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THE ECONOMIC SIGNIFICANCE OF URBAN AREAS

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Table of Contents

Key Findings	3
Introduction	4
Benefits of Agglomeration	5
Economic Growth	6
Business Dynamism	7
Innovation	8
Productivity	9
Challenges of Urbanisation	10
References	11



Key Findings

01

With an annual influx of 13 million people to urban areas, equivalent to establishing a new Bengaluru annually, the nation's urban landscape is expanding at an unprecedented pace. This trajectory is projected to continue until at least 2050, solidifying the role of cities in India's economic development.

02

Urban agglomeration yields a multitude of benefits that contribute significantly to economic growth, productivity, and innovation.

03

Our findings reveal a robust correlation of 90% between the number of registered Micro, Small and Medium Enterprises (MSMEs) and the gross district domestic product (GDDP), underscoring the symbiotic relationship between business dynamism and economic output within urban centers.

04

For many individuals, cities represent the most promising avenue for social mobility. Despite comprising only 1% of all cities, Tier 1 cities account for 28% of all jobs created by new businesses.

05

An increase in the density of people promotes knowledge spillovers and innovation. Five cities in India host 97% of the country's Unicorns, despite comprising only 7% of its population.

06

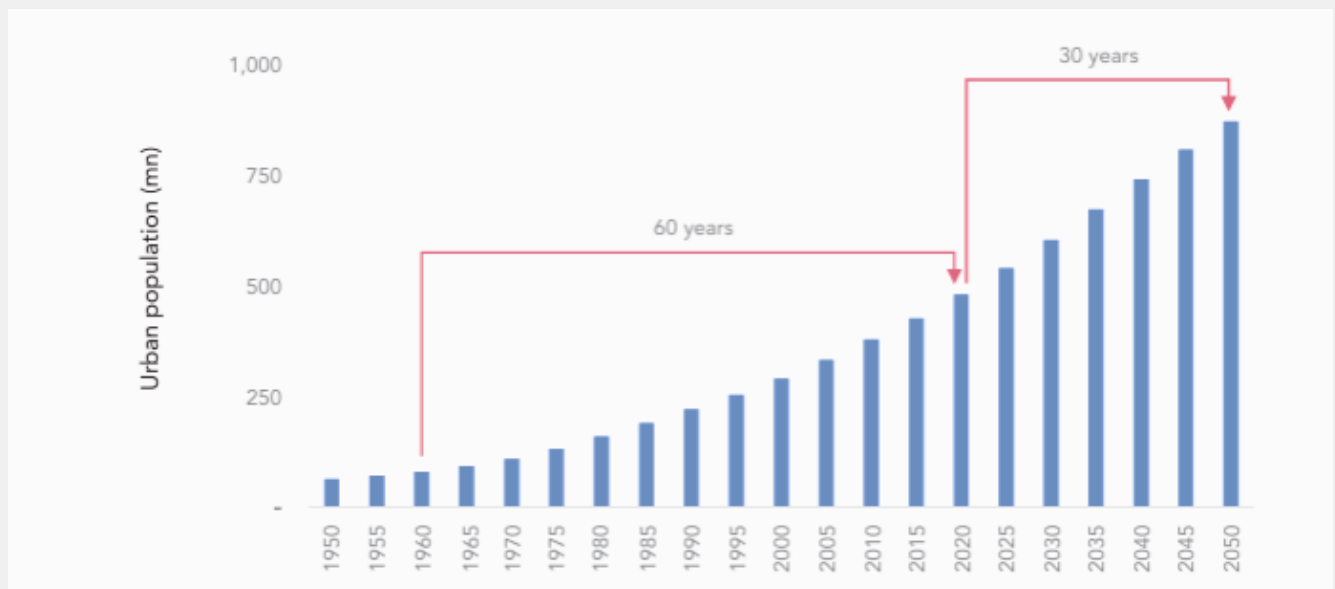
The widening gap between available financial resources and the spending requirements of municipalities engenders an infrastructure deficit. Cities run the risk of diseconomies that may outweigh scale benefits, leading to a deteriorating quality of life and a loss of economic output.

