

REBUILDING THE CITY: A FOCUS FOR INDUSTRIAL POLICY?

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Rebuilding the City: A Focus for Industrial Policy?

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"Cities concentrate poverty, but they also represent the best hope of escaping it", in "Unleashing the Potential of Urban Growth".

UN Population Fund (2007).

"Cities have the capability of providing something for everybody, only because and only when they are created by everybody", Jacobs (1984) p251.

Introduction

The city offers the potential of dynamic agglomeration economies which can spur the achievement of economic growth. Yet the city often appears as a centre of crisis in the early 21st century. How are we to reconcile these two, probably valid, but seemingly paradoxical, observations? If indeed the city offers such potential for dynamism and economic growth then it could be viewed as a crucial site for industrial policy, provided we conclude that a developmental basis for economic policy is a relevant focus.

The appearance of the city as a centre of crisis may mean the policy for growth should be directed elsewhere, or it may mean that the costs imposed by an unregulated market economy disproportionately affects city development. Clearly history matters: recent history has witnessed the precipitate decline of the old

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industrial cities of the developed world - United States, Japan, Western Europe, and various countries of European settlement. It has also seen the emergence of large dynamic cities elsewhere in the developing **economies**, notably recently in China and India, following the earlier growth of the Pacific Rim countries.

To understand the city and its potential requires us to go behind the scenes to establish the roots of dynamic economic performance, and precipitate decline in the early 21st century. One link between the old industrial world and the new which we see as providing a fundamental explanation, at both ends of the development process, is the modern transnational corporation. By switching investments around the world these large and powerful firms are able to determine the global distribution of economic activity, Dickens (2003). The transnationals can, at one and the same time, deindustrialize the older industrial countries and industrialize the new, within themselves.

And within themselves, only certain people matter in this process: the strategy within the corporation, that is the direction and type of development is determined by those who control the corporation. Who are these? The literature concludes that the major shareholders and the senior managers, jointly, determine strategy, for a recent survey of the evidence see Branston et al (2006). Others involved and affected by such strategy may object but ultimately they cannot reverse such policies. The fundamental point is that a small elite will dictate strategy and thus such strategy will reflect their aims and ambitions: the aims and ambitions of others will be neglected.

The decline of major industrial cities of the advanced world is related to many more or less proximate factors, in turn related to a changing technology of production and changes in the conditions of international trade, but this decline is underpinned by the strategies of the major corporations, and these are in turn determined by the aims and ambitions of their controllers, a small minority of those involved with these powerful entities. Of course governments are not without power, but in an increasingly global world national governments are rendered increasingly powerless if they accept the rules of the game laid down by the transnationals.

It is therefore the case that strategies for development of the developed world - and the cities within them - have not met the aims and ambitions of the majority of the population within them. Such strategies have not been in the wider interest - the public interest, see for example Branston et al (2006). As a matter of history, technology and communications have developed to allow this global development of transnational companies to exploit the huge supply of labour in the underdeveloped world: the integration of China into the world market economy has almost doubled the available labour force. This has involved centrifugal and centripetal development: work has been put out from the older industrial centres to countries where labour costs are much lower (centrifugal), but control over such work has been increasingly brought to the centres of the new transnational system (centripetal).

And the role of the city?: as the location of rapid economic growth has switched so the industrial cities of the developed world have declined because the transnational corporations can see little advantage when faced with the alternative of cities elsewhere with significantly lower costs. Of course, if the cities of the older industrial world are able to establish new industries in response to this threat then a future can be fashioned for them in the new world. So long as the headquarters of the transnationals remain in the older industrial cities they will require services, associated with both production and consumption, for their future at such locations: global production requires management, marketing, research and development and this

will tend to be centralised at the headquarters site for some time, equally consumption out of the income generated by the corporation will demand local retailing, entertainment, medical and educational facilities. But basically opportunities will be limited and not congenial to the interests and abilities of larger sections of the community: those who work for the corporation at the centre will require specific skills not readily available within the labour force displaced with deindustrialization.

The large transnationals will have a limited loyalty to their origins: they will seek profits on a global basis with limited restrictions. Local **long-term** development requires a production system willing and able to invest in the locality in the widest sense: to maintain and develop the local infrastructure in terms of human capital, as well as physical. Transnationals will take human capital wherever they find it at a minimum cost and will be interested in government investing in it, wherever it has such influence².

The evidence suggests that large cities can maintain a long-term dynamism but only when they are sufficiently diversified to support this, Glaeser et al (1992). City decline is evident where this has not been maintained: Detroit and Birmingham (UK) may be cases in point, their precipitate decline connected with the auto industry in both cases, and Krasnoiarsk - 26 would be a case, perhaps more extreme, from a socalled planned economy³.

