



HABITAT III ISSUE PAPERS

12 – LOCAL ECONOMIC DEVELOPMENT

New York, 31 May 2015

(not edited version)





ISSUE PAPER ON LOCAL ECONOMIC DEVELOPMENT (LED)

KEY WORDS

local economic development, competitiveness, urbanization, equitable development, diversification, resilience, externalities, business-enabling environment, skills development

The sustainability of cities and towns should be based on endogenous growth, and for this a local economic development (LED) approach is essential. Municipalities need to use their own assets and comparative advantages to the full. Yet, this is not always accomplished. This paper aims to raise the awareness about the LED strategy, with its related tools and data. While there is a burgeoning literature on LED, it is beyond the scope of this paper to cover all its aspects.

MAIN CONCEPTS

- Local Economic Development: LED is a participatory development process that encourages partnership arrangements with representatives from all sectors. It aims to provide a roadmap between the main private and public stakeholders in a defined territory, enabling the joint design and implementation of a common development strategy. The strategy makes use of local resources and competitive advantages in a global context with the final objective of creating a resilient and sustainable city with decent jobs and stimulating economic activity.
- Economies of urbanization & localization: This has two forms: economies of urbanization and economies of localization. The former which entails benefits accruing from different types of companies locating near each other. The latter entails benefits from companies in the same sector locating near each other. Higher densities of people and firms allow for ideas to flow giving birth to innovation. Density also allows firms to benefit from economies of scale and links to input and product markets.
- Partnerships and networks: local economic development requires collaboration among sectors and institutions, individuals and organizations. Success is possible when collaboration is effective, accountable and coordinated.
- Business-enabling environment: positive and predictable context in which to do business, where conditions related to policy, institutions, regulations, infrastructure and culture lay the foundations for markets to work.

FIGURES AND KEY FACTS

- Cities generate more than 60% of global GDP and house more than 50% of the population. It is estimated that 600 cities will generate nearly 65% of world economic growth by 2025.¹ For example, 1.9% of the population of China lives in Shanghai and the city produces 13% of GDP.

¹ McKinsey Global Institute, *Urban World: Cities and the Rise of the Consumer Class*, (2013)



- Higher productivity results from economies² of urbanization and localization, which attract skilled workers, as well as more productive entrepreneurs and firms.³ Controlling for skill level of labour force, elasticity of income per capita with respect to city population has been estimated to be between 3 and 8%. Smaller cities also have a role to play with medium sized cities becoming centres of manufacturing at mature stages of urbanization. Smaller cities serve as links between larger urban markets and rural areas. A city's competitiveness depends foremost on the strengths of its economic sectors. However, competitiveness also depends on the quality of the governance institutions, including their ability to tax, plan, legislate, and enforce laws, support enterprises and human capital development, and elicit public participation in decision-making. A total of 11 out of 20 of the world's most economically competitive cities also rank as having the highest quality institutions in the world.⁴
- Youth comprise one of the largest untapped sources of economic potential. Some 262 million youth are economically inactive; and most of these youth reside in cities.⁵ Gender-based occupational segregation persists, as does the gender pay gap; while women, including young women are more affected by unemployment and under employment.
- LED is important to promote a sustainable and inclusive urban economy and consequently to improve the quality of life in cities, and address inequalities, between rich and poor and also gender inequalities. LED is also important to make cities more resilient and ready to address crises. During crises, connection to regional, national and the global economies are particularly difficult.

ISSUE SUMMARY

Effectively addressing the opportunities and challenges of urbanization is essential to the long-term success of cities and countries. Decisions taken by city leaders today will be long lasting and hence have the potential of building long-term success or send their cities down a path of unsustainable development. Local economic development strategies can help city leaders lay the foundations to long term and resilient growth by empowering local actors, building capacity, and providing the tools to better manage cities. Local economic development is a critical tool to manage long-term change and enact short term fixes.

A high per-capita economic productivity, grounded in the clustering of firms and skilled labour, means cities are regional economic engines. Growing cities could inject up to US\$30 trillion a year into the world economy by 2025.⁶

² Rosenthal, S. & W. Strange, "Evidence on the nature and sources of agglomeration economies" in V. Henderson and J. Thisse (eds.) *Handbook of Regional and Urban Economics*, (2004). Vol. 4. Amsterdam: North-Holland, 2119–2171.

³ K. Behrens; G. Duranton, F. Robert-Nicoud, "Productive Cities: Sorting, Selection and Agglomeration", *Journal of Political Economy*, (2014) 122 (3), pp. 507-553.

⁴The Economist Intelligence Unit, *Hot spots 2025: Benchmarking the future competitiveness of cities*. (2013)

⁵ World Bank Database, <http://databank.worldbank.org/> (Accessed 27 May 2015)

⁶ McKinsey Global Institute, *Urban world: Cities and the rise of the consuming class* (2012).



