

Why Does A City Grow? Institutions and the Urban Economy

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The Problem

- Studies of metropolitan growth and development are weak on analysis of causes
- They tend to “measure” and “account” for factors – specialization, costs, business climate, infrastructure, R&D, human capital
- But most of these factors are themselves just *intermediate variables*: they need to be *explained*, and placed into *causal sequences*, not just measured or described

Why do we need a better framework?

- Huge amounts of money and policy effort are spent trying to influence urban “success”
- Physical planning, social investments, education, competitiveness, targeted industrial policies, sectorally targeted infrastructure and facilities, “amenities” and “quality of life,” “business climate”...

Why we need a better framework

- Virtually *no serious systematic evidence* exists on the contributions of any of these factors to sustained growth of particular city-regions, i.e. their relative success over the medium-run (30 years or so)
- So, a huge policy apparatus is operating in a vacuum of evidence –even when they are “measured” and “correlated,” are not subjected to sophisticated causal analysis

New Economic Geography

- In economics, causal models of growth emphasize the *specialization* of the urban economy.
- They show why specialized high-cost cities can continue to grow

Specialization: but where? and over time

- But economics does not tell us why *any particular city* “captures” or retains a particular specialization
- This then re-opens the door for ad hoc “accounting” theories that, wrongly, confuse the factors that *describe* an economy with *causes* of why it has developed in a certain way
- Moreover, even well-specialized cities must cope with change (activities leave and technologies change and make them out-dated)
- So, the problem is to explain the *resilience* and *adaptation* of the urban economy *over time*: re-creating favorable specializations

Other causes

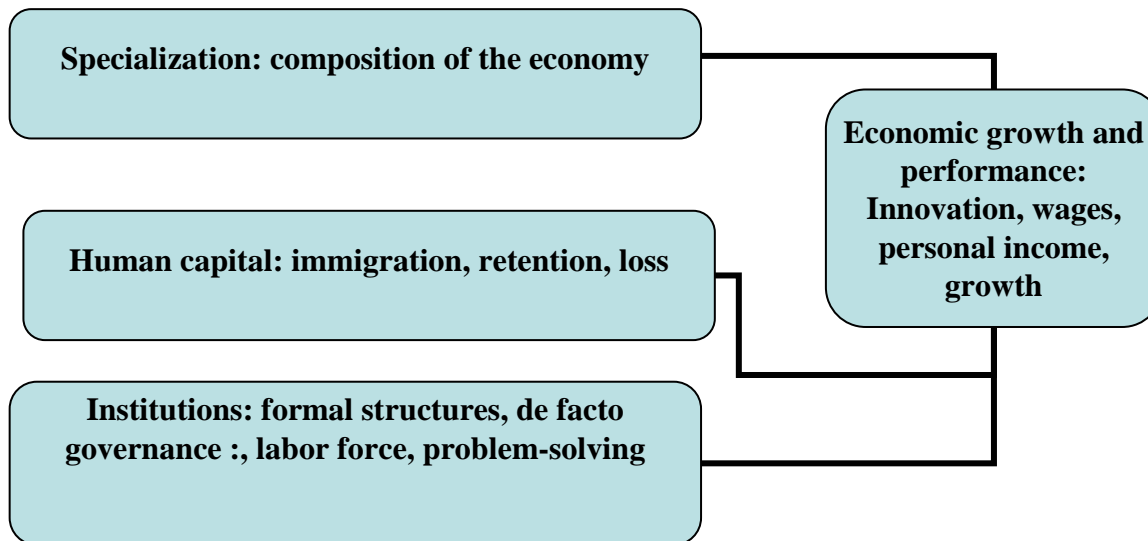
- Economic growth theory, mostly applied to international development, has made big advances on causes of growth
- Growth is said to be due to knowledge accumulation (skills and *human capital*)
- *Institutions* determine which places build up knowledge and skills and whether they have long-run adaptive capacity

A way forward

- These three causal theories can form the basis of an explanation of why cities grow:
 - Specialization
 - Knowledge, in the form of human capital
 - Institutions (governance) from the new growth theory