Introduction

In today's world, urbanization pervades our global landscape. Over half of the world's population resides in urban centers. These centers serve as vital hubs of economic activity, propelling innovation, commerce, and cultural exchange. They collectively generate more than 80% of the world's Gross Domestic Product (GDP), acting as engines of growth. Notably, they contribute disproportionately to national economies.

New York, despite housing only 3% of the US population, accounts for 8% of the nation's GDP. London, with 16% of the UK's population, contributes 23% to the GDP. Mumbai, with just 2% of India's population, adds 4% to the GDP. These figures highlight the economic significance of urban centers and their unmatched productivity compared to rural areas. In the next 25 years, India is poised to urbanize at a rate exceeding the global average. With an annual influx of 13 million people to urban areas, equivalent to establishing a new Bengaluru (a city in South India) annually, the nation's urban landscape is expanding at an unprecedented pace.

Years taken to add 400 million (mn) urban population in India



Source: United Nations, Dun & Bradstreet

This trajectory is projected to continue until at least 2050, solidifying the role of cities in India's continued economic development. However, with the promise of economic prosperity comes a set of challenges. Urban centers grapple with issues ranging from infrastructure deficits and environmental degradation to social inequality and housing shortages. The influx of migrants strains existing resources, exacerbating these challenges, and necessitating innovative solutions for sustainable urban development. Therefore, as India continues its urbanization journey, understanding and addressing the dynamics of urban growth will be critical for shaping a prosperous and equitable future.

Benefits of Agglomeration

Urban agglomeration, the clustering of economic activities and populations in urban areas, yields a multitude of benefits that contribute significantly to economic growth, productivity, and innovation. Underpinning these benefits is the economies of scale and scope fostered by agglomeration. The density of markets in urban areas enhances competition and facilitates specialization, encouraging firms to focus on their comparative advantages. The presence of many firms in the same industry in the same place benefits the firms due to rising economies of scale in the intermediate inputs of production. This is because suppliers of intermediate inputs such as raw materials, machinery, or specialized services also tend to cluster in the same area to serve the needs of multiple firms.

As a result, these firms can access a wider range of suppliers, negotiate better prices, and reduce transportation costs, leading to lower production costs. Localisation also provides firms with the opportunity to study and adopt the successful practices of their counterparts within the industry. Examples of this phenomenon include clustering of technology firms in the Silicon Valley and Bangalore, automobile manufacturers in Detroit and Chennai, garment producers in Guangzhou and Tirupur, and chocolatiers in Brussels and Ooty.

