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Guy, Frederick (2020) Who wants their city to become a world city? Comment on “Expanding the international trade and investment policy agenda: The role of cities and services”. Journal of International Business Policy , ISSN 2522-0691.

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Journal of International Business Policy 19 June 2020, https://doi.org/10.1057/s42214-020-00055-9

Who wants their city to become a world city?

Comment on "Expanding the international trade and investment policy agenda: The role of cities and services"

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Abstract

In proposing a role of economic diplomacy on behalf of cities, Cote, Estrin and Shapiro (2020) take it as read that promoting a city in the ranks of world cities, of key centers of corporate headquarters, business services, and new technology, is a good thing for that city. A city, however, is made up of heterogeneous actors, and in any particular city that grows in this way many of those actors will become worse off. Moreover, if we consider the problem from the standpoint of a national economic system, or of the global system as a whole, the growth of world cities may be due not so much to the conduct of mutually beneficial trade as to the appropriation of monopoly rents. Business policy researchers should identify the stakes for the likely winners and losers, and also take market structure issues into account. Policies based simply on promoting a city's growth and international standing make inequality within and between a country's cities worse, and implicitly embrace the growth of market power as a worthy objective.

Keywords: world cities, urbanization, monopoly, financialization

Cote, Estrin and Shapiro (2020) offer us a thought-provoking proposal to treat trade, investment, and innovation policy together and, in doing so, to consider cities' commercial diplomacy in parallel with national economic diplomacy. As a positive matter, there is little in the paper I disagree with: certainly, world cities are nodes in international networks of trade and investment, and in particular in the trade of services; a city's leaders do often act to promote the growth of their city and the improvement of its status, and their choices can make a decisive difference in a city's trajectory (Storper et al. 2015; Storper 2013); this promotion does reach across international borders, and does so in ways that are complementary to and distinct from the trade diplomacy of the nation-states in which they are situated. It is reasonable to view this as a multi-level bargaining problem.

But Cote, Estrin and Shapiro are offering us a policy proposal, and entering this normative territory raises two questions about their framework. First, how do we define the city's interest: for whom do these municipal diplomats act? In the diplomacy of trade between nation states we think in terms of the national interest. National interest in matters of trade is a problematic concept: national commercial diplomacy favors the interests of particular industries or even particular firms, and their gains may come at the expense of others in the same country (Rodrik 2018). This division between trade winners and trade losers within a country can be a serious problem – we see it front and center in today's populist politics – but at the level of the nation state there is at least the possibility that the problem will be mitigated because the losers from a trade deal are citizens of the country, and so may have some political leverage to secure compensation from the national government for their losses. Moreover, at the national level, some compensation will occur through market mechanisms – the winners make purchases and, in the relatively closed context of a national economy, some of their benefits trickle down to the losers.

Tenuous though these compensation mechanisms may be at the national level, they are even weaker at the level of the city: many of the losers simply exit, while the political voice of the winners is amplified by the arrival of new workers for the city's growth sectors.

The second question has to do with trade. World cities, we are told, grow from trade, particularly trade in business services. This trade is not simply country-to-country, but specific to places within countries, to certain cities, because it is trade mediated by a network and the network has nodes that are in particular places. Cote, Estrin and Shapiro do not, however, consider the distinction between trade travelling freely across the network, with gains from trade accruing simply according to comparative advantage; and world cities as nodes of control within that network, and thus as points where rent is extracted. We are all, of course, familiar with this duality – the World Wide Web as a common carrier, versus the Amazons and Facebooks of the world which find ways to set up as toll collectors within the Web; the networks of scholarship and science, versus the academic publishing corporations that monetize the exchange of knowledge. What appears as the prosperity of a world city owes much to the control of, and appropriation of rent from, trade networks; a public policy which if effective in promoting a city in the world city rankings is likely one that allies with rentiers, rather than the logic of open networks and free exchange. Indeed, as Rodrik (2018) shows, modern trade agreements are crafted precisely to *extend* such market power across national borders.

Let us look more closely at the problem of whose interest a city's interest is.