A framework

- The three forces that determine urban economic growth and performance



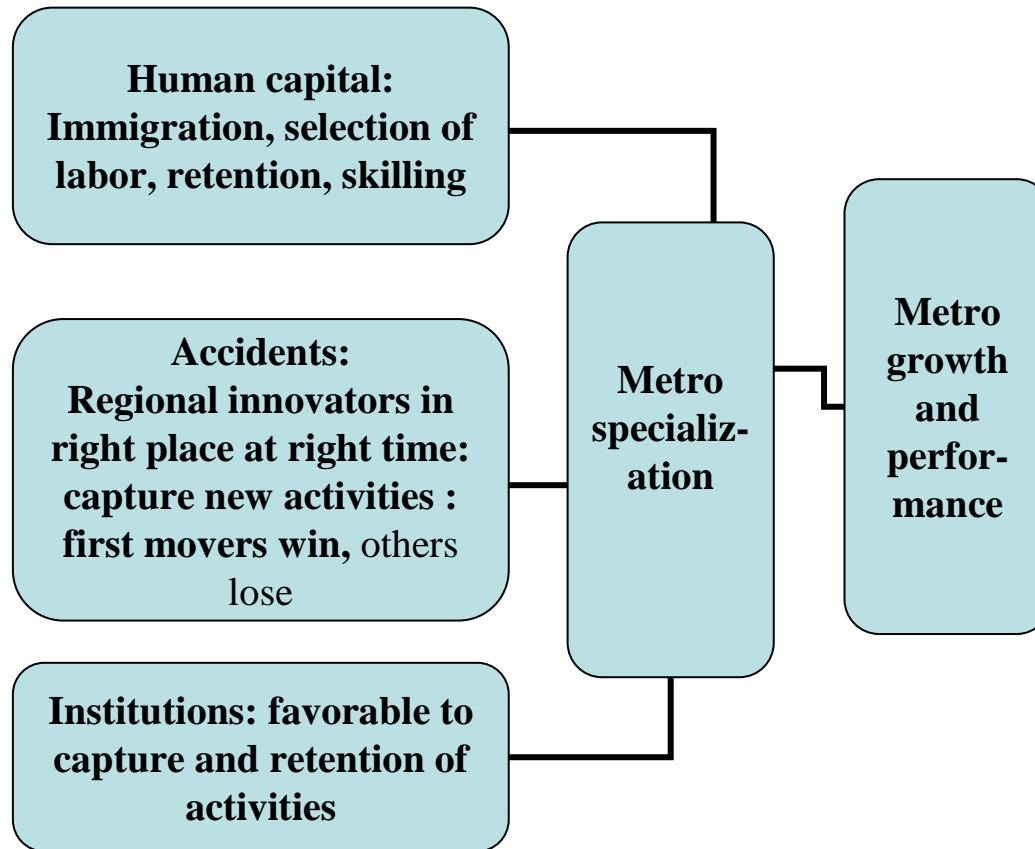
Interactions

- The three forces identified can *interact*. They can become causes of one another (“endogeneity”)– what is the direction of causality?
- Is specialization caused by human capital (labor force development)? Is this what allows a city-region first to capture, and then to hold a sector and hence benefit from specializing in it?

Endogenous specialization

- Is specialization accidental? The right place at the right time + lock-in through agglomeration economies? (in this case, policy doesn't matter)
- Is specialization due to institutions? Do they capture first-mover advantages? If not, do they “hold” a sector once its seeds are first planted in the region?

Specialization has deeper causes..



What causes human capital?

- Where does the metropolitan stock of human capital come from?
- From the forces that *attract and retain migrants* selectively, or *train* them in the region and then *retain* skilled persons.
- This has a lot to do with...specialization! Because that creates specific opportunities (circular causation)
- But also from *institutions*, which filter immigration and bias it toward certain kinds of populations and their skills, and solve problems, making the metro environment hospitable to certain kinds of people

Human capital

- Institutions are responsible for the patterns of *retaining* people who are trained in a region – it's not enough to educate people, if they leave...
- Human capital is probably *not* created principally by amenities or better physical urban planning (no evidence to suggest this).
- Instead, skilled people encourage the creation of amenities through their influence on regional institutions – demand creates supply, not the other way around