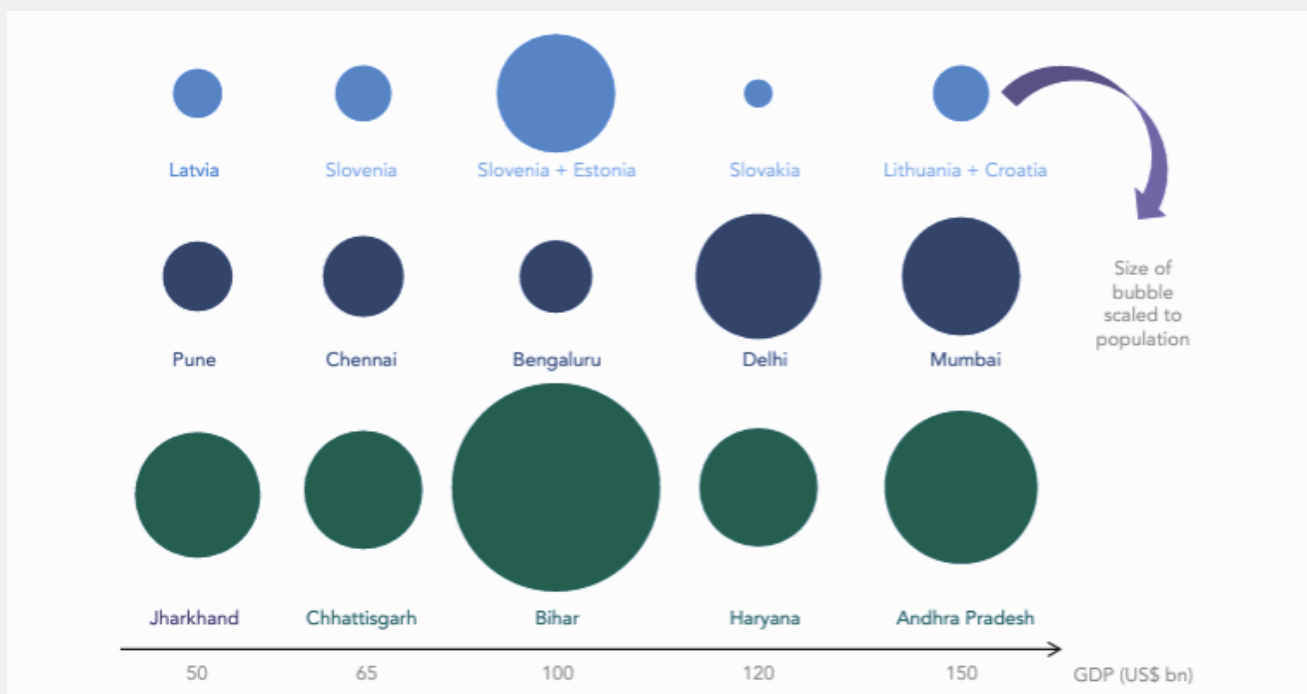


Economic Growth

Cities undeniably stand as economic powerhouses, often rivaling entire states or even countries in terms of GDP. For instance, the Mumbai Metropolitan Region boasts a GDP of US\$150 billion, almost the same as that of the entire state of Andhra Pradesh. Similarly, Bengaluru's economy exceeds that of Bihar, while the Chennai Metropolitan Area's (CMA) GDP surpasses Chhattisgarh's, and Pune's GDP outstrips that of Jharkhand.

Notably, these cities' economies also surpass those of entire countries; Mumbai's GDP alone surpasses the combined GDP of Lithuania and Croatia, while Delhi's eclipses that of Slovakia. Similarly, Bengaluru's GDP outweighs that of Slovenia and Estonia combined, with Pune's GDP surpassing that of Latvia.

Gross Domestic Product - 2022



Source: World Bank, Ministry of Health & Family Welfare, Dun & Bradstreet

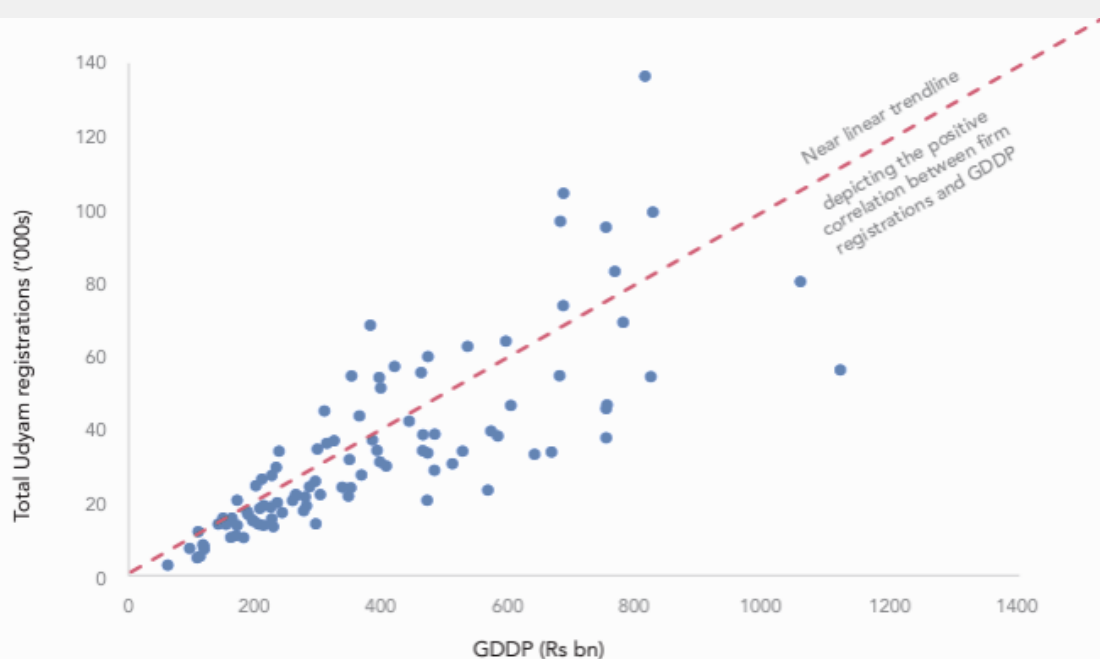
Additionally, urban agglomeration supports a vibrant cultural and social life. Cities are hubs of diversity, creativity, and cultural exchange, offering a wide variety of experiences, amenities, and entertainment options. This cultural vibrancy not only enriches the lives of residents but also attracts tourists and businesses, bolstering local economies through tourism, hospitality, and creative industries.

