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# URBANIZATION AND STRUCTURAL TRANSFORMATION

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An overview of Mexico City. © UN-Habitat/Julius Mwelu

## Introduction

Urban areas are crucial for national development. According to conventional wisdom, no developed country has achieved its level of development or prosperity without urbanizing but this statement must be qualified, it is about sustainable urbanization. Most of a country's wealth is created in its cities, hence the maxim that cities are the engines of economic growth and development. Productive cities are engines of economic growth where critical sectors have replaced low-productivity agriculture and experienced high productivity growth in industrial manufacturing.

Cities account for about 70 per cent of global GDP<sup>1</sup>. Economic activities in urban areas account for as much as 55 per cent of the GDP in low-income countries, 73 per cent in middle-income countries, and 85 per cent in high-income economies<sup>2</sup>. Indeed, it is anticipated that 80 per cent of future economic growth will be in cities<sup>3</sup>. In some countries, a single city could account for

a significant share of the national wealth. For example, Seoul, Budapest and Brussels respectively accounts for over 45 per cent of the GDP of South Korea, Hungary and Belgium<sup>4</sup>. In other countries, it is a group of cities that contributes a significant share of GDP. For example, in South Africa, six major cities collectively account for 55 per cent of the GDP. The case of China is quite remarkable, with 50 per cent of the GDP generated in the coastal areas that constitute 20 per cent of the territory<sup>5</sup>. For all cities, their contribution to GDP is greater than their contribution to the national population. The disproportionate economic contribution of urban areas is often ignored in development policy or not duly integrated in development strategies and plans.

Besides the positive contribution of cities to growth, urban areas are associated with higher levels of income. Indeed, the relationship between the level of urbanization and per capita income across countries is positive. Figure 1 suggests

