

## THEMATIC AREA 3: ENABLING CITY ECONOMIES

### A Macro-Perspective on Cities and Economic Growth

79. *With more than half of World GDP coming from cities, the economic future of most developing countries will be determined by the productivity of these burgeoning urban populations.* As the WDR 2009 points out, urbanization is necessary for growth but is not sufficient to assure it. The interdependency between macro-economic performance and urban welfare has been seen in the aftermath of macro-economic crises in Argentina, Brazil, East Asia, and Russia, where the poor have fallen farther than their middle class counterparts.<sup>36</sup> On a global basis about 70 percent of economic production takes place in cities. Developing countries are rapidly increasing the urban shares of their GDP, with most countries already surpassing the 60 percent level. But the results in this regard are highly conditioned on whether a country proactively plans for and enables urbanization while managing the downside risks. The benefits of agglomeration have been well-documented in East Asia where cities have been a major part of rapid economic growth in countries such as China, Japan, Korea, or Malaysia.<sup>37</sup> The case of China is perhaps most revealing, with 50 percent of GDP generated in coastal urban agglomerations accounting for only 20 percent of the territory. Many of the Bank's client countries have cities that would like to emulate China's experience and local economic development approaches are in high demand.

80. *One of the main insights from economic thinking on geography and economic development is that firms in many industrial and business service industries value agglomeration economies.* Evidence shows that firms prefer to concentrate in proximity to other firms engaged in the same or related product lines, as well as locations with good access to domestic and international markets. This concentration accelerates when countries liberalize and open up to trade. In India, liberalization in the early 1990s led to greater concentration of industry in port cities and metropolitan areas. Recent evidence suggests that just 20 cities -- with good market access -- accounted for some 60 percent of private manufacturing investment in India between 2000 and 2005.<sup>38</sup> Similarly, in China, foreign firms entering after the introduction of the "open door" policy in 1978 have preferred to locate in cities with a large industrial base and a history of foreign investment.<sup>39</sup>

81. *What are the priorities for urbanization policies in cities and towns in intermediate and advanced stages of urbanization?* In addition to the challenge of facilitating density, it becomes important to ensure that urban settlements are well connected to each other to gain from complementarities in their production structures. While market towns facilitate scale economies in marketing and distributing agricultural produce, medium-size cities provide localization economies for manufacturing industries, and the largest cities provide urbanization economies, characterized by diverse facilities that foster innovation in business, government, and education services. As demand for land bids up prices in metropolises, investors make decisions on relocating businesses – weighing the costs of wages, rents and congestion with the benefits of

#### **Profile 8: City Systems in China.**

China's economic growth illustrates the power of agglomeration economies in action. China's government is now actively encouraging 'city clusters or systems' across the country.

<sup>36</sup> Morley 1998., Minujin and Anguita 2004.

<sup>37</sup> Yusuf and Nabeshima 2006.

<sup>38</sup> Lall and Chakravorty 2005.; Lall and others 2007.

<sup>39</sup> Head and Reis 1996.

agglomeration economies. While it is common for manufacturing activities to de-concentrate from city centers to their surrounding suburbs – this is not commonly observed for services.<sup>40</sup>

### **Enabling Infrastructure for Cities and Metropolitan Regions**

82. *Systems of Cities: Gains from specialization and connective infrastructure.* In Indonesia, many manufacturing firms moved out of Jakarta to the peripheral areas of the Greater Jakarta metropolitan region in the mid-1980s.<sup>41</sup> These moves were facilitated by the construction of toll-ring roads around the city, which allowed firms to retain most of the agglomeration benefits of the region while minimizing the rising production costs associated with congestion and higher land rents. Aggregate transport costs per unit of sales revenue dropped because a larger market could be accessed by a better road network. Similarly in Brazil, there is evidence of specialization and de-concentration of manufacturing from the largest cities to medium sized towns.<sup>42</sup> As the country ramped up its service sector share from 55 percent of employment in 1970 to 70 percent in 2000, there has been increasing concentration of service sector employment in bigger cities. And the manufacturing industry share in non-agricultural employment is highest in the medium size cities (30.2 percent in 2000).