Business Dynamism

The positive correlation between business dynamism and city GDP is substantiated by our analysis of business registration data across 111 districts in Karnataka, Kerala, Maharashtra, and Telangana. Our findings reveal a robust correlation of 90% between the number of registered Micro, Small and Medium Enterprises (MSMEs) and the gross district domestic product (GDDP).

This underscores the symbiotic relationship between business activity and economic output within urban centers. As more firms cluster together, economic activity rises, drawing in additional businesses and creating a self-reinforcing cycle of growth.

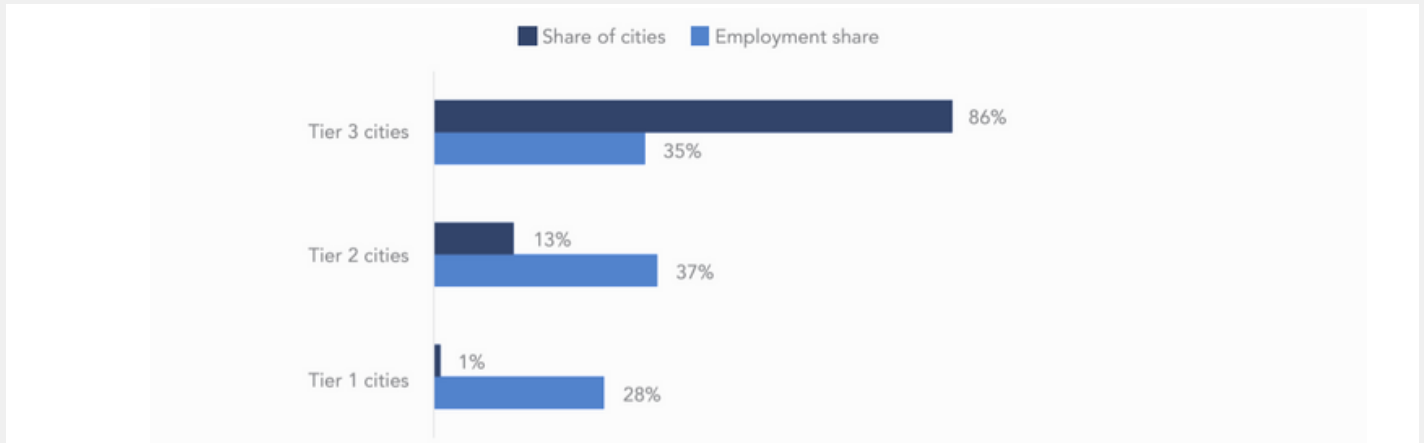
Firm registrations and GDDP across 111 districts



*Source: Ministry of MSME, Directorate of Economics and Statistics
– Karnataka, Kerala, Maharashtra, Telangana, Dun & Bradstreet*

Cities not only significantly contribute to GDP and the formation of new businesses but also serve as key drivers of employment opportunities. For many individuals, cities represent the most promising avenue for social mobility. Our analysis of new business registrations in 2023 reveals an interesting trend: despite comprising only 1% of all cities, Tier 1 cities account for 28% of all jobs created by new businesses. Similarly, Tier 2 cities, constituting 13% of the total, generated 37% of these jobs, while Tier 3 cities, making up 86%, produced the remainder 35% of the jobs.