Basic models of city size tell us that costs grow as cities grow larger, because congestion drives up the price of property and makes it more expensive to travel between home and work; still, urbanization continues because productivity is higher in large cities, and this compensates for the congestion costs (Gaspar and Glaeser 1998). In international business terms the reasons for this productivity advantage would typically be seen from the standpoint of the firm, as a locational advantage; most economic models considers it from the standpoint of the employee, but the issues are the same. There are various ways of explaining this productivity advantage: greater specialization and improved matching of workers with jobs; sharing of things such as knowledge (spillovers), of specialized infrastructure facilities and knowledge spillovers; the creation of new knowledge from the interaction of people who know different things or who compete or cooperate to create new things (Duranton and Puga 2004). For our purposes it does not matter which these of these mechanisms is at work, and in any case they are not mutually

exclusive: any and all of the mechanisms can give the city a comparative advantage in goods and services for export.

There are kinds of work in the modern city to which these advantages clearly apply: jobs which involve a fine division of specializations and difficult problems of matching skilled workers to roles; fields which move quickly, with valuable new knowledge that is both unique and tacit; and fields – such as trade in financial markets – in which small advantages in the currency or accuracy of information are the difference between profit and ruin. Hence, Moretti (2019) shows that high-tech inventions are extraordinarily concentrated, with the top 10 US city-regions account for nearly 60 percent of inventors in biology, chemistry and medicine; Balland et al. (2020) find, again for the US, that patents and research papers – and, more generally, what they dub "complex economic activities" - scale super-linearly with a metro area's population; Crescenzi and Rodríguez-Pose (2017) show that innovation in China and India is even more concentrated in a few large cities, and that this concentration is growing over time.

But we need to bear in mind that, in many jobs, a worker gains little or no productivity benefit from being situated in a large city. Some refer to these as "routine" jobs, but there are plenty of non-routine jobs which can be done just as well, just as productively, in a much smaller city. Some of these may be jobs in footloose industries which can relocate outside the expensive city; retirees, likewise, can collect their pension checks just as well in another location. When the city becomes a world city, many people associated with footloose industries, together with pensioners and others on fixed incomes, are driven out by rising costs. One manifestation of this is what we call "gentrification" (Rodríguez-Pose and Storper 2019).

Yet many – in medicine, teaching, public administration, public safety, retail trade, food service, construction, sanitation and so on – must stay in the city just to keep it running; these workers, in fact, amount to *most* of the city's workforce. And, while most of this majority can expect some small pay premium to compensate for the higher cost of living in the big city, recent research in both the UK and the USA tells us that, in cities which are centers of technology development or high-level business services, these other workers typically can expect little if any net benefit from the city's apparent wealth, and that inequality grows within them (Lee and

Clarke 2019; Kemeny and Osman 2018; Hudson 2006). In contrast, productivity growth in manufacturing both raises local average incomes and reduces local inequality (Hornbek and Moretti 2019).

Nor should we look at the growth of the world city in isolation from the progress of the rest of the country in which that city is located. For reasons that lie beyond the scope of this note, the growth of these superstar cities is associated with growing disparities of income, wealth, opportunity and power between those cities and other parts of the same countries: the polarization we see between the Southeast of England and the North, between America's coastal cities and its rustbelt-heartland (Rodriguez-Pose 2018). One simple way of understanding it is that the activities in which the world city specializes may bring great wealth with relatively little employment and, like oil wealth, be an economic curse rather than a blessing for the country as a whole (Christensen, Shaxson, and Wigan 2016). To see the case for such an effect, let us turn now to my second question: to what extent is the "productivity" of the world city based on gains from comparative advantage, and to what extent rents from control of trade?

In the models discussed above, cities grow big when agglomeration raises productivity more than it raises costs. In models of city growth, and in policies devoted to city growth, it is almost always assumed that the productivity is *real,* that these spatial concentrations of workers and firms succeed because they produce more or better useful goods and services per hour worked (see e.g. Scott and Storper 2015). When we measure productivity, of course, we are not measuring contributions to use values but to revenue, which come in part from what is produced and in part from rent. Sassen's (1991) concept of the world city focuses on the control function: control is what the corporate headquarters, and many of the specialized business services in finance, accounting, law, IT and management consultancy, are *for.*

Control could, in principle, be in the service of pure cost-minimization, either as internalization by a multi-national firm or coordination of a value chain. But it may, also, be in the service of appropriating rents (see the response to Scott and Storper by Walker 2016).