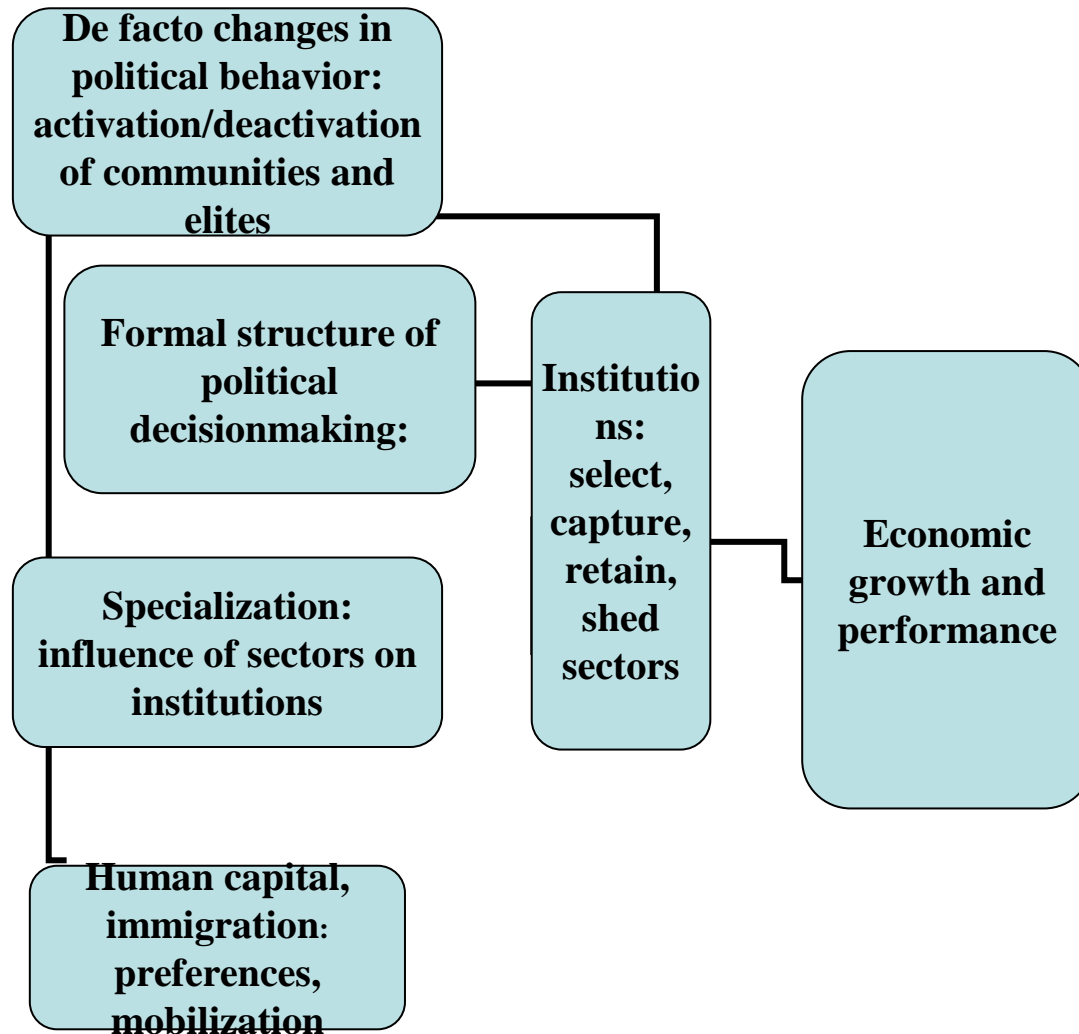
What shapes institutions?

- Institutions have complex roots: in law and history and custom
- The *formal* context is the set-up of jurisdictions and their authority over city-building and regulation processes
- The *de facto* context is the real politics and behaviors of governmental, business, electoral and popular constituencies – within the de jure framework

Institutions, specialization and human capital

- Institutional performance in a city-region can be shaped by constituencies and interests
- It can be shaped by *specialization*, which determines the business elites in the region and their interests and goals
- It can be shaped by the labor force more generally, through *human capital actor-networks*
- More generally, the various actor-networks in the region will shape institutional priorities and performance

What shapes institutions?



