



POLICY BRIEF

11.2009

**Opportunities and
Challenges for Cities in the
Globalisation Era**

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ABSTRACT

In times of increasing population densities in metropolitan areas, urban development issues have moved back forcefully onto the agendas of researchers and policy-makers. On the one hand, cities attract the most productive economic agents by providing a competitive environment where knowledge and technology diffuses quickly. On the other hand, cities face challenges in terms of congestion, high costs of living and social disruption. To discuss the push and pull factors of modern metropolises from a theoretical and from a policy point of view, experts came together on 12-13 October 2009 at FEEM during the first Conference in Urban and Regional Economics (CURE) and the subsequent roundtable, which was jointly organised by FEEM and the Camera di Commercio of Milano. This article summarises some of the ideas that emerged from the two-day meeting.

This Policy Brief builds upon the proceedings of the CEPR-FEEM Conference on “Urban and Regional Economics” (CURE) and on the follow-up roundtable on “Opportunities and challenges for cities in the globalisation era: creativity, entrepreneurship and quality of life” held on 12-13 October 2009 in Milan at the Camera di Commercio of Milan.

Policy Challenge

The recent rise of “urban superstars” comes along with promises and challenges. While one observes more innovation, entrepreneurial activities and higher productivity in metropolitan areas, solutions to make this development sustainable are likewise needed. Questions that arise in this context are the following: Which are the mechanisms behind higher productivity in large cities? What are the effects on different groups of society? How can governments and policy-makers achieve urban development without experiencing a backsliding periphery?

Background

Ever since the rise of ancient metropolises, mediaeval and renaissance business centres, today’s capitals of finance, fashion and design, most examples of entrepreneurship and innovation are associated with large successful cities. For a long time, however, both the media and scholars dealing with social trends have focused on the decline of large cities, whose role was seen as increasingly irrelevant in an era of rapid transports and instant communication. Paradoxically, globalisation and technological development, which were initially perceived as the main cause of urban demise, are recently stimulating the rebirth of metropolitan areas and a renewed interest in the sources of their competitiveness.

In a time when many markets are dominated by a few superstar competitors, one is also witnessing the rise of some “urban superstars”. Not only do successful metropolitan areas attract and train high-qualified people, but they also allow for social interactions that, in turn, spark new ideas and an entrepreneurial culture. As new concepts and new products arise, innovative services are required for people and firms alike. These are developed and provided for in those same urban areas, thus creating a virtuous circle of cultural, entrepreneurial and financial dynamism. At the same time, the renewed urban development poses new challenges. If one is to make the virtuous circle sustainable, one needs to find innovative solutions to make urban areas liveable and manageable and to avoid the formation of clusters: creative and dynamic people on the one hand, and immigrants and poor people on the other. Only the cities capable to manage efficiently the tensions arising within their

territory will be able to compete on the global scene and to emerge as “superstar cities”.

Renowned experts from all over the world came together at FEEM to discuss these topics and their impact on the development of metropolitan areas and their actors in the first edition of the Conference on Urban and Regional Economics (CURE). The conference was followed up with a roundtable, jointly organised by FEEM and the Camera di Commercio of Milano, to complement the scientific outcomes with a policy perspective focusing on the entrepreneurial and cultural future of the city of Milan.¹

The causes of rising urban superstars

The world’s population is increasingly clustered in a few locations. While back in 1900, only 13% of the population lived in cities, this share rose to 49% in 2005 and is projected to reach 60% in 2030 (UN World Urbanization Prospects). Although the transition has largely come to an end in developed countries, for developing countries, and foremost China, experts forecast the peak of migration from rural to urban areas still to lie ahead. What makes cities so attractive that urban residents nowadays account for a growing majority of the world’s population?

Innovation, knowledge spillovers, productive linkages and creativity are common attributes of modern metropolises. How does the interplay of these features impact the distribution of economic actors and activities across space? What does this mean, in turn, for economic growth and productivity in the city and its hinterland?