<sup>1</sup> World Bank, 2009a

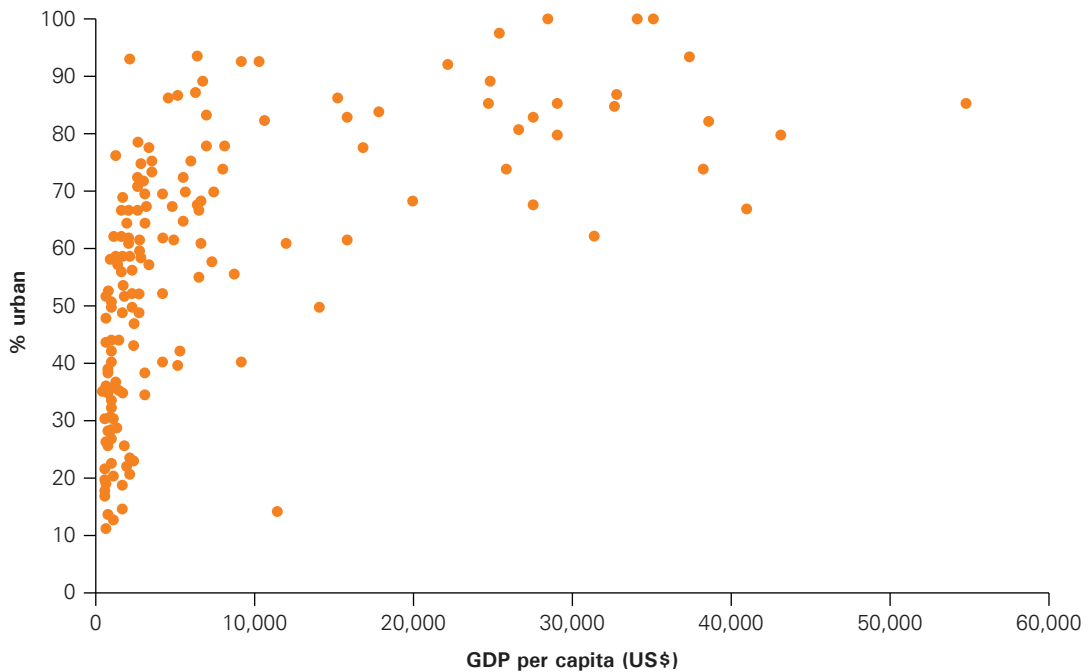
<sup>2</sup> UN-Habitat and DFID, 2002

<sup>3</sup> SIDA, 2006

<sup>4</sup> UN-Habitat, 2010

<sup>5</sup> World Bank, 2009d

Figure 1.1: Urbanization and GDP



Source : UN (2010), percentage urban ; World Bank (2010), GDP per capita

that few countries have reached income levels of USD 10,000 per capita before becoming 70 per cent urbanized. Among developing regions, few countries attain income levels of USD 5,000 before becoming 60 per cent urbanized (Annex 1). Corresponding figures for Africa, Asia and Latin America and Caribbean can be gleaned from Annex 1. What this shows is that countries urbanize as they get richer and as they accumulate skills and infrastructural assets to modernize.

From the figure 1.1 below, urbanization correlates strongly with wealth generation at the early stages of development but this relationship weakens as countries get richer. The positive relationship between urbanization and income also applies at the regional level. The regions that have the highest levels of urbanization are the ones with the highest levels of GDP per capita. Among developing regions, Latin America and Caribbean (with 78 per cent of its population residing in urban areas) has a GDP per capita of USD 4580 as against USD 601 and USD 647 for sub-Saharan Africa and South Asia, which are 36

per cent and 29 per cent urbanized respectively<sup>6</sup>.

There are however, exceptions. Figure 1.1 also shows that there are several countries with relatively high levels of urbanization but low levels of income. This implies that high levels of urbanization alone are not sufficient to generate high levels of prosperity. Such countries might not be drawing on the full benefits of agglomerations<sup>7</sup>, or that urbanization might be occurring in the absence of long-term economic growth or in a situation where growth has been too low. The latter is common in sub-Saharan Africa, and has been characterized by rapid urban growth occurring within the context of low economic growth<sup>8</sup>, poor agricultural performance, climate change, rising unemployment, financially-weak municipal authorities incapable of providing basic

<sup>6</sup> UN-Habitat, 2010

<sup>7</sup> Polese, 2000; 2005

<sup>8</sup> Between 1970 and 1995, Africa's urban population grew at 5.2%, while GDP per capita fell by an annual rate of 0.66% (Fay and Opal, 2000)

services, poor governance and the absence of coherent urban planning policy that integrates economic, social and physical planning<sup>9</sup>. Under such conditions, "... rapid urban growth... has been an inevitable recipe for the mass production of slums"<sup>10</sup>.

Figure 1.1 further indicates that, when countries reach urbanization levels of more than 70 per cent the link between urbanization and income weakens. Beyond this point, increasing levels of urbanization contribute little to income. This suggests that there are other key factors besides the level of urbanization that contribute to the prosperity of cities. Some of these factors relate to appropriate urban policy, planning, design, management and governance, as well as the existence of institutions capable of responding to the problems, consequences and challenges associated with rapid urbanization.

Given the size of the contribution of cities to the national economy, the future of African countries will be determined by the productivity of urban areas and the extent to which urban growth and the accompanying challenges are managed. Developing countries that want to grow must engineer sustainable urbanization. There are at least three ways by which this can be achieved<sup>11</sup>.

The first is to nurture the growth of high-productivity activities particularly manufacturing followed by services, both of which benefit from agglomeration economies. The sectoral composition of countries that have experienced long-term growth shows that the urban sector in the form of manufacturing and services led the growth process. In developing countries, 86 per cent of total growth in national value-added between 1980 and 1998 came from the urban sector growth, specifically industry, namely and services<sup>12</sup>.

## Structural Transformation and Sustainable Urbanization

Urbanization is one of the most significant global trends in the 21st Century. More than 50 per cent of the world population now lives in urban areas, while about 5 billion people or 60 per cent of the world's population will live in urban areas by 2030. Approximately, 90 per cent of world urban population growth between now and 2030 will take place in developing countries. Hence, cities are the locus of significant global challenges.

