

OECD Territorial Reviews

Competitive Cities in the Global Economy

Summary in English

The Urban paradox: a challenge for nations' and the world's economy and sustainability

The acceleration of urbanisation has strengthened the weight of large cities, or metropolitan regions. Today, more than half (53%) of the total OECD population lives in predominantly urban regions. The OECD contains 78 metro-regions with 1.5 million or more inhabitants, which tend to concentrate an important part of their national economic activities. For instance, Budapest, Seoul, Copenhagen, Dublin, Helsinki, Randstad-Holland and Brussels concentrate nearly half of their national GDP whilst Oslo, Auckland, Prague, London, Stockholm, Tokyo, and Paris account for around one third. More importantly, most OECD metro-regions have a higher GDP per capita than their national average (66 out of 78 metro-regions) and higher labour productivity (65 out of 78 metro-regions) and many of them tend to have faster growth rates than their countries.

A number of factors explain the **advantages of large agglomerations** in generating higher output per capita and productivity.

- **Agglomeration economies** allow large metro-regions to attract global or regional corporate headquarters, offer a wide range of choice in resources and concentrate more specialised business services and infrastructure. Such agglomeration economies are confirmed by a positive correlation between metro-regions' *size and income*, especially when they concentrate over 20% of national GDP.
- Metro-regions typically provide both *advantages of specialisation and diversity*. Specialisation takes place in high value-added activities thanks to easier access to knowledge. The favourable pattern of metro-regions' industrial mix depends also on their capacity to concentrate *R&D activities and generate innovation* (more than 81% of OECD patents are filed by applicants located in urban regions).
- Metro-regions tend to have *greater endowments of capital (human and physical)*. The level of skills is higher than the national average for the majority of metro-regions and the demographic structure is more favourable. Metro-regions also have a higher stock of physical capital as measured by the equipment of firms and the stock of buildings and infrastructure facilities, and better endowment of transportation and telecommunication infrastructure.

Yet the growth capacity of metro-regions should not be overestimated, as metro-regions are **not always synonymous with success**.

- A number of *metro-regions lag behind the national average*, including Berlin (Germany), Fukuoka (Japan), Lille (France), Naples (Italy) and Pittsburgh (US). Moreover, for many metro-regions, differences of output, productivity and employment levels from national averages are not so large. Large cities' *innovative capacity might also be overstated* as patents are generally registered in large cities, while they might have been generated at research sites in other regions.
- Metro-regions concentrate large and persistent *pockets of unemployment*. One third of the 78 metro-regions have unemployment rates above the national average. Moreover, urban regions surprisingly feature *lower activity rates* than other types of regions (44.3% against 49.7% and 44.5% in intermediate and rural regions respectively in 2003).
- *Exclusion and poverty* in most OECD countries have become urban phenomena, not only in less-advanced metro-regions like Mexico City but also in cities that have faced strong industrial restructuring (Rotterdam, Lille, Detroit) as well as in the suburbs of some of the richest metro-regions (Paris, London). *Socio-economic inequalities* are common to all metro-regions. A particularly vulnerable portion of the metro-regions' population are *immigrants* and their descendents, who tend to cluster in large cities. Many of them have lower skills but even skilled immigrants find it difficult to integrate into economic networks.
- Poverty and social exclusion have important costs including high levels of *criminality* (on average 30% higher in urban areas than the national level) and strong *spatial polarisation* (in ten OECD countries surveyed, 7% to 25% of the population live in distressed neighbourhoods, representing up to 10% of their national population). Deprived neighbourhoods often have lower access to public infrastructure and services, and feature lower levels of investment per capita than richer neighbourhoods.

In fact, metro-regions also have important *negative externalities*.

- *Congestion costs* are particularly prominent (*e.g.* traffic, air and water pollution, noise levels and degradation of green areas) in recently and rapidly developing metro-regions in OECD countries (*e.g.*, Seoul, Istanbul), but also in such long-established major cities as Paris, Tokyo and London, and even in some parts of such less densely populated regions as Helsinki and Stockholm.
- *Poor-quality infrastructure* may also arise in some metro-regions because of high maintenance costs. This is most likely to be seen in areas with concentrations of social housing, or in areas where economic activities are associated with noise and other unwanted environmental effects.
- Mega-cities might feature *diseconomies of agglomeration*. Bigger means richer until a certain threshold (around 7 million), *i.e.* the correlation between metro-region size and income becomes negative, (*e.g.* Seoul, Mexico City, Istanbul, and Tokyo).

Increasing role of large cities: what should policy makers do?

The combination of economic advantages and difficulties posed by the rise of metro-regions presents a number of *strategic choices* or *dilemmas* that confront policy makers.

Dilemma I. Positive or negative spillovers?

Are metro-regions the causes of economic growth or its consequence? If the former, they need to be encouraged; if the latter, does their tendency to attract resources away from other regions do more overall harm than good?

