approximately US$4 trillion annually, with a gap – or missed opportunity – of at least US$1 trillion every year.[21] The challenge of adequate infrastructure varies significantly across countries and cities as highlighted in earlier chapters. Advanced economies must maintain and upgrade extensive transport, power, water and telecommunication networks, as technology changes and demands shift. In developing economies, cities must build sufficient infrastructure to keep up with the demands of expanding populations and surface areas. Even in more advanced Latin American economies, cities such as Buenos Aires, São Paulo, Bogotá, Lima, Rio de Janeiro and Mexico City experience major deficits in basic infrastructure.

Still, overall, technological change has had an impact; cheaper mobile phone networks have overtaken conventional fixed telephones (see Chapter 2). Substantial backlogs remain in the provision of water and sewerage, though, as national and city governments in many developing countries lack financial resources for planning, financing and building capacities, with detrimental effects on living standards and productivity. Indeed, one of the top priorities of participatory planning in developing country cities should be the provision of adequate infrastructure for informal businesses: sheds for open-air roadside artisans, substitution of proper covered markets for rags-and-sticks petty trading stalls, etc. This could be a first step toward gradual mainstreaming of the informal into the formal urban economy.

Property and land markets

The past two decades have witnessed volatility and change in urban property and land markets (Chapter 3). Liberalization nurtures inequality as it is clearly detrimental to local demand, with speculators dramatically raising values from the mid-1990s to 2007, followed by some dramatic falls. Since 2013, property prices have risen by an average five per cent in 19 OECD countries[22]—but by much more in most favoured destinations like megacities and large metropolitan regions. In London, on top of raising prices, foreign speculators (especially from the Middle East and Asia) leave myriad downtown properties uninhabited, even in the face of massive local demand from low- and middle-income households— consequently pushing these households ever farther out on the fringes with high commuting costs.



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Property investment abroad serves as protection against currency or political risk, but deprives countries of origin from much-needed domestic capital of a more productive nature.[23] A five-year survey of 44 countries found a significant impact of ownership, property rights and investor protection on the functional efficiency of capital markets.[24]

Climate change

Since Habitat II, action on climate change has emanated mainly from local and urban authorities, in anticipation of long-term structural effects— as demand emerges for different or new goods and services (including land), and costs shift accordingly. International actions and agreements on climate change may result in both constraints and opportunities ("green" growth) for urban economies: "clean" and renewable energy production, "green" building technologies and materials, as well as more energy-efficient modes of transport (Chapter 5).

In property and land markets, factors like slum upgrading/relocation, deployment of public/green spaces and exposure to the effects of climate change are sure to cause some changes. Urban governments are also likely to face new demands, such as assessing various risks and developing appropriate management policies, as well as for new infrastructure and services, including disaster mitigation.

India has the world's largest young population in the world, still nearly 10 per cent or around 100 million are elder. Catering for the special needs of this population will become an increasing challenge in the country that is expected to have 300 million by 2050. Special places to meet and socialize are needed, as this group of friends engages in a conversation in the sidewalk. New Delhi, October 2015.

Source: Eduardo L. Moreno

Ageing populations and urban economies

With increasing longevity and, more importantly, declining fertility, the world population is becoming older on the whole as highlighted in Chapter 1. The economic impacts of ageing populations on urban economies are wide-ranging. Invariably, there is a decrease in workforce participation rates and a reduction in potential output. Often, consumption patterns change with special needs: housing, elevators, wheelchair access, care facilities —hospital wards, nursing homes, support services— turning this into one of the fastest growing employment sectors (if only potentially). Governments also face new demands for strengthened safety nets (income support, pensions), healthcare and social services. There is also a gradual social change marked by the transfer of the responsibility of care for the elderly to private or public institutions, posing mounting challenges in both developed and developing countries for the foreseeable future.