Sustainable urbanization is known to be a vehicle for national economic and social transformation. By sustainable urbanization we mean the transition of rural-urban landscapes that structure both rural and urban economy, ecology and society in ways that reward the present generation with higher quality of life but without endangering and diminishing the living standards of future generations. This structural shift is underpinned by proper planning, supported by enforceable legal mechanisms and, by so doing, brings about rapid economic progress and the equitable development of citizens. When rural-urban shift is properly managed alongside industrialization and planned urban space, it tends to lead to higher productivity and, eventually, rising living standards and better quality of life. Sustainable urbanization spawns cities that evolve into centres of change and innovation, mainly because the concentration of people, resources and activities support human creativity.

However, research has shown that there are a number of countries that are highly urbanized without having seen a large shift of economic activity towards manufacturing and services in most developing countries. This phenomenon will be discussed in this study.

Successful countries that have been able to sustain a rapid transition out of poverty, due to a rapid rise of productivity in the agricultural sector in ways that transformed the rural-urban economies, have mostly achieved sustained urbanization. Conventional wisdom interprets this process as a successful structural transformation, where agriculture (through

<sup>9</sup> Cheru, 2005; Barrios et al, 2006; Annez et al, 2010

<sup>10</sup> Davis, 2004, pp. 10-11

<sup>11</sup> Spence, 2008; Oyelaran-Oyeyinka and GehlSampath, 2010

<sup>12</sup> National Research Council, 2003 cited in Annez and Buckley, 2008, p.9



Ain Beni Mathar Integrated Combined Cycle Thermo-Solar Power Plant, Morocco. © World Bank/Dana Smillie

higher productivity) provides food, surplus labour with skills and even savings for the process of urbanization and industrialization. Clearly, a vibrant agricultural sector raises labour productivity in the rural economy, pulls up wages and gradually eliminates the worst dimensions of absolute poverty. Concomitantly, the process also leads to a gradual decline in the relative importance of agriculture to the overall economy, as the industrial and service sectors grow even more rapidly, partly through stimulus from a modernizing agriculture and migration of rural workers to urban jobs<sup>13</sup>.

Most natural resource exporters in Africa and elsewhere do not conform to the standard model of urbanization<sup>14</sup>. For example, in 2010, Asia and sub-Saharan Africa were both at the same level of urbanization; while the former recorded the

fastest-growing nations (which are South Korea and China), the latter has equally rising wealth but has seen little growth in income per capita over the years. Generally, in developing countries urbanization has taken place in cities of all sizes.

### The Convergence of Urbanization and Structural Change

Structural transformation is defined as the development of an economy's structure from low productivity and labour-intensive activities to higher productivity, capital and skill-intensive activities. It involves a long-term shift in the fundamental institutions of an economy and helps to explain the pathways of economic growth and development.<sup>15</sup> In technical terms, four essential and interrelated processes define structural transformation in any economy:

<sup>13</sup> Timmer, 2007; Timmer and Akkus, 2008

<sup>14</sup> Gollin, Jedwab and Vallarta, 2013

<sup>15</sup> Etchemendy 2009; McMillan, Rodrik and Verduzco-Gallo, 2013



- (i) a declining share of agriculture in GDP and employment
- (ii) a rural-to-urban migration underpinned by rural and urban development
- (iii) the rise of a modern industrial and service economy
- (iv) a demographic transition from high rates of births and deaths (common in underdeveloped and rural areas) to low rates of births and deaths - associated with better health standards in developed and urban areas

In sum, the process leads to the reallocation of economic activities across three broad sectors (agriculture, manufacturing and services) that accompany the process of modern economic growth and the changes to the structures of the economy and society.

### Productivity Growth results from Sustainable Urbanization

Structural transformation is characterized by the transition of an economy from low productivity and labour-intensive economic activities to higher productivity and skill-intensive activities. The driving force behind structural transformation is the change of productivity in modern sectors which are dominated by manufacturing and services.