Polarisation

The polarisation the US and many other countries experience -with increasingly dense areas and, simultaneously, a rising number of sparsely-populated regions- can best be analysed by looking back to the pre-urbanisation period.

¹ The roundtable was held on 13th October 2009 at Palazzo Affari ai Giureconsulti. Authoritative policy-makers and experts composed the panel: Antonio Pastore (Camera di Commercio di Milano and Osmi Borsa Immobiliare), Bernardo Bortolotti (FEEM and University of Turin), Gerald Carlino (Federal Reserve Bank of Philadelphia), Diego Puga (Instituto Madrileño de Estudios Avanzados - IMDEA and CEPR), Costanzo Ranci (Politecnico di Milano), Andrés Rodríguez-Pose (London School of Economics and IMDEA) and Gianmarco I.P. Ottaviano (Bocconi University, FEEM and CEPR).

By exploring population and employment information of US Minor Civil Divisions (MCDs) between 1880 and 2005, dynamics are explained through structural transformations away from the agricultural sector. Over time, higher productivity growth in agriculture than in non-agriculture has reduced the relative price of the agricultural good because demand did not step in to absorb the effect. As a consequence, labour has been reallocated, leading to a decreasing share of agricultural employment. At the same time, non-agricultural activities seem to be more concentrated across space. Understanding these transformations is central to urban development as they impact the spatial organisation of economic activity and present major challenges for public policy. Agriculture and non-agriculture differ substantially in the extent to which their productivity is tied to persistent idiosyncratic features of locations such as soil and climate.

Additionally, more rapid productivity growth in agriculture than in non-agriculture may help to overcome nutrition shortages of the urban population in developing countries. Addressing these issues empirically still poses a challenge, since reliable data on income growth is either available at a too aggregate level or not at all for some of the least developed countries.

Using satellite data on lights at night as a proxy entails at least two advantages. First, it serves as an additional and under many circumstances more precise measure of income growth. And second, it is available at a much finer geographical level. Given these features, satellite data may be used to address a wide range of policy questions. In an application to Africa, for example, increased agricultural productivity in the hinterland is found to contribute to higher income growth in urbanised areas.

Sorting, selection, and agglomeration

One distinct feature of urban development is higher productivity, measured as labour or total factor productivity. The mechanisms behind it are threefold. Cities attract the most productive agents, select the best of them, and make the selected ones even more productive via agglomeration economies. Hence, the location of firms and workers has important consequences for productivity and growth. On the one hand, density allows firms to share workers and suppliers while, on the other hand, it also implies a better match between firms and their workers and suppliers. Finally, density raises the ability to learn due to a higher diffusion of

knowledge that is available in such a competitive environment.

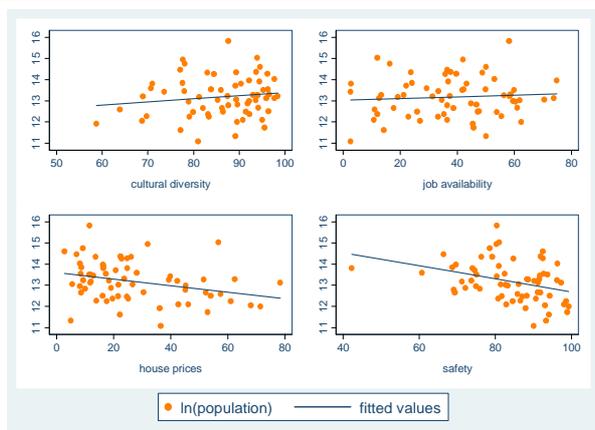
The link between employment density, innovation and productivity growth has been profoundly analysed. Theoretically, innovation in manufacturing induces employment shifts to the service sector, boosting innovation incentives there, as well. As a result productivity growth in the service sector catches up. Empirically, the positive relation between city size and earnings is well-established and remains even after controlling for many other factors, like education and experience. At the same time, the application rate of patents rises disproportionately in population density. The agglomeration economies that arise in such clusters magnify the effect: for the U.S., the Gini coefficient of employment concentration drops by 48.5% if agglomeration forces are not accounted for.