- ***The causal relationship between levels of urbanisation and per capita incomes is not obvious.*** Yet being areas with considerable internal diversity, metro-regions stand a better chance of becoming the locations for innovation than smaller, more specialised or less pluralistic areas.
- ***The impact of metro-regions on other parts of a country is also not clear.*** Although wealth and economies of scale generated in a metro-region are likely to spill over on a wide territorial scale, metro-regions may drain other areas of their capital (especially talent).
- ***Reconciling national and dominant-region interests in a positive-sum game*** requires a new strategy that goes beyond the typical "centre *versus* periphery" dichotomy. Experience of containment policies in OECD countries (Paris, Tokyo, London and Seoul) has provided mixed outcomes. The most effective measures do not consist in distributing direct subsidies to lagging regions while ignoring the best performing regions, but in capturing differentiated regional competitive advantages.
- ***Synergy effects could be generated by building co-operative exchange networks*** between the major cities and other regions (e.g. programmes for twinning universities and other regions, location in two places of different aspects of major technology projects).

Dilemma II. Which public strategic vision in a market context?

A strategic vision is required to encourage the competitiveness of metro-regions. But can public authorities do this without attempting direct substantive economic planning which cannot work in a dynamic, changing economy?

- ***A diversified, cluster-based approach could help to limit the risks of a strategic vision.*** A major advantage of large agglomerations is their diversified economy containing various specialised clusters. Both specialisation and diversity should be enhanced through tailored policies, taking into account the development stages of clusters, without sacrificing the advantages of diversity in prioritisation.
- ***It is essential to build assets of relations and provide local collective goods.*** Networks are a key asset for metro-region development. Policies should aim at building sector-specific links between university research departments and science-based industry or broker services to promote inter-firm linkages and SME participation. Other collective goods such as transport and other public infrastructure are essential too.
- ***Not all metro-regions will become world leaders in high-tech activities.*** There is a need to search for strong, viable niches outside this range. Decision-makers at the metro-level often try to encourage new sectors for which there is little evidence of past success; even radical innovations often develop from existing capacities and recognisable potential.

- ***Involving a wide range of players could help to reduce the risk in a strategic vision.*** Public authorities in metro-regions should identify the critical relations among many agents which are likely to shape the future development of a territory.

Dilemma III. Economic dynamism or liveable city?

Concentration of population, which partly account for metro-regions' dynamism, also causes congestion, poor environment, housing shortages and the formation of ghettos. Is there a choice between economic dynamism and having a liveable city?

- ***An attractive environment contributes to economic success.*** Problems are often far more difficult and expensive to resolve after they have developed than when they could have been prevented. For instance, ghettos of poor housing are almost impossible to eradicate once they have developed without massive disruption to people's lives that causes new problems.
- ***A more sustainable spatial approach enhances a city's liveability and attractiveness.*** Examples of such strategies include the development of green areas (Seoul), multi-nodal approaches (Melbourne), as well as road pricing or congestion charges (London, Stockholm, Singapore). Urban renaissance strategies based for instance on developing cultural assets in depressed areas (Glasgow, Bilbao, Cleveland and Kitakyushu) help to attract creative and innovative populations, promote tourism and territorial branding and can be a major component to attract FDI.
- ***Poverty and spatial polarisation are probably the most difficult challenge*** for metro-regions. The above approaches do not resolve all problems since it is possible to achieve attractiveness for central parts of a city alongside ghettos of the socially excluded. Although metro-wide economic growth depends both on economic interdependencies and social cohesion, social and distressed neighbourhoods policies have produced mixed outcomes. Most city and national authorities accept some responsibilities for tackling these issues, but there is rarely the political will to devote adequate resources to the challenges posed.

Dilemma IV. Appropriate scale or closeness to citizens?

The need for strategic visions and overall infrastructural planning in metro-regions suggests some need for a relatively autonomous public authority at the appropriate geographical level. But this level will be remote from many citizens' local concerns. How can these tensions be balanced?

- ***There is a wide diversity of metropolitan governance models within OECD.*** The most radical solutions involve the establishment of new authorities at the functional level, either by interposing an additional layer of government (*e.g.*, London, Stuttgart, Portland) or by expanding the boundaries of existing cities (*e.g.* Montreal, Toronto, Busan, Istanbul). There are also various forms of collaboration, ranging from the formation of specialised agencies or inter-municipal bodies, through contracts among different authorities to work together, to informal co-operation agreements. There is also diversity in scope, some collaborations being multi-functional (*e.g.* Vancouver, Lyon) and others being designed for individual services, such as transportation (*e.g.* Athens, Philadelphia).
- ***The different models contain considerable trade-offs in terms of benefits and costs.*** In terms of efficiency, relying on a co-operative mechanism may be second-best

compared with a self-financed and directly elected administrative organ, yet it fosters communication and limits the tendency to bureaucratic mission creep. Associations or networks of local municipalities, typically with opt-in, opt-out possibilities, contribute to flexibility of the experiment by allowing for step-by-step inter-municipal co-operation according to local circumstances and culture. Formal institutions might be in a better position to co-ordinate policy objectives throughout a metro-region area and to deal with spatial disparities. Lighter and more informal forms of governance generally tend to better mobilise metropolitan-wide stakeholders around a common vision, but implementation then requires an action plan and a critical mass of financing that might need a more formal arena for co-operation or collaborative tools.