Poverty, rising inequality and social safety nets

The twin phenomena known as "globalization" and "economic liberalization" keep nurturing "a disheartening trend"[25] whereby increased inequality *within* countries has offset the drop in inequality *among* countries (see Chapters 1 and Chapter 4). What slum-dwellers expect from urban economies are basic livelihoods to survive, minimal healthcare to maintain basic physical capital, and schools to develop the basic intellectual capital of the next generation. What they keep hoping for is fulfillment of basic spatial rights such as basic security of tenure, decent housing in healthier environments, basic services, and opportunities to make the most of their abilities. Indeed, they hope to develop the basic dynamics of economic activity, i.e. *productivity*, accumulation of capital that will give them the degree of security they need to project themselves, and the next generation, into the future in a most positive, constructive way (short of which outright disenfranchisement looms, and socio-political trouble with it).

Evidence shows there is much which national, local and municipal authorities to combat poverty. Brazil, for instance, formally launched the nationwide *Bolsa Família* (Family Grant) scheme in 2003. Under the programme, extremely and moderately poor families receive monthly handouts (US$65 to US$200) on a number of conditions, including medical checkups as well as offspring school attendance and immunization. The direct handouts effectively double beneficiaries' average households incomes. The scheme has since been emulated in about 40 countries, mostly South American, but also Bangladesh, Indonesia, Morocco, South Africa and Turkey[26], on account of a variety of direct and indirect benefits:

- Handouts paid through banks are more effective than distribution of goods, also cutting out bureaucracy and corruption.
- Handouts go to mothers, not fathers, generating both rational spending and women's empowerment.
- The scheme has significantly reduced poverty and inequality.
- *Bolsa* has broken the transmission of poverty across generations, reducing infant mortality, malnutrition and child labour, and improving school attendance.
- *Bolsa* has increased household consumption, cushioning the poor against external economic shocks (i.e. drops in world commodity prices).
- *Bolsa* has instilled a sense of dignity and civic enfranchisement among the 14 million formal beneficiaries (and 41 million dependents).

Two cities in the US (Memphis and New York) have emulated the scheme, an earlier version of which had been tested by 100 local authorities in Brazil since 1995. However, strictly urban "family grants" can succeed only if appropriate back-up is secured in terms of public finance and management (Chapter 6) as well as health facilities and proper schooling. Moreover, it is best to avoid a situation where, as in Brazil, up to 55 per cent of *Bolsa* monies is recouped through high indirect taxation.

8.5 The Functioning of Urban Economic Systems

National urban policies

It has become increasingly clear since Habitat II that a city perspective is integral to any country's economic policy-making. Habitat III is expected to set out a New Urban Agenda. While other perspectives are important, it is no longer tenable to adopt a sector-based or countrywide approach to development while ignoring the complex, "system within system" dynamics of urbanization at city, country and global levels. Even seemingly unrelated issues such as food security and rural water supplies are closely tied to the economic growth and prosperity of cities.

Most countries, at different times, have developed national urban policies. Most are shaped by a hierarchical system for the classification of cities based on population size or political jurisdiction. Some countries, such as Colombia, Vietnam and the Philippines, split cities and towns across different categories.

Most national urban policies are linked to national and sub-national physical development plans. Such plans are often used to define the scope and scale of national infrastructure programmes, such as India's Jawaharlal Nehru National Urban Renewal Mission.[27] They can also form the basis for the development of special industrial and economic areas as well as housing and environmental improvement programmes. Across the world, the links between physical planning and economic development policies for cities are found to be very poor. Planning systems rarely integrate financial and budgetary considerations effectivel— i.e. balancing the needs for investments and services with budgetary and financial considerations and realistic timeframes.