The importance of institutions

- Once again, regional growth studies often reduce institutions to their “instrumental” character. For example, they claim that government spending creates metro/regional specialization
- Very few cases of this. Usually it’s not public spending or *deliberate* attempts to create specialization *in a particular metropole* that works;
- Rather, the governmental intervention/policy *indirectly* influences the *sector* (technology, procurement, etc). In turn, *regional* behavior is the result of many *other* forces (exceptions = one big, government-owned firm is the stimulus...these are infrequent cases, not the norm today)

Why institutions?

- So, the importance of institutions to metropolitan economies is *not* principally through traditional regional economic policy mechanisms such as government spending
- Instead: it is through long-term and subtle effects on specialization through *problem-solving*, adaptability, good governance
- And long-term and subtle effects on human capital – creating, attracting and retaining talent – through problem-solving and good governance

Institutions and development

- International development economics argues that institutions are critical because they shape business conditions in general (*confidence*), labor force participation (*skills and levels*) and *problem-solving* (developmental coalitions that adjust rules as necessary to changing economic conditions)

Regional versions of this

- Institutions at the level of the metropolitan city-region influence all these factors as well
- But how do they do so?

Regional versions of this

- Institutions of regions subtly orient the attention of actor-networks in a region:
- Specialization driven by the *qualities* of labor. Specialized labor markets are *actor-networks*. Labor market networks also have strong overlap with *business networks* and *educational and training networks*
- Regional institutions and politics can affect these processes of *network construction and change*.

Regional institutions: what do they do?

- Let's be modest in our claims: such networks are affected by many things that are beyond the power of regional formal and informal institutions (national policies and international flows)
- These networks combine elements that are formal, informal, business, civil society, norms, and relationships – and some of these are strongly regional in scope

Regional institutions: change

- The urban politics/governance literature emphasizes deliberate (policy-backed) change: they emphasize elite-based strategies to extract rents from land-based development. For some others, it's enlightened government action to attract industries

Regional institutions: change

- But these perspectives are far from explaining major change in actor-networks at a regional level, of the type that changes specializations
- Many of the formal powers of local government are about land use regulation, but most economic sectors are only secondarily interested in land development (financial services needs office towers, but that's not its principal goal; high tech needs production sites, but land speculation is secondary)

Regional institutions: it's not principally about physical planning issues

- More general elite strategies for “building clusters” use local governments mostly to....redevelop land! Physical planning oriented. *Very* remote link to actor-networks and specialization (*no* econometric test has ever supported the link). Mega-projects (convention centers, sports stadiums) almost never pay off
- So they have little to do with these deeper processes of actor-network construction and effects on human capital and hence specialization

A contrast in institutions

- A North American case illustrates the importance of institutions
- Detroit 1960-2007 versus Boston 1960-2007
- Detroit “healthier” in 1960 than Boston! (“motor city” versus “declining mill town”)
- In 2007, Boston income is 40% higher than Detroit. Detroit loses population, Boston re-gains it.
- Why?

Institutions and problem-solving

- In Detroit, private sector institutions (big car companies) do not solve their problems
- Government fails to help them. Government is absorbed by racial conflict and hence cannot devote attention to underlying economic problems
- Car companies continue to weaken, but also move away from Detroit
- A spiral downward that has never been solved

Institutions and problem-solving

- Boston creates a *political coalition* in the 1970s and 1980s – it includes “old labor” (leadership from textile mill towns) + “new economy” interests (universities, suburban communities) + the inner city.
- It is aided by the “growth plan” created by Massachusetts – incentives to cooperate
- Race and class conflict are very deep, but they are dealt with in coalition-forming manner, so that attention can be given to *solving problems of economic conversion and adjustment*

Governance and problem-solving

- Regional institutions consist of formal decisionmaking structures, combined with political participation in city regions
- They affect formation of political coalitions, and the problems they put on the agenda through two processes:
- What priorities “get through” (voice)
- What voices get “heard” (aggregation and selection of ideas, priorities)
- This is a problem that requires less the old-fashioned “urban politics” approach and more a sophisticated *new institutionalist approach*