83. *A good infrastructure backbone facilitating mobility and connectivity is vital to a healthy city economy.* The highest payoff for economic growth lies in infrastructure that functions at the scale of the urban or broader metropolitan region, or where urban infrastructure assets are key hubs in national or even international networks. Reviews of recent empirical work<sup>43</sup> demonstrate that the stock and quality of electricity networks, road and other transportation systems, and telecommunication systems matter most for national growth. In India, the quality of transport interconnectedness between cities is closely related to urban growth and urban productivity.<sup>44</sup> Further evidence shows that improving urban airport accessibility and size in countries such as Uzbekistan and Honduras can reduce total air transport costs by 10 percent.<sup>45</sup> Similarly, improving urban seaport efficiency, port infrastructure and handling can reduce shipping costs by more than 12 percent.<sup>46</sup> In international trade, this is equivalent to reducing the distance between origin and destination by 500 miles. These findings stand up in other sectors of economic infrastructure and in particular regions, like Sub-Saharan Africa, an analysis of the global competitiveness of Africa's manufacturing sector find that power failures in Tanzania account for the equivalent of a 10% sales loss for the median manufacturing firm.<sup>47</sup>

84. *The scale at which urban and metropolitan regional economies now operate often do not coincide with their physical and administrative boundaries.* In many countries, there is no institutional entity that covers the economic footprint of the urban or metropolitan economy. Consequently, decisions on infrastructure investments at this scale and its financing are made through complex (and often inefficient) negotiations between central government, often multiple municipalities, regional or state authorities, and the private sector. A critical part of urban strategy involves filling this void, both in terms of infrastructure decision-making and financing.

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<sup>40</sup> Glaeser and Kahn 2001.

<sup>41</sup> Henderson, Kuncoro, and Nasution 1996.

<sup>42</sup> Da Mata and others 2005.

<sup>43</sup> World Bank 2007, Straub 2007.

<sup>44</sup> Lall, Shalizi and Deichman 2004.

<sup>45</sup> Micco and Serebrisky 2006.

<sup>46</sup> Clark et al 2004.

<sup>47</sup> See Eifert, Gelb and Ramachandran 2005. Other examples may be found in Ter-Minassian 2008.

## **Asset-based Approaches to Growing a City Economy**

85. *As city economies evolve from pre-industrial to industrialized to post-industrial structures, the nature of commercial activity changes and requires new strategies to attract investment and promote business retention.* An increasing number of developing country cities today are facing the transition from industrial to post-industrial economies. During this phase, the city experiences a “hollowing out” of manufacturing industries. When cities reach this stage various redevelopment options can play a vital role in transforming vacant or otherwise underutilized land and property assets into new uses. Redevelopment can take the form of transforming manufacturing properties to new housing or office space, brownfield redevelopment, or riverfront revitalization with improved amenities to attract and retain businesses. Depending on the nature of the project, environmental remediation, wastewater treatment solutions and other measures may be important pre-requisites to successful redevelopment that can also include tax incentives, rezoning measures and other policies that attract private investment.

86. *Cultural Heritage has proven to be an important asset-based approach to local economic development.* The preservation of key monuments –in either consolidated city cores or urban redevelopment zones -- raises property values in their neighboring areas thereby increasing the local revenue base while making available additional resources to support local institutions and public services. Many cultural heritage projects are also aimed at improving poor and neglected urban inner-city areas and have the co-benefit of being labor intensive, thus creating local temporary work opportunities. Over time, the Bank’s work in supporting cultural heritage resource management has evolved substantially: from initial projects that sought to ‘do no harm’ to investing in heritage properties, to a new generation of projects aimed at leveraging cultural assets to achieve economic and social development linked to the tourism sector.

## **A World Bank Strategy for Promoting City Economies**

87. *At the national and regional level, policies will need to enable cities to function as gateways to international markets and as facilitating agents for domestic production and consumption markets.* This cannot be achieved by cities alone. National policy coordination is essential to ensure cities have good connectivity to port and other transport infrastructure and to ensure appropriate linkages and connectivity between cities and their hinterland to serve as markets for agricultural goods and production centers for agro-processing and marketing. The World Bank can assist by supporting regional planning and integration analysis and strategy formulation, as well as related inter-agency coordination efforts that facilitate such linkages.

88. *Improving the sub-national investment climate is often the first place to start in attracting investment to cities with a focus on reducing red-tape.* Over the past several years the World Bank has expanded the scope and coverage of subnational ICAs and Doing Business Surveys (See Annex F, Table F-5). These surveys provide critical information about a city’s ability to attract investment based on a private sector perspective. Because the methodology and indicators are standardized, cities can compare their performance to their peers and establish benchmarks for improvement. Such data has been used to define appropriate entry points for technical assistance and investments in improving a city’s economic prospects. Going forward, the Bank will seek to ensure appropriate linkages of sub-national ICA and Doing Business data with the design of the next generation of local economic development projects, where such data is available.