Employment creation by city tiers



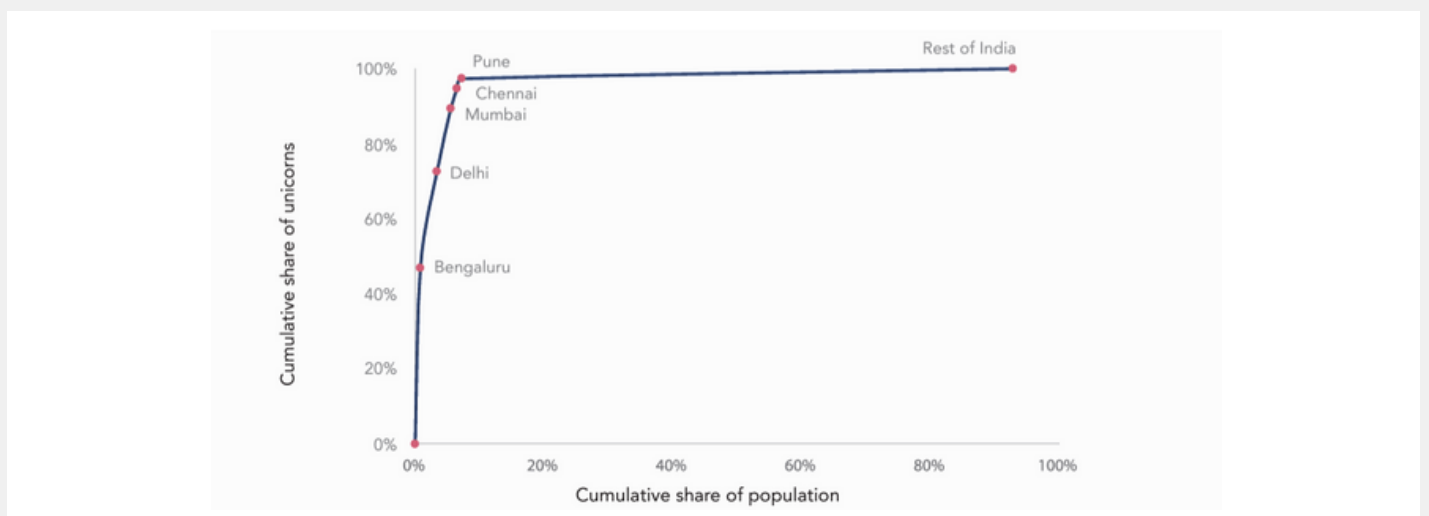
Source: Ministry of Corporate Affairs, Dun & Bradstreet

Innovation

An increase in the density of people promotes knowledge spillovers and innovation. Proximity facilitates face-to-face interactions, which are crucial for the exchange of ideas, information, and tacit knowledge. In cities, individuals and firms have greater opportunities for networking, collaboration, and learning, leading to the cross-fertilization of ideas and the emergence of new technologies and business models. Certain spillovers, such as those induced by diversity or access to international human capital, may exclusively manifest in large cities.

Five cities in India — Bengaluru, CMA, Mumbai Metropolitan Region (MMR), National Capital Region (NCR), and Pune — host 97% of the country's Unicorns, despite comprising only 7% of its population. These companies spearhead innovation by disrupting incumbents with pioneering technologies or processes. Additionally, trends in patent filings by startups and other businesses further underscore the concentrated distribution of innovation within urban centers.