Given the productivity of cities, rapid urbanization presents a unique opportunity to lift hundreds of millions out of poverty. However, if left to proceed unchecked, rapid population growth can also adversely affect quality of life by reducing access to good health care, increasing environmental degradation, leading to lack of adequate housing, and increasing inequality. These issues contribute to diseconomies (e.g. congestion, pollution, displacement) that overtime will affect a city's economic efficiency, productivity and competitiveness in a progressively negative feedback loop. For cities of all sizes to exploit their strengths: LED tools and strategies are vital, include promotion of a business enabling environment, and require local and institutional capacity building.

1. LED is a key urban development tool

Local and regional governments require effective support to raise capacity in developing LED strategies. In addition to traditional cooperation, involving Overseas Development Assistance (ODA) and international organizations, decentralized cooperation, city to city and multilevel partnerships can strongly enhance the value and the sustainability of the strategies developed.

The complexity of the urban environment requires a set of instruments tailored to local challenges. City governments have recognized this reality and many are actively taking more initiative in the management of their cities. The decentralized management of cities is becoming more than a practical solution, it is being formalized through national policies that are devolving powers to local governments. However, this is not always accompanied by the necessary access to resources or legal ability to implement new funding mechanisms. The new responsibilities for local government decision-makers and administrators also mean that there is an urgent need to develop local skills and capacity.

By designing strategies to harness economic potentials of a territory and to manage and mitigate the negative externalities of urban growth, LED can help build up the economic capacity of a city and improve the quality of life of its residents. But designing good LED strategies requires availability of high quality data that can be used to identify challenges and prioritize actions to address them. Specific activities and the form of their implementation must always respond to the unique needs of the local context; however there are core analyses and strategies which any jurisdiction should consider as part of a LED programme.

There are important connections between urban and rural areas, related to the workforce, division and exchanges of labour, value chains and capital transfers; which affect the economic and social development of both areas. Urban-rural connections and a territorial approach linking them are important for all. There is a positive relationship between adequacy of infrastructure connecting rural and urban areas and ease of mobility, access to decent jobs and livelihood opportunities and enhancement of urban food security and incomes. Adequate investments in rural-urban infrastructure, particularly transportation and communications infrastructure, also improves rural productivity and allows better access to markets, jobs and public services in both areas.



2. Creating business-enabling environments

A key aspect of LED is to create a positive and predictable business-enabling environment to support well-functioning markets that allow existing businesses to thrive and attract new firms and foreign and domestic investment into the area.

To create this environment, local governments can think about a portfolio of policy instruments including strengthening local institutions and regulatory frameworks, providing the needed infrastructure to support innovation, enhance human capital, and promote the fluidity of markets (e.g. land and finance) while maintaining the cultural conditions and strengthening local identity.

By streamlining or redrafting onerous and out-dated restrictions, and helping smooth the business permitting process, policy makers can lower the barriers to growth and entry for established and emerging firms. This can include simplified and streamlined administrative processes, such as business licensing, land rezoning and development approval, and creating “one-stop business centres” to remove unnecessary red-tape.

Coordinated land use and infrastructure planning is also essential to create vibrant areas where people can reach their jobs with ease. Flexible land use and zoning regulations that adapt to a changing environment and take into account the infrastructure available are also important to support economic development (e.g. office space near the regional core, or industrial land near transportation rail or port facilities). Investing in the necessary infrastructure, including schools, housing, training institutions, hospitals, child care facilities, recreation facilities, green space, for appropriate servicing of employment lands (e.g. transportation connections, water and wastewater, high speed internet) can further attract new business by reducing start-up costs. Regulations that allow financial markets to flourish will also have a bearing on investments.

Additional interventions like providing training on skills, and supporting incubators can also help foster innovation. Finally, an efficient and reliable legal framework that gives confidence to contracts as well as the administration of fair and transparent fees and taxation regimes will provide firms with the stability and confidence they need to make long-term investments in a region. By ensuring a portion of that revenue is invested back into local servicing and infrastructure, a local government can demonstrate the value of private sector investment in an area.

3. Strengthening local capacity and institutional development through LED

In many cases, successfully creating a business-friendly environment requires building local government capacity and increase municipal self-sufficiency. Cities are increasingly expected to manage more with less as higher-level governments give more responsibilities to local governments. Rarely are these increased responsibilities accompanied by the necessary increase in skills, capacity or funding. Given this challenge, the importance of empowering local governments and the ability for local institutions to make major contributions to sustained economic performance cannot be overemphasized. The evidence supports this; 11 out of 20 of the world’s most economically competitive cities also rank as having the highest quality institutions in the world.



Capacity building in local government includes leadership and management, efficient and transparent tax collection and revenue spending, local assets management, investment planning, and the ability to coordinate local and regional land use and transportation planning. Local governments empowered with capacity and tools to implement LED programmes can leverage their local assets and advantages, diversify their economies and expand economic opportunities for their population.