Why would we be concerned about the appropriation of rents? Cote, Estrin and Shapiro rightly associate today's world cities the opening, of old national economies, to global markets and in particular to new regional systems (Baldwin 2006; Guy 2015). The rhetoric of that opening is one of liberalization, which would seem to imply more competitive markets, reduced market power. But, just as the World Wide Web promised free exchange and then gave us Facebook and Amazon, the larger markets were not necessarily more competitive ones. Instead, in much of the world we have seen a move toward greater market power, as documented in the US case by Autor et al (2017), De Loecker and Eeckhout (2017) and by Eggerston et al (2018). The rise in market power has been particularly marked in the leading firms in sectors which make intensive use of digital technologies (Calligaris, Criscuolo, and Marcolin 2018 examine this across OECD countries). Some of those sectors are spatially dispersed in their operations – notably wholesaling, retailing and various other services (Hsieh and Rossi-Hansberg 2019, for the US case). The most marked rise in power (and rents), however, is among the originators of these new technologies, together with finance, and these sectors are concentrated in particular cities – in the US case, global centers of technology (e.g. San Francisco, Boston) or of finance and business services (New York) (Feldman, Guy, and Iammarino 2019): in the knowledge economy, market power and agglomeration economies reinforce one another, and this helps drive city growth.

But to really see the linkage between world cities and the *control* of markets, we need to consider finance. In the decades since 1980, alongside with the liberalization of trade and the general growth of market power, we have seen the deregulation of finance, and the growth and greater concentration of financial power (banks, hedge funds, private equity). It has been widely noted that financial sector actors have gained in their ability to influence the choices made by non-financial corporations, a development often called *financialization.* Prior to 1980 even publicly traded firms in the US, for example, were largely self-financing from retained earnings; since then it is far more common for firms to either be used as cash cows, paying funds out, or to seek external finance for new capital investment. This increased engagement of firms with financial markets – whether paying out funds, or taking them in – is what Rajan and Zingales (1998) call *financial dependence.* This period has seen sharply increased concentration

in the banking sector, an astonishing growth in financial sector profits to total (Appelbaum and Batt 2014; Gourevitch and Shinn 2005; O'Sullivan 2001).

If non-financial firms were operating in classically competitive markets, we could see the growth of financial dependence as something that facilitated a reallocation of capital to more productive uses (Jensen 1986; 1989). With growing market power in some portions of the economy, however, financial dependence serves to reallocate capital from firms in more classically competitive markets to those firms with market power (or start-ups with apparent prospects for market power). Long ago, Myrdal (1957) described how such a process can exacerbate disparities between regions in economic development. International capital mobility has seen to it that this process crosses national borders.

I submit that the growth of world cities in the post-1980 era of globalization rises precisely from the rise in opportunities for rent-seeking which have grown in this era of weakly regulated network industries, strong intellectual property rights, a powerful financial sector, and unparalleled international capital mobility.

Beyond doubt, there are people who serve as trade diplomats for cities; we should not take it as read, however, that they represent the broad interests of the people who live in that city, to say nothing of the people who once did but can now no longer afford to. Nor should we assume that wealth that flows into a great city betters the overall condition of the country in which the city is located: the processes which bring that wealth to the city may contribute to the economic decline of other parts of the country; the wealth may reflect, in substantial part, the appropriation of rents from the control of trade, and hence be a benefit to the few who appropriate it.

Policy research is normative. Business policy is never about policies which promote business or economic growth *in general*; it is always about particular kinds of business, particular paths of growth. In this light, we can think of international business policies related to cities on a couple of different levels. On one level, those considering the situation of a particular city must take the overall condition of national trade policy and market structure as given; on another level – national or international – those conditions themselves are contested. But in either case there

are policy options, each with winners and losers. A policy proposal which does not identify the winners and losers is simply making a choice to ignore the latter.

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