- ***Public support and legitimacy determine the success of a reform.*** Often strong leadership by a charismatic and influential individual and/or area-wide coalition (*e.g.* NGOs, private sector) has been crucial to create the new body. Yet models that are imposed or lead to confrontation could undermine the reform (*e.g.* the vote in a referendum in Amsterdam to reject plans for a merger) or undermine the stability of the new structures (*e.g.* de-merger movements in Montreal). Accordingly, participation of local actors is essential to deal with social conflicts and tensions, not only through voting and representation, but also through policy networks of non-governmental actors and associations.

Dilemma V. Metro-regions versus central/state government?

Autonomous public authorities at the metro-regional level may seek devolved powers whilst the higher levels of government (central or state government in federal countries) still want to maintain control of large cities. Where is the balance between these to be found?

- ***Higher levels of government are central to building metropolitan co-operation.*** In most cases, the national government has played a leadership role either by imposing or by encouraging the reform. A legal basis frequently plays a role in legitimising the process (*e.g.* Korea, Quebec and Ontario provinces in Canada), or facilitating co-operation among local authorities (*e.g.* France, Italy, Portugal). Incentives (fiscal or financial) behind these laws are determinant for the implementation process.
- ***New tools for vertical relations for metro-regions are being developed.*** Top-down strategies alone appear unable to generate a reassuring vision of the future on which to build an overall development strategy. Particularly important are legal measures that enable urban partnerships taking the form of contracts across several authorities (*e.g.* large French cities, Stockholm, Vancouver). Contractual arrangements are more efficient where a negotiated planning process among different levels of government exists, with incentives for participation, a structured round of negotiations with clear objectives, a precise timetable, and evaluation components.

Dilemma VI. Participation of private sector actors in metro-regions' governance?

Public authorities must involve the private sector in constructing regional partnerships for economic development. But can this avoid improper lobbying and a squeezing out of small and medium-sized enterprises by large corporations?

- **Private sector involvement in metropolitan governance entails opportunities and risks.** Involving local firms in the construction of the metropolitan strategic visions may help authorities to stay close to market realities. Yet firms chosen as interlocutors may use such a position to exclude competitors (*e.g.* multi-national corporations with local SMEs). Public authorities can partly address the problem by dealing mainly with trade associations rather than individual enterprises; but this might favour established (and possibly declining) sectors at the expense of new ones (*e.g.*, in European cities during the 1980s and 1990s dominated by the steel or metalworking industries).
- **Metropolitan level offers greater opportunities for capturing activities** of existing and potential sectors than the local level. Here again, there is a trade-off between ensuring the valuable participation of business interests in the formulation of development strategies and opening the door to privileged lobbying and market distortion.

Dilemma VII. Unequal burdens or distorting subsidies?

The large spending needs of metro-regions create major fiscal challenges. At the same time, national goals – such as a demand for regional equity - might force metro-regions to contribute financially to the rest of the country. How can the right balance be found?

- **The specific challenges of metro-regions require an urban approach to local public finance.** The local taxation system must be better adapted to metro-regions which often provide a wider variety of services than other regions in the country. *On the revenue side*, sufficient autonomy should be provided to metro-regions to allow them to decide on local taxes and to set local priorities. A case can be made for diversifying tax revenues and introducing "smart taxes" such as congestion charges and other environmental taxes. *On the expenditure side*, assignment of functions to the most appropriate government level may increase spending efficiency. General principles are that the delivery of local services, such as waste management and maintenance of roads, should be delegated to a local level whilst public goods with larger externalities such as air pollution and water management have to be addressed at a larger entity than city level.
- **Equalisation schemes might have some perverse effects.** A major dilemma for central governments is how to get enough from metro-regions to ensure some territorial equity objectives without deteriorating their financial capacity.
 - *Intra-metropolitan equalisations* are used to combat negative effects of urban sprawl and deal with income polarisation. These mechanisms are implemented by a number of metropolitan governments (*e.g.* Istanbul, Tokyo and Seoul), as well as in some highly fragmented metro-regions (*e.g.* Minneapolis-St. Paul). In France, the central government provides an additional grant to municipalities that accept a form of intra-metropolitan equalisation scheme.
 - *National equalisation schemes* aimed at redistributing resources from richer to poorer regions are a commonly debated and controversial issue. In some cases, some elements of expenditures are not taken into account such as higher labour costs (*e.g.* Stockholm), higher land costs (*e.g.* Helsinki). In other cases, municipalities with high tax capacity receive more equalisation transfers (*e.g.* Amsterdam). Equalisation schemes can also create disincentives to increase tax

efforts, which is not beneficial to metro-regions with their large efforts to collect tax revenues (*e.g.*, Seoul).

Summing up: rethinking national urban strategies

Cities are key components in a territorial development strategy. But national urban policies in the past have been reactive and remedial, not pro-active and dynamic. Not only must urban issues be given greater visibility and higher priority in national policy but also new policies may be needed at national, regional and local levels. Governments at all levels must re-examine their roles and responsibilities and explore ways to foster synergies in a collaborative framework.

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