KEY DRIVERS OF ACTION

Based on the analysis of the three broad issues above, a set of solutions and action points have been identified which can enable full realization of the value of LED:

- Reliable data and careful analysis and diagnostics should drive the strategy. Quality data can also improve understanding of the causes and local variation of negative externalities that accompany rapid urbanization and economic growth (e.g. poverty, rising land prices, environmental degradation). Trend analysis and sex disaggregation can help policymakers identify bottlenecks and opportunities. Data on demographics, employment and sector trends, will make local governments not only better informed decisions about land allocation, infrastructure investments and policy, but also provide businesses with the tools they need to do the same. A global data strategy should be developed, involving local, regional and national governments, their associations and international organization so that quality, adequacy and accuracy are ensured along with their dissemination.

With the Big Data and IT revolution that the world is experiencing today, cities and local authorities have the opportunity to better understand their challenges on real time, and to steer their economies on a growth trajectory that is responsive and inclusive. But the increasing availability of large amounts of data also poses a challenge for their analysis. It is the analysis of the data rather than data per se that is of great value for a good LED strategy. Such analysis identifying the area's strengths, weaknesses, opportunities and threats. Building internal capacity for such analysis should be considered a key component of a LED strategy.

- Ensure that local values and objectives drive the development of actions that support the local economy. By conducting economic development at the local level, and as part of a participatory process, partnership and networks between local government, private sector (workers, employers and cooperatives), non-governmental organizations, including those representing the voice of women, youth and other local institutions can be constructed that help make good decisions coordinated, broadly supported and thus durable over time.
- Use LED strategies to ensure coordinated land use, transportation, infrastructure and investment planning. Coordinated actions across these lines can help cities overcome the challenges brought by rapid growth. While financing and investment planning are the driving concern for city leaders, investment alone cannot help economic development thrive. Coordinated actions that bring together land use planning and management and transport and infrastructure decisions are essential. Such coordination will help local leader identify the set of policies that will allow cities and their surrounding regions to reap the benefits of agglomeration economies, attract and leverage private investments, and connect people to jobs, while minimizing environmental, social, and natural risk hazards.



- Define and strengthen a full portfolio of instruments that enhances economic development while ensuring supporting a high quality of life. This will require as a first step understanding the trade-offs brought by enhances to productivity and economic growth in terms of costs to liveability and thinking about a comprehensive set of tools that supports growth and development while minimizing the negative externalities that rapid growth may bring with it (e.g. pollution, congestion, etc.). A comprehensive LED strategy requires the use of a portfolio of instruments that include planning and land management tools, development rights, investments in human capital and innovation, as well as taxes among many others instruments. Examples include supporting a business-enabling environment through policy and regulatory reform and effective public investment. Integrate training and education into LED activities. Support emerging industries and entrepreneurs through job training to create a skilled and appropriately qualified labour force to provide workers to businesses, advice and support services for potential entrepreneurs (e.g. incubators, one-stop business service centres), and extension services to help businesses modernize and export. Address youth unemployment by developing policies such as linking programs specifically designed to match the needs of local industry and connect students with potential employers. Consider how financing, including microfinance, and investment can be targeted to achieve larger objectives.
Identifying the best instruments to enhance efficiency while ensuring equity and minimizing costs is a key input to LED.
- Identify best practices in LED. Global best practices can be adapted and implemented in city-specific contexts through the LED process. An LED strategy can be used to build capacity at the city level and combine it with proven LED actions. Strongly reinforce cities, local and regional governments' capacities to develop inclusive LED strategies such as gender equality and women's economic empowerment. Support a holistic implementation of the decent work agenda through LED. Develop and reinforce networks of exchanges between cities, involving cities of similar size, interest and challenges with the support of relevant international organizations.
- Identify comparative advantages and priority areas for investment to leverage the existing assets of a region.⁷ Priority areas are identified through analysis of the local context that examines comparative advantage, competitive sectors opportunities for value-added activities and available natural assets. By leveraging and expanding local strengths and capabilities to support a city's role as an efficient hub for improving economic competitiveness, LED initiatives can stimulate economic growth throughout the surrounding region and foster urban-rural linkages. Specific activities can involve filling gaps in supply chains and building on sector specific value-chains to reduce economic leakage out of a region, or improving the access of goods to larger markets. Land use designations and policy can be appropriately adjusted to enable high value activities with limited externalities.

⁷ Assets can also include intangibles such as history, culture, natural beauty and heritage which can be capitalized to develop and promote the tourism industry. For tourism see for example Conceptual Framework for TSA <http://statistics.unwto.org/content/tsarmf-2008> (accessed 27 May 2015).



PLATFORMS AND PROJECTS

- [UN-HABITAT](#): Urban Economy Branch/ Local Economic Development toolkit
- ILO: Local Economic Development LED [page](#)
LED dedicated [portal](#)
- World Bank: Local Economic Development [page](#)
- UNDP: [ART](#) supporting local development

This Issue Paper has been elaborated with contributions of the World Bank, UN-Habitat, ILO, UN DESA, WFP, UNWTO, CBD and UNESCO.