Unicorns by cities



Source: Dun & Bradstreet

Urbanisation and Productivity – International Trend

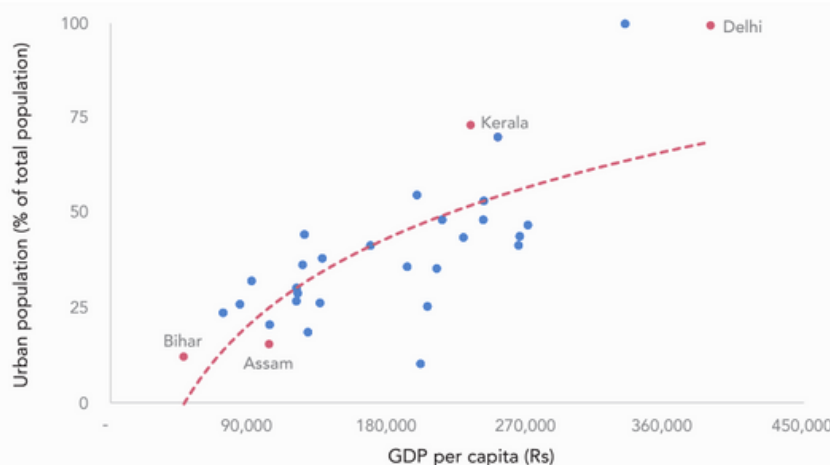


Source: World Bank, Dun & Bradstreet

Productivity

Urban agglomeration enhances labor market efficiency. Cities offer diverse job opportunities across various industries and skill levels, enabling workers to find better matches for their skills and preferences. This job matching reduces unemployment and underemployment while increasing labor force participation and productivity. Additionally, urban areas attract migrants seeking economic opportunities, leading to a more dynamic and flexible labor market. The economies of scale and scope previously discussed enhance capital efficiency, resulting in an overall increase in productivity. Both international and domestic experiences demonstrate a positive correlation between the level of urbanization and GDP per capita. This indicates that as urbanization increases, so does productivity and welfare levels.

Urbanisation and Productivity – Domestic Trend



Source: World Bank, Dun & Bradstreet

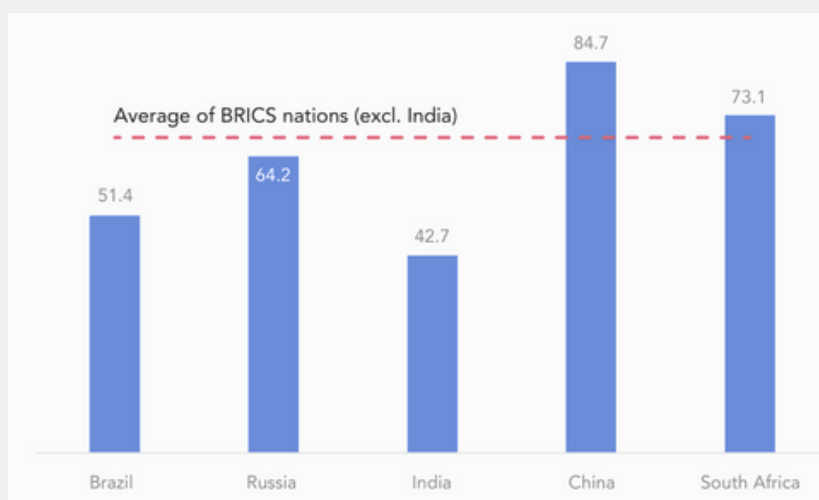
Challenges of Urbanisation

While cities act as epicenters of economic growth, innovation, and cultural exchange, they grapple with an array of challenges. The rapid influx of people into urban areas strains existing infrastructure, resulting in challenges such as lack of affordable housing, congested transportation networks, and environmental degradation. Social disparities widen, as marginalized communities struggle for access to basic amenities and opportunities. For instance, according to data from the World Bank, only 43% of the urban population in India utilizes safely managed sanitation services, contrasting starkly with an average of 68% in the other BRICS nations that comprise of Brazil, Russia, China Mainland, and South Africa.

The rapid pace of urban sprawl creates an ever-increasing demand for public services and new infrastructure, presenting a significant challenge for local governments. Various studies show that the urban build up area of major cities in India have expanded by up to tenfold over the past four decades. These cities run the risk of diseconomies that may outweigh scale benefits, leading to a deteriorating quality of life and a loss of economic output.

Addressing these challenges requires holistic urban planning strategies that prioritize inclusive growth, environmental sustainability, and social equity. Investments in infrastructure, affordable housing, education, and healthcare are imperative to harnessing the full potential of urbanization while ensuring that its benefits are accessible to all segments of society. However, the widening gap between available financial resources and the spending requirements of municipalities engenders an infrastructure deficit.

Percentage of urban population using safely managed sanitation services



Source: World Bank, Dun & Bradstreet

An RBI study reveals that municipal revenues and expenditures in India have remained stagnant at around 1% of GDP for over a decade. In comparison, municipal revenues and expenditures constitute 7.4% of GDP in Brazil and 6% of GDP in South Africa. This needs to improve for India to keep up with its urbanisation trend and to address the existing deficiency. The next whitepaper of this series will delve into the sources of financing for local governments, the challenges they encounter in mobilizing additional capital, and present solutions to enhance access to financial resources.

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