Development and implementation of urban policies is a significant issue, as is beginning to be recognized in Sub-Saharan countries

Resource flows— grants, loans and transfers from central to city governments— are often distorted on a per capita basis in favour of large cities. Central governments often fail to appreciate the important role, for national development, of secondary cities, and the different sets of policies and programmes they may need in support of local economic development, together with strategic infrastructure. If they are to mainstream the New Urban Agenda into nationwide policies (Chapter 10), governments must heed secondary cities, recognizing these as part of the overall urban system (if only because they are where most of urbanization has been taking place lately). Proper decentralization should be taken as an opportunity to boost the dynamism of fast-urbanizing secondary cities and the hinterlands, instilling the funding required for infrastructure, since efficient, two-way, mutually beneficial linkages with larger cities have a major role to play in national economic development.

Development and implementation of urban

Box 8.3: The streetwise economics of urban density

Densification has many advantages: more people on the street (which usually offers a safer environment), more shops, more amenities, more choice, more efficient mass transit, higher property values. Densification also produces a larger municipal tax base. Urban densification tends to occur in proximity to amenities such as downtowns, cultural districts, parks, and waterfronts. It is precisely density that allows these amenities to achieve their full potential. The success of a shopping street, a city park, or a waterfront esplanade depends on the presence of large numbers of people. Virtually every technological innovation of the past 50 years has facilitated, if not actually encouraged, urban dispersal. But concentration is making a comeback.

Concentration also takes new forms like power centres, office parks, theme parks and village-like planned communities. All such gathering places are evidence of the age-old desire for human contact, crowds, variety, and expanded individual choices. It is no good having a lot of people if they are spread out. Walkability is important since it is one of the competitive advantages that downtowns offer compared with suburbs. Increasing the density of housing will require paying more attention to public amenities such as well-designed streets, public spaces, and town centres.

Source: Rybczynski, 2010.

policies is a significant issue, as is beginning to be recognized in Sub-Saharan countries, and not only in South Africa where (whatever the reasons) they have traditionally been considered an inherent part of long-term nation-wide planning. Although development policies do retain an anti-urban bias in developing countries, it is acepted that managed urbanization needs requires leadership by higher government tiers. This is essential since, short of a comprehensive approach to national urban policy, only the most competitive cities are likely to attract investment, create good jobs and raise the capital needed to fund the backlog of infrastructure and urban services they currently need. The rest will become lagging and laggard cities.

Poor municipal finance, particularly in rapidly urbanizing developing countries, is one of the reasons that cities are not keeping pace with the demand for infrastructure and services

Financing and maintenance of urban infrastructure

All city governments are under pressure to do more, as municipal roles and responsibilities become more complex. Policies and programmes can range from job generation and economic development to activities for social inclusion and to anticipate the effects of climate change. However, most cities still depend on transfers from higher tiers of government. Analysis of endogenous revenues shows that property tax, while potentially an efficient source of local revenues, represents less than three to four per cent of local revenues in most developing countries, compared with 40-50 per cent in cities in Australia, Canada, France, the UK and the US.[28]

Poor municipal finance, particularly in rapidly urbanizing developing countries, is one of the reasons that cities are not keeping pace with the demand for infrastructure and services. Few cities in the developing world, because of informality, lack of land registration, and governance issues, have been able to capture, for the public purse, the rents accruing to property ownership resulting from land-use regulations.[29] This inability both increases inequality and reduces the local revenue base. Revenues from land taxes remain low in most countries.

In the push for efficiency and to meet service shortfalls, old models of direct public sector service provision are slowly being replaced by more market-based approaches, using competition to cut costs and provide new services. This is taking place not only in the construction phase, where competitive tendering has been common practice, but also in financing, operations and maintenance. Privatization or leasing of entire operations (or appropriate component packages) has shifted responsibility for financing, design, construction and operation of activities from the public to the private sector. Public-private partnerships (PPPs) can combine various modes of participation from both sectors.[30] New models of public sector financing of infrastructure and urban development are also being developed (Box 8.4). However, municipal authorities must be aware that PPPs, like borrowings on capital markets, require degrees of transparency, proper management, legal and financial expertise which make them unaffordable to most[31]— and that current (early 2016) very low interest rates are unlikely to stay.