89. ***For post-industrial cities in transition, the Bank can assist by supporting urban regeneration and brownfield redevelopment approaches.*** While the Bank's engagement in these areas has been somewhat limited to date, growing demand, particularly in Eastern Europe, East Asia and the Middle East and North Africa, has signaled the need to expand engagement in both advisory services and investment lending in response. One effort that is now underway is to document good international practice, for instance in the area of riverfront or waterfront redevelopment approaches. Here the experience of OECD countries provides insights regarding approaches in dealing with real estate developers, environmental remediation for brownfield redevelopment, and district level redevelopment.

***Profile 9: Brownfield redevelopment and urban regeneration in Central and Eastern Europe.*** Former industrial areas account for relatively high shares of urban land in Central and Eastern Europe. Brownfield redevelopment aims to return such land to beneficial use, through remediation followed by redevelopment. The Bank is currently developing a brownfield redevelopment toolkit and a range of advisory and investment services to support cities and countries undertaking such work.

90. ***City Development Strategies with a Local Economic Development (LED) focus will continue to provide opportunities to prepare locally-owned, strategic frameworks within which the Bank can provide financing for technical assistance and investments.*** Competitiveness analysis is one tool used to prepare CDSes and typically focuses on a combination of sector analyses -- services industries, tourism, manufacturing, as well as maritime, fisheries and port activities -- and city district level development or revitalization. In the latter case, a focus on Central Business Districts, industrial and small-scale manufacturing zones, or tourism villages generally characterize the approach. The CDS provides an operational framework for city visioning exercises, participatory consultations (with the private sector, NGOs, educational institutions, the media, and other stakeholders). Linkage of strategy formulation to masterplanning and capital investment planning is vital, but many CDSes lack well-prepared investment plans and the financing to implement them. This is an area where the Bank aims to support cities in the years ahead through the development of a Capital Investment Planning Module for the CDS that can assist in preparing bankable investments over a multi-year program that can attract needed financing.

***Profile 10: Local Economic Development in Aden, Yemen.*** Small-scale investments in a local fish market and infrastructure for an industrial estate are being extended in a City Development Strategy that aims to improve the business environment, revitalize districts within the city, and set the stage for further investments of a large scale nature in the Aden Free Zone and Container Terminal.

91. ***More than a decade of experience in Cultural Heritage interventions linked to sustainable tourism development position the Bank to provide critical assistance in this area drawing on lessons learned.*** Since the 1970s, the Bank has provided financial resources for 241 projects having a direct investment component in heritage conservation and reuse with a total investment value of US\$4 billion. There are currently 117 projects under implementation with a direct investment value of US\$1.8 billion in cultural heritage components. In 2000, the Bank established a dedicated Trust Fund for Cultural Heritage, which is funded by Italy and has provided almost 30 grants for an overall amount of US\$5.74 million. The first round of funding supported 21 grants for vital technical assistance, capacity building, training, analytical work and pre-investment design studies that attracted additional financial support, leveraging approximately US\$185 million. The overall impact of this assistance has made cultural heritage preservation, its adaptive reuse, and sustainable tourism a fast growing area of support from the Bank and its development partners in their efforts to assist developing countries in promoting local economic development.

92. ***Market intelligence can help cities to attract investment in often overlooked innercity areas.*** The Urban Anchor has launched the development and piloting of a new tool called the Inner-City Market Assessment (IMA) in the cities of Bogota and Johannesburg. IMA utilizes data mining techniques to uncover underserved markets in urban areas as a means of attracting investment, broadening retail services, and creating jobs. Conventional market information analysis in the U.S., for example, is built around census data and developed at the aggregate level. However, due to the informality of living conditions and market opportunities in inner-city areas, there has been severe undercounting in terms of population and market potential. Initial indications have been positive in suggesting that there is potential scope for enhancing services and attracting investment (in addition to expanding the local tax base for both cities). In Johannesburg, partnership has been established with the Post Bank which aims to provide basic S&L services down market and is specifically targeting the Urban Development Zone (UDZ) within the city. Facilitating access to formal sources of finance and credit in informal, inner-city areas can assist residents and businesses in avoiding predatory lending practices that prevail in these underserved markets. In other cities, attraction of retail establishments has expanded the range of fresh produce available to local residents as an alternative to canned and packaged shelf products, thus contributing to improved health outcomes. IMAs can also be used to attract real estate developers as part of a broader redevelopment effort and to encourage private provision of housing to underserved markets in the inner city.