The consequences for different actors

Not only higher productivity, more innovation and earnings premia come along with increasing density, but also amenities, like creativity and cultural virtues, develop simultaneously. So, why do not all people and all firms move to cities? The advantages of metropolitan areas neither materialise immediately nor equally across the population. Additionally, higher housing prices tend to offset higher earnings of workers and higher costs for land and labour tend to offset the productivity advantages firms experience in densely populated areas.

Figure 1 displays a basic regression of population size on the satisfaction of inhabitants of European cities along four criteria. While larger cities tend to provide higher cultural diversity and better job availability, they also make it more difficult for their inhabitants to find affordable housing and to feel safe.

Figure 1: Population size and perception of living conditions in European cities



SOURCE: EUROSTAT (2006)

Congestion, elevated prices, malnutrition and waste are problems that cities face in the developed and the developing world alike. Which actors and activities are mostly affected by these repulsive forces of urban centres?

Social cohesion

Skilled workers and knowledge-intensive firms will find it beneficial to co-locate in large diversified cities, despite the exalted costs of living. Standardised production and unskilled workers, however, may not be able to bear the high prices and possibly switch to the outskirts. Despite the cost-saving and productivity-enhancing properties of clusters, policy-makers need to manage them with caution as social divide poses new challenges. While there is some evidence that gender, rather than migrant discrimination, dominates on the European labour market, in cities inequality often hits hardest on migrants. Take Berlin as an example for a large, culturally diverse city. The over 470000 foreigners have experienced an unemployment rate of 33.1% in 2008, and thereby more than doubled the overall unemployment rate of 16.1% (German Federal Statistical Office, 2009).

The literature frequently discusses two counteracting forces as influencing the economic success of migrants. On the one hand, they are dynamic and have an entrepreneurial spirit but, on the other hand, they often face an initial discrimination on the labour market. For that reason, regional externalities described through per-capita wages and educational endowments may impact migrants and non-migrants

differently. In addition, educational differences and regional externalities help explaining the wage gap between locals and international migrants. Rising inequality and lacking social cohesion are also a serious concern to policy-makers since they affect the crime rate which, in turn, affects the spatial distribution of economic activities. Different firms might react differently to crime conditional on the dependency of their business on safety. Retail industries and high-end restaurants are found to be most sensitive to crime and, more generally, entrepreneurs take crime into account when bidding for a location.

Housing

Governors have come up with state programs to smoothen the undesirable side effects of high house prices. In the US, homeownership has been substantially subsidised, especially in neighbourhoods with below-average incomes.

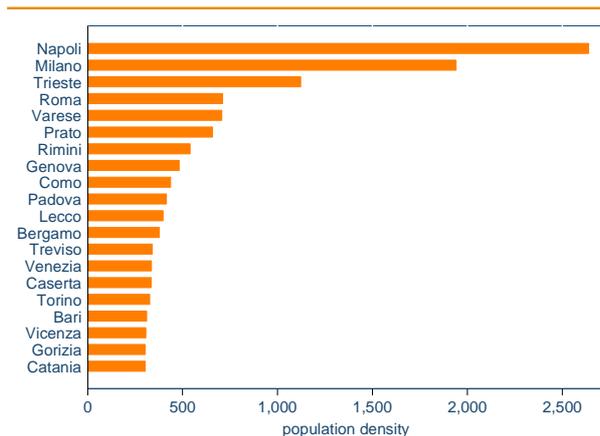
Even when ignoring the by now well-known distressing impacts such a policy has on risk-taking, tax-cuts can be politically justified only if external benefits arise. Existing studies name better maintenance, the behaviour of kids and citizenship as three externalities but evidence is rather vague. Is there a stronger willingness to pay for housing in neighbourhoods with high rates of homeownership? Controlling for a large range of observable and unobservable factors, homeowners are found to generate an externality of about 1000\$ per year, outweighing the welfare loss of the tax subsidy for all but the highest income households. Still, subsidisation encourages risk-taking, which, in turn, raises the rate of forced sales. Besides bankruptcy and foreclosure, death of one of the owners can force homeowners to sell the houses. The data shows that such forced sales experience a significant discount as compared to unforced sales, attributable to worse maintenance and vandalism actually decreasing the value of the house or to liquidity needs because of urgency.