City governments vary greatly in their capacity to leverage their assets. Such assets may include land and buildings, rivers, coastlines, parks and air space. Singapore has leveraged sub-surface development rights for underground shopping arcades linking parts of the central business district together. Many "value capture" opportunities can enable city governments to raise revenues for infrastructure and services, and the Lincoln Institute of Land has developed a wide range of dedicated policies.[32] However, an essential precondition for success is none other than strict enforcement of proper land management and administration laws and regulations, planning and development controls.[33]

New technologies and products have facilitated the transition from public to private sector infrastructure provision (Chapter 2). In sectors such as tel-

Box 8.4: Special funds for municipal infrastructure

Various countries have managed to deploy fund allocation programmes to municipalities in accordance with specific needs.

The example of Germany's Stuttgart Region Metro demonstrates how interconnected issues affecting the municipalities of a metropolitan region can be addressed. A public institution for cooperation among urban and rural municipalities coordinates projects and allocates funding to achieve common objectives in land-use planning, public transport and economic development.

In the Philippines, a performance-based incentive policy attaches performance criteria to public funding of local authorities for the purposes of planning, fiscal management, transparency and accountability. In India, too, the Jawaharlal Nehru National Urban Renewal Mission (JnNURM) attaches specific criteria to funding. The cities meeting these criteria are eligible to apply for the city-modernization scheme sponsored by the central government. Before they can access any funds, the municipalities must implement specific mandatory reforms.

Unlike in the first two cases described above, the Indian development scheme does not cover a whole region, but a pool of selected cities. As in the Philippine case, though, it aims at encouraging necessary reforms and rationalizing governmental transfers, rather than at integrating and coordinating common objectives of neighbouring municipalities, as in the case of Stuttgart.

Source: UN-Habitat, 2016e.

ecommunications, the shift in demand from fixed line to mobile phone communications has encouraged new market entrants and intense competition. In other sectors such as electric power, some countries have privatized various aspects (generation, distribution) of supply, which are also if slowly being transformed by new technologies (e.g. domestic solar power), often encouraged by government concerns over global warming. Importantly, communications and information processing have changed production functions and opened up opportunities for contestable markets for what were once seen as public goods. The extent to which cities and countries have used markets to drive down the cost of infrastructure and services varies considerably.

As the infrastructure gap increases, particularly in some developing countries, further innovative approaches to provision and financing of urban infrastructure will be essential. There is no single, ideal financing model. Rather, it is for city governments to evaluate revenue bases, capital requirements and ability to accommodate risk. They will also need to assess the appetite and requirements of domestic and international capital markets for different types of investment opportunities and securities, and appropriately package projects for financing. National governments will inevitably play a role in setting financing guidelines and in the planning for, and financing of, larger projects.