Another example

- Los Angeles and San Francisco
- Start out in the 1970s with similar economic indicators (per capita income in LA = 92% of SF).
- Both among the wealthiest North American metropolitan regions
- But in 2006, LA per capita income is only 62% that of SF's (this is for the entire metro regions, 14 million people and 7 million people, respectively)

A contrast

- Part of the difference is population growth: LA grows much more, but more of the growth is low-skill immigrants than SF
- In the past, low-skill immigrants climbed up the economic ladder in LA, so they presented no problem for regional economic development
- More recently, structural change seems to be occurring so that the LA economy is taking a “lower road” than the “high road of SF

Specialization

- Partly due to specialization: SF is the high tech capital of the world
- But LA was formerly the high tech capital of the USA, in the Cold War era. Its companies did not effectively *adapt* to the New Economy era
- Instead, it has created a dualistic economy, which reminds us of Latin America: a super-high skill, high income part (Hollywood, financial services, design, and IT), and a growing low-skill, low-wage part

What drives specialization?

- Human capital obviously has something to do with these two different pathways: more low-wage, low-skill people in LA, a higher proportion of high-wage, high skill people in SF
- But – as noted – this is a recent development. What caused the change?
- Institutions. How did they do this?

Institutions and specialization

- In SF, institutions are able to generate policies that reinforce the “high road” – coalitions between different localities that address regional needs, and inventive localities that attend to their local needs
- In LA, institutions are pre-occupied with “crisis abatement” – dealing with accumulated, urgent issues such as violence, homelessness, outdated infrastructure
- Hence, SF pushes itself along the high road, but LA does not
- Why is this so?

Formal institutional structure

- Paradoxically, SF's institutions are *more* fragmented than LA's (10 counties for 7 million people versus 5 counties for 14 million, biggest city with 750K people vs biggest city with 3.5 million).
- More fragmentation leads to more cooperation! Because there is no dominant agent to “crush” the others
- Smaller localities have more homogeneous preferences that enable fresh new ideas to emerge

Political culture

- LA is historically more “top down” (run by its elites, who attempt to marginalize community participation) – until about 20 years ago
- SF historically more based on power-sharing among labor, business and local community groups -- so more compromises happen. Experienced *coalition-building for problem-solving*
- In LA, powerful groups try to use big jurisdictions (LA County = 10 million people) to get their way. Bad projects get through in many cases. In other cases, lacking a tradition of coalition-building, there is simply *paralysis of the governance process*
- Then, crises emerge and “suck up all the air,” leaving no energy for positive, forward-looking initiatives

Regional institutions

- *Hence, the action outcomes are radically different.* Different types of coalitions, structured by the formal structure of jurisdictions and the political practices within them.
- In both the Boston and SF cases, *more cooperation* between the different levels of the social and economic hierarchy leads to better problem solving and more room for positive initiatives— so fragmentation and competition generate....cooperation!
- These initiatives, in turn, create the conditions for attracting, training and retaining the human capital that corresponds to the specializations that drive economic growth

Institutions

- Fragmentation = diversity and new ideas
- Cooperation = bringing ideas together into coalitions at metro level
- Coalitions = there must be incentives for them
- When these are absent (eg LA, Detroit), dominant jurisdictions and their actors eliminate diversity of ideas and interests
- Let problems accumulate
- Leads to “crisis mode” and playing to weaknesses rather than strengths
- Paradoxically, in the latter case, the “winner takes all” strategy leads to “everyone loses” in the long run

Conclusion

- I have attempted to show that:
 - Simplistic attempts to correlate factors to urban economic development don't explain anything
 - Explanation involves taking into account very complex interactions: specialization, human capital, institutions
 - the three main forces that structure growth and development have, at their center, *institutions*

Conclusion

- The tendency in metro area policy circles today is to emphasize *either* a turn to redistribution (bottom up, social justice etc), *or* “high end, New Economy, business-oriented” policies
- This is a false opposition. Institutional reform involves precisely creating the coalitions based on social and geographical inclusion *so that*:
 - Multiple goals can be pursued with mutual support
 - Crises and urgent problems are dealt with *so that* there is room for higher-end strategies
 - Higher-end strategies are understood to be the necessary direction of long-term institutional action by *all concerned*