Structural change is equally attended by the movement of the workforce from labour-intensive activities to skill-intensive urban-based ones. The key constraint to the movement of labour from rural to urban space is the lack of opportunities in skill-intensive sectors such as manufacturing. When labour migrates to cities with little or no opportunities, available labour is underemployed or employed inefficiently.

Clearly, the analysis of productivity change is of utmost important to our understanding of the causes of urbanization and structural transformation. This study uses the ratio of value added to total employment in a particular sector as a measure of labour productivity. Labour productivity is decomposed into two components,

namely; (1) change in productivity due to structural change and (2) intra-sectoral productivity growth. The analysis helps in quantifying the association between labour productivity and structural transformation.

### Urbanization without Change in Labour Productivity in Africa

Recent empirical evidence suggests that structural change could take place without much change in labour productivity; this is the case with many African countries. One of the reasons for this phenomenon is that peculiar urban dynamics occurs with little change in deep-going type of economic structure that accompany transitions observed in industrial settings, but is caused largely by the export of natural resource based products which Africa tends to specialize in.

A recent study that focused on structural transformation in eleven Sub-Saharan African countries examined its implications for productivity growth during the past 50 years. They found that the expansion of manufacturing activities during the early post-independence period led to a growth enhancing reallocation of resources but the process of structural change was stalled in the mid-1970s and 1980s. Growth rebounded in the 1990s but instead of expanding industrial activities, workers mainly relocated to the service industries rather than manufacturing. The present study analyzes the reasons for stagnant or declining productivity in modern sector, usually manufacturing, in Africa<sup>16</sup>.

### Urbanization Poverty and Employment

Employment creation and structural economic transformation are amongst the two major challenges at the forefront of current African growth and development strategies. At the micro level, employment creation provides opportunities for earnings and underpins increases in household expenditures and secure livelihoods. At the macro level, development occurs through the

<sup>16</sup> deVries et. al. 2013

reallocation of labour across sectors toward those with the greatest growth potential and the highest productivity. Jobs also facilitate social (such as female wage employment) and political (seeking identity) transformations. However, it is not easy to achieve sustained employment generation<sup>17</sup>.

African countries will achieve high and sustained economic growth rates alongside improved levels of social development, only if productivity changes are based on widespread economic diversification<sup>18</sup>. The achievement of development goals and higher living standards will therefore depend on the ability of countries to foster entrepreneurship and promote innovation, including the spread, adaptation and adoption of pre-existing know-how and techniques, services, processes and ways of working. Unfortunately, much of the growth in low income countries over the past decade has not led to structural changes.

About 70 per cent of the total population in large metropolises lives in slum communities. Research revealed that there is a negative correlation between informal employment and GDP per capita; hence, informal growth tends to be growth-reducing in developing countries. Thus, informal workers tend to be less well-off than those who work and live in more formal settings.

The formation of cities in developing countries is taking the shape of informality, illegality and slums. Therefore, urban growth in most developing countries is strongly associated with

## Empirical Analysis of African Countries

To our knowledge, little or no systematic empirical work has been done to identify the causal relationship between structural transformation and urbanization in ways that foster economic development. It is argued in this study that the association is mutually reinforcing. In order to establish a causal relationship, measurable indicators are needed. From the perspective of industrialization, labour productivity is considered an appropriate proxy. The sources of productivity growth are numerous. For instance, optimum allocation of resources and technological advancement are expected to lead to higher productivity. Industrial policies coupled with human resource development initiatives could also lead to higher productivity. The changes in productivity within various sectors result in structural change with respect to employment and contributions of sectors to total value added or GDP growth.

This study proposes to quantify associations between urbanization<sup>19</sup> and quality of life which is measured by human development index (HDI<sup>20</sup>). The HDI is a geometric mean of three indices, namely life expectancy, education, and income per capita. Life expectancy is measured as that at birth whereas education index is based on mean years of schooling and expected years of schooling. The income index is based on Gross National Income (PPP USD). HDI is considered a better measure of prosperity than simply income. It includes three main dimensions of prosperity. The non-availability

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