City systems

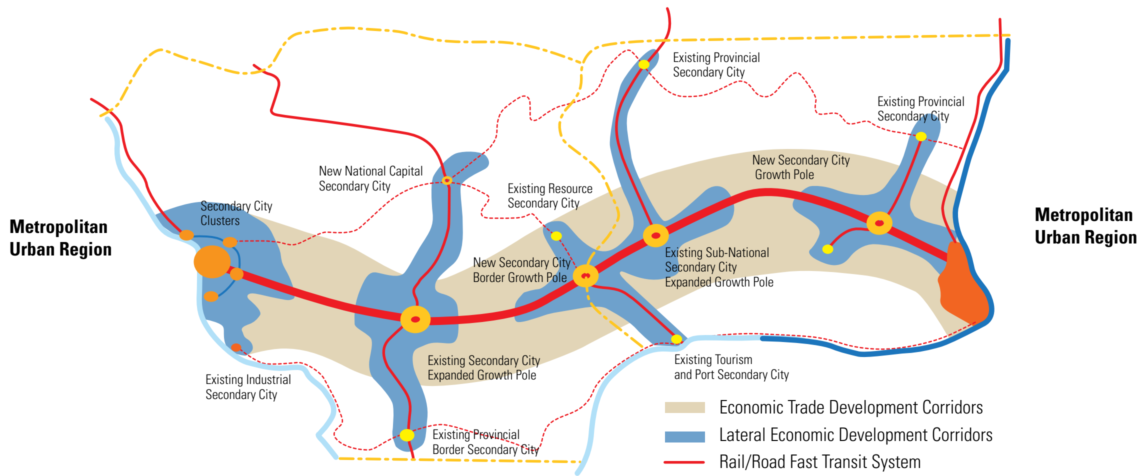
The dynamics of urban economies are becoming much more sophisticated and linked into global systems. Alignment of economic and other strategic infrastructure across cities, within countries, and between nations is becoming increasingly important for improved productivity, investment flows and employment creation. New forms of partnership, such as proposed by Asia-Pacific Economic Cooperation (APEC),[34] are necessary to link the economic systems of cities, to encourage informal trading relationships, cross-industry and cross-cluster collaboration, innovation- and knowledge-sharing, as well as identification of new opportunities for linkages among cities. Mobilizing domestic capital has a crucial role to play.

Economic development corridors also give cities significant opportunities to work together. Trading corridors are emerging in South America, Asia and Africa.[35] The Pearl River Delta corridor between Guangdong and Hong Kong is a network of interdependent cities which mutually support each other in a very wide range of manufacturing activities. Figure 8.3 depicts a conceptual pattern for value-added activities in secondary cities, as developed under a new initiative by the Cities Alliance.[36] Participation in city networks requires coordinated involvement of government and industry, often at national, region and city levels. This can be a problem in developing countries where governance is weak.

The dynamics and governance of systems of cities, intermediate cities, metropolitan and regional areas, is a new macroeconomic trend that requires specific financial, legal and planning instruments, as well as in the political realm since a broad range of stakeholders are involved. In the next decades, expanding corridors and secondary cities will create more metropolitan areas, more and more turning into hubs of economic activity and growth within countries.

Figure 8.3: An economic trade corridor incorporating a network of secondary cities

Source: Roberts, 2014.



8.6 City Governance

Paradoxically, while the urban economy is increasingly private-sector driven,[37] the quality of urban governance has never been more important. The modalities of urban governance are changing, but efficient and equitable provision of infrastructure and services remains a key responsibility of urban government (Chapter 6) and is critical to encouraging investment and growing a successful urban economy.

City governments as facilitators

Urban government and administration are moving from direct providers of services, to facilitators of such provision. This involves new skills and modes of operation with a focus on community consultation and needs, project design and monitoring, legal and contracting issues, financing options as well as economical pricing and efficiency concerns. It is now for urban governments to act both as regulators (ensuring acceptable standards of service provision and avoiding predatory monopoly pricing), and as customers, too (such as underwriting build-operate-transfer (BOT) projects by guaranteeing to purchase a pre-determined amount of project outputs).

Better managed and resourced cities— with an eye to developments in international practice and well-developed links and coordination arrangements between the private and public sectors, as well as recognition of the informal economy— have generally moved ahead of more poorly resourced cities which are slipping further behind. This is particularly a problem for secondary cities in some developing countries, where populations are fast-expanding.

For all the talk about mobilizing foreign investment, developing countries ought to take good notice of the more basic capital sitting on urban fringes, and focus on leveraging informal economies. As previously underlined by UN-Habitat, "…genuine economic inclusion leading to equitable allocation of opportunities and income is, to a very large extent, determined by the political, cultural and social equality parameters that are specific to any given city."[38] Based on SDGs, it is for civil society and Habitat III to shape these parameters and to highlight the urgent need "to democratize the business sector in order to open it up and provide opportunities for all, instead of systematically denying these to most citizens due to weak institutions, inadequate regulatory frameworks, and poor government management of the economic sphere."[39] Procurement modalities could help, in sectors such as waste collection and recycling, but corruption may stand in the way.