The highest discount is connected to foreclosure, where urgency and vandalism might play a role. Sale due to death faces an especially high discount three years prior to the event, for old sellers and for single family houses. This suggests bad maintenance to be an important explanation. At a very fine geographical level, these discounts spill over to unforced sales and lower their prices by about 1%.

Policy lessons for the city of Milan

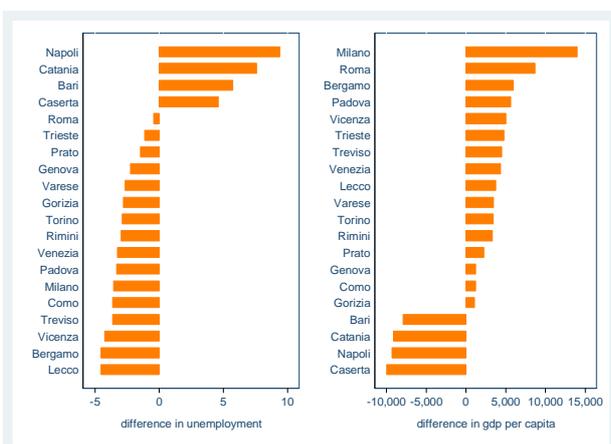
Italy, in general, and the city of Milan, in particular, resemble the picture drawn above well. With the exception of Naples, denser regions feature a higher GDP per capita and a lower unemployment rate than the national average (see Figures 2 and 3).

Figure 2: Population densities of the 20 densest Italian cities



SOURCE: OECD (2005)

Figure 3: Differences with respect to national level



SOURCE: OECD (2005)

How can policy-makers sustain and strengthen these assets of urbanisation while countervailing its drawbacks? Big events like the Expo 2015 and globally recognized fields of excellence in arts, fashion and science promise a high potential for future economic growth but come along with huge challenges to the city of Milan.

Housing

The success of a city depends on the inflows of highly qualified and creative people. For Milan, two facts need to be considered in this respect.

First, young people commute simply because of high house prices and second, while the vibrant creative environment attracts talented people from all around the globe, they do not find appealing conditions that would make them stay after they finish their education. Property and real estate do not seem to be developed enough to attract skilled people in the long run, requiring a renewal of the urban planning system in the upcoming years. In order to avoid a social selection through house prices, it is essential to provide adequate and affordable accommodation.

Transportation and infrastructure

As a rising share of the Milanese workforce lives in surrounding areas or other cities, commuting time increases. Policy-makers need to back this tendency with the provision of a functioning infrastructure. Connecting the periphery to the centre by reducing transportation costs appears as a priority in achieving sustainability, social inclusion and long-term growth. It does come at a price, however: while transportation within and across major cities is improving, in between areas seem to fall behind. Hence, instead of smoothing the development rates across one country, high-speed transportation often consolidates a hierarchy of cities within countries with relapsing middle-sized cities. This concern should not only be on the agenda of national governments, but also of local governments that are already struggling with the management of increasingly dense areas.

Conclusions

Cities attract talented people and train the best of them further by providing an environment where creativity and knowledge spreads easily. These urbanisation advantages make modern metropolises appealing in times where low transportation costs have facilitated the worldwide dispersion of activities. The gains do, however, not accrue to all economic agents equally. Hence, policy-makers of prospering cities around the world are challenged to make urban development socially sustainable by managing housing and transportation in a way that procures cohesion among different groups of society.