Starting point

• How seriously should we take the "from cities to growth" connection?

• Does a growth agenda alter urban policy recommendations?

• The urban landscape is a (political-) equilibrium outcome
Output

An integrated framework to think about cities in developing countries

• Highly tractable and flexible
• Can be used to make sense of the empirical evidence
• Highlights key policy tradeoffs
• Can be used as a basis for ‘urban diagnostics’
A simple graphical framework to think about urban development

Graphical modelling inspired by Combes, Duranton, and Overman (2005):

*The 3.5-curve approach to urban economics*

- A wage curve
- A cost of living curve
- A net wage curve
- A labour supply curve

Think about rich countries for the time being
Figure 1

(a) Wage Curve

(b) Cost of Living Curve

(c) Labour Supply Curve

Net Wage Curve

$w(N)$

$H(N)$

$w_C$

$w_B$

$H_B$

$H_C$

$w_B - H_B$

$w_C - H_C$

$N_B$

$N_C$
Two important asides

• Natural tendency towards ‘specialisation’

• General equilibrium effects
Main policy issues in the 3.5-curve framework

Main inefficiencies

• Local externalities in production
• ‘Urban’ inefficiencies affecting the cost-of-living curve
• Migration inefficiencies
• Inefficiencies associated with the development of new cities
Figure 2a
Figure 2c

(a) Wage Curve

(b) Cost of Living Curve

(c) Labour Supply Curve

Net Wage Curve

$w(N)$

$H(N)$

$w(N) - H(N)$

$N$
Key issues:

• Some inefficiencies are ‘easy’ to fix, some rather hard, some extremely hard

• ‘Local’ second-best (key interdependencies)
What’s special about cities in developing countries?

The benchmark is consistent with urban features in developing countries:


- Cost of living (Thomas, 1980; Richardson, 1987; Henderson, 2002a; Timmins, 2006)

- Bell-shaped net benefits (Au and Henderson, 2006a,b)

- Migration (Brueckner, 1990; Ravallion and Wodon, 1999; Lall, Selod, and Shalizi, 2006)
But key features are missing

• Primate city favouritism
• Market access
• Dual labour markets
• Migration
• Dual housing markets (to be done)
Primate city favouritism

Driven by politics

• Local rents? (Ades and Glaeser, 1995; Davis and Henderson, 2003)

• Endogenous (internal) market access? (Saiz, 2006)

• Trade? (Moomaw and Shatter, 1996; Krugman and Livas Elizondo, 1996; Nitsch, 2006)

• Other channels? (Henderson, 2002b)
Figure 3

Wage Curve (favoured city)

Wage Curve (non-favoured city)

Cost of Living Curve

Labour Supply Curve

$w(N) - H(N)$

$w_A - H_A = w_B - H_B$

Net Wage Curve

$w_B$

$w_A$

$H_A$

$H_B$

$N$
Internal market access

As highlighted by the new economic geography (Fujita, Krugman, and Venables, 1999)

• Empirical work so far: general negative effect of poor access (Lall et al., 2003, 2004b; Lall, Funderburg, and Yepes, 2004a; Deichmann et al., 2005)

• Theory highlights non-linear effects (Head and Mayer, 2004; da Mata et al., 2007)

• Should also affect the cost of living (Timmins, 2006)
Migration and dual labour markets

Inefficient migration in the traditional approach (Harris and Todaro, 1970)
Figure 5

Expected wage

Wage Curve
(formal sector)

Wage Curve
(informal sector)

Cost of Living
Curve

Net Wage
Curve

Labour Supply
Curve

$w(N) - H(N)$

$w_A - H_A$

$w_B - H_B$
Alternative approaches to migrations

\[ w(N) - H(N) \]

Net Wage Curve (Harris Todaro)

Labour Supply Curve (no mobility)

Labour Supply Curve (costly mobility)

Labour Supply Curve (free mobility)

Figure 6
Does all this matter for growth?

Henderson (2003):

- No effect of urbanisation on growth
- But very large negative effects of excessive primacy

How much should we trust these estimates?
Explaining large effects of primacy I: static surpluses?

- Like all growth models, city-growth models have two equations: production and accumulation (Duranton and Puga, 2004)

- Static externalities in production without action on accumulation equation might have large growth effects (through subsistence effect)

- Empirically not very credible
Explaining large effects of primacy II: growth constrained by cities?

The urban system as the spatial imprint of growth:

- Innovation cities vs. production cities (Duranton and Puga, 2001)
- Business centres vs. production centres (Duranton and Puga, 2005)

Constraining the urban system may reduce growth

Empirically minor?

Explaining large effects of primacy III: Dynamic externalities

- Cities as engine of growth (Lucas, 1988; Eaton and Eckstein, 1997; Black and Henderson, 1999)
- Diffusion across cities through workers movements?
- Consistent with large regional disparities
- How important are (dynamic) human capital externalities?
  - Large literature but still open question
  - Dynamic externalities taken seriously in macroeconomics (Klenow and Rodríguez-Clare, 2005)
What about policy?
Static vs. dynamic efficiency

Traditional urban policies: static in nature

- Housing
- Traffic congestion / public transport
- Delivery public services
- Access / Infrastructure
- Reduction in primacy
- Etc
What could foster dynamic efficiency?

- An end to primate city favouritism?
- Many different forms of ‘mobility’?
- Access?
- Many other policy areas whose forgotten urban/spatial dimension is often forgotten?
Drivers of growth vs. constraints and bottlenecks

- Fostering all ‘growth drivers’ may be counter-productive
- The 3.5-curve approach can help identify the constraints to harmonious urban development
- The diagnostic will differ across countries
- Difficulty: static constraints are easier to identify than dynamic ones
Priorities vs. ‘second-best’

• Politics and other feasibility constraints require priorities

• But hard to achieve results in a second-best world
National vs. local ‘cities and growth’ policies

- Strong general case in favour of decentralisation
- But one city alone cannot do much
- Asymmetry: primate city vs. others
References