City governance structures

While cities are facing long-term structural change, governance arrangements often have hardly changed and mostly remain a complex web of national, State, regional and local government responsibilities, only compounded by the roles of parastatal companies (electricity, water supply) and ill-suited national policies. Complexity and economic efficiency are uncomfortable bedfellows (Chapter 6), leaving many, even large, cities bedevilled in politics, with major infrastructure shortfalls and the diseconomies of small scale, together with inefficient, costly services and infrastructure.

Collaborative urban governance

Economic development calls for clear, effective vertical and horizontal integration of policy, planning, regulation, finances, and operations (Chapters 5 and 6), including consultation with business and the broader community. For most cities, economic governance arrangements and policies are weak, with a lack of clarity around functions and responsibilities, undermining the environment for private sector development and business innovation, not to mention the informal economy.

For collaborative governance to work, all parties to decision-making must appreciate how supply chains and logistics systems function in cities and how the inputs, outputs and throughputs of these systems are not just linked to the physical systems supporting the operations of local economies, but also to the services, human capital and information systems.

Garbage collection at a street food market in Milan, Italy.

Source: Paolo Bona / Shutterstock.com

8.7 An Urban Economic Agenda for Cities in the 21st Century

The focus of many industrializing economies over the last few decades on export-oriented growth based on agglomeration economies, new transport and communications technologies, value chains and skilled labour carries an important lesson. The extent and speed of these changes were not envisaged fifty years ago. The future is always uncertain. All that is certain is that macroeconomic conditions will continue to change, new technologies will transform production processes and cities will economically rise and fall as they have in the past.

The global economy appears to be entering a period of sustained slow growth, with a weakening of economic growth prospects and a slowdown in trade growth and capital flows particularly for developing countries. It is uncertain if, or when, these trends will be reversed. Moreover, the speed of technological change is only increasing, and new models of production will inevitably develop to take advantage of these new technologies. Such changes will affect the products produced, inputs used in production, the prices of these inputs and the productivity of different locations, flowing through into the form and location of economic activity within cities and between cities.

Looking at developments since HABITAT II, the lesson for city governance is to focus on getting the basics right. Plan for the known, assess and manage risks and be flexible and open to change. Consult and engage with all sections of the community. The best opportunity for jobs growth and the economic development of cities comes from a focus on the quality and efficiency of

While cities are facing long-term structural change, governance arrangements often have hardly changed and mostly remain a complex web of national, State, regional and local government responsibilities infrastructure and services, strengthening education and health services, improving the quality and adaptability of human capital, and on reducing where possible the costs of doing business, such as through cutting unnecessary "red tape" and non-tariff barriers. Social inclusion, including a focus on poverty reduction and equity, is also critical, not only for ethical reasons but for all of a city's resources to be utilized and for social stability.

Managing the changing dynamics of cities calls for new ideas, changes in the way we manage urban development and economies

Importantly, in late 2015, governments committed to "transform our world" by 2030 through an "agenda for sustainable development" which takes the shape of "a plan of action for people, planet and prosperity." [40] Governments are agreed that "people-centred economies" and "wealth sharing" are in order for the next 15 years, along with "structural transformation," "strong economic foundations" and "strengthening productive capacities." Of the 17 Sustainable Development Goals, one (SDG 11) focuses on cities, half a dozen directly focus on economic policies (the "end of poverty in all its forms" ranking as SDG 1) and the balance have major roles to play in the shared, sustainable prosperity of cities.

Together, the Sustainable Development Goals provide the Habitat III conference with the basic guidelines national and urban governments need if they are to make a success of their "emerging futures." Indeed, an urban economic agenda for cities underpinning the New Urban Agenda would focus on:

- Reducing inequality and stimulating economic growth through regulation of financial and labour markets, progressive taxation and welfare policies.[41]
- Recognition of the informal economy and more efforts to harness its significant economic and social capital.
- Social inclusion with a focus on job creation, social safety nets, housing provision, and spreading the benefits of economic development between and within cities.
- Efficiency, facilitating more productive use of resources to create more wealth and jobs.
- Strengthening infrastructure and logistics networks and reducing barriers to trade and business development within and between cities.
- Public investment in knowledge and strengthening the domestic private sector —with this caveat: "provide what the private sector needs, not what it asks for."[42]
- Partnerships with foreign firms are welcome but local governments must make sure that these abide by their corporate social responsibilities (investment, infrastructure), terms are equitable and value is added in the recipient country.[43]
- Developing urban policies to link cities into networks, which are better able to face increasing global competition for resources, trade, investment, skills and knowledge.
- Efficient urban governance with a focus on creating and regulating markets for service provision, reducing costs of doing business, consulting and engaging with all segments of the community.
- Strengthen municipal financial capacities through better use of public-private partnerships, local land taxes and user charges, and development of more effective and equitable fiscal equalization arrangements between national and city governments.
- Improving environmental sustainability and taking opportunities for creative and innovative adaptation to climate change.
- Improving data collection to identify winners, losers and redress imbalances

Achieving this economic agenda will be a challenge for all cities and respective national governments. The world is becoming an intricately networked and increasingly inter-dependent system of cities. Cities must learn how to collaborate, cooperate, partner, become more competitive and efficient, improve logistics systems and linkages, and differentiate themselves and the products and services they produce. Managing the changing dynamics of cities calls for new ideas, changes in the way we manage urban development and economies, together with new forms of governance that maximize a city's physical, social, cultural, and economic potential.

Notes

1. United Nations, 2015a.
2. Banerjee and Duflo, 2012.
3. Power, 2008.
4. UN-Habitat, 2013.
5. Kotkin, 2005.
6. By its nature, the informal economy is difficult to define and measure. While most people in the informal economy are in small scale, marginal work, on low incomes, others operate successful businesses and seek to avoid tax authorities, as well as employment and social security regulations.
7. World Bank, 2013e.
8. The Economist, 2012.
9. UN-Habitat, 2011f.
10. McKinsey Global Institute, 2011.
11. UN-Habitat, 2010a.
12. UNDP, 2015
13. World Bank and International Monetary Fund, 2015
14. United Nations op. cit.
15. Ravallion et al, 2007
16. Bourguignon, 2016.
17. Sylvestre, 2015.
18. Muro, 2013; HUD, 1996.
19. Bakshi, 2014.
20. World Bank, 2009a.
21. World Economic Forum and Boston Consulting Group, 2013.
22. The Economist, 2015b.
23. Piketty, 2014
24. Eklund and Desai, 2014
25. Bourguignon, op. cit.
26. Tepperman, 2016.
27. Government of India, 2011a.
28. United Nations, 2015f.
29. United Nations, 2015g.
30. Activities and projects are often referred to by their acronyms BOT (build, operate, transfer); BOOT (build, own, operate, transfer); BLT (build, lease, transfer); DBOT (design build, operate, transfer) and so on.
31. Tribillon, 1996.
32. Land value capture depends heavily on context and legal framework (UN-Habitat 2015 Expert Group Meeting on Land Value Sharing, Barcelona, Spain. May 2015.)
33. Smolka, 2013.
34. Roberts, 2014
35. Mulenga, 2013; CAF, 2009; ADB and ADBI, 2009.
36. Roberts, 2014; Markillie, 2012; Rifkin, 2014; The Economist, 2013c; Rifkin, 2011.
37. OECD, 2007.
38. UN-Habitat, 2010a.
39. Ibid.
40. Ibid.
41. Bourguignon, op. cit.
42. World Bank ,2015d.
43. Ibid.