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² The Department for Innovation, Universities and Skills (England) has produced a paper "A Higher Level Skills Strategy", which sets out the case for devoting the bulk of extra university funding to degrees jointly designed and funded by employers, see **Financial Times**, February 26th 2008,. Experience suggests that such funding will be another case of the tail wagging the dog,

³ Glazyrina (2000) reports that Krasnoiarsk - 26 had a golden age from 1958 to the early 80's as a centre for nuclear weapons production. It was seen as "A City of the Communist Future", but "In practice the factory could not adapt to changed circumstances and operate in conditions of a market economy" (p200). Today it has been called "A City without a Future", despite possessing "significant scientific potential".

The process of city decline can only be reversed by changing the industrial and organizational structure of the city. To release the city from the domination of the big corporations, private or public, and encourage the development of a more diffuse base, replacing the hierarchical system with a more horizontal one: City development is related to industrial development and industrial development is related to city development. Agglomeration is necessary but not sufficient for development, see Jacobs (1984). What is required is a more democratic base, where locality can be more effectively introduced into local strategy. We will make some proposals in line with this aim. Suggestions include (1) creating structures reminiscent of industrial districts, Becattini et al (2003), but having a coherence within the city; (2) creating "self-sustaining high skill ecosystems" based on local universities and research institutions, Finegold (1999); (3) creating multinational webs of cities, Cowling and Sugden (1999), facing similar problems, Edinburgh/Dublin; Glasgow/Hamburg; London/Berlin; Paris/Milan and by these various means and processes reshaping the economic basis of the city, from dependence on the strategies of the major corporations to a collective self-reliance of multi-national communities.

The City as a Priority Focus for Industrial Policy

In developing the ideas in this paper I have been very much influenced by the much earlier writings of someone from outside economics, Jane Jacobs (1961, 1994, 1984). She was not taken very seriously by economists for many years but one central proposition of Jacobs has now become familiar in the theory and empirical analysis of economic growth, see for example Glaeser (1992). Recent work on economic growth sees externalities, particularly knowledge spillovers, as a central driver, the "engine of growth", see Lucas (1988). Jane Jacobs's inspirational writings, as viewed by this author, and many others, fitted in quite nicely to the new mainstream economic theories of the 1980's and 1990's, but her analysis and observations went

much further. She sees the city as a centre of innovation and experiment and ideas where small scale is seen as functional, as portrayed in the anarchist literature, see for example, in Woodcock Hers is a rejection of top-down planning, whether (1975).governmental or corporate: a celebration of the grass-roots, witness the quotation we report on page one from Jacobs (1984). Mainstream economics took the (or a) central idea, which it labelled dynamic agglomeration economies and forgot about much of the rest of the story. Within mainstream economics the production and use of knowledge is at the heart of dynamic agglomeration economies: external economies arise from knowledge spillovers, Romer (1986), Lucas (1988). And these spillovers are even more important in urban economies with greater physical proximity. For Jacobs (1969), the earliest proponent of knowledge spillovers as a central ingredient in economic development, diversity rather than uniformity results in new products and processes. Knowledge spillover is wider than the industry, but not as wide as the entire economy. Within this context she believed, and observed, that local competition fosters innovation; monopoly restricts.

Glaeser et al (1992) gave some validation of Jacobs' beliefs in their econometric analysis of panel data for large cities, and industries in large cities, in the United States for the period 1956 to 1987: local employment growth was aided by city industrial diversity and competition within industries for those cities. But as we have already noted Jacobs extols the virtue of the city which grows and develops without central direction, either government or corporate: the successful city is an outcome of the many decisions of its population. Yet the reality in the case of the United States, as for other countries, is that cities are subject to the dominance of the big and powerful: therefore we have many cities in crisis, suffering the consequences of strategic failure. Thus cities should be seen as a priority focus for policy making, because of the potential rewards associated with the

creativity of the city which is not currently being fully realised, but also because of the present need of those cities in real crisis.

We can see the city as a lynch-pin of development. As a focus of new ideas springing from the intensity of interaction of people within a specific location: rural locations do not have the intensity and diversity of experience necessary for some developments. Perhaps surprisingly agricultural innovation was an edge of city phenomenon historically as Jacobs demonstrates, Jacobs (1969). It is also true that relatively recent major scientific developments affecting agriculture have been produced by state research agencies and the research arms of firms serving agriculture, Cowling et al (1970), Huffman and Everson (1993), springing from the intensity of interaction of people within a specific location. But this proximity should not be seen as purely locational, for out of that intense interaction of different peoples and their different ideas emerges a consensual view of ways forward which reflects a new mental proximity which in turn allows further development of mutual dependency, Sacchetti and Sugden (2006). This free interaction between people is a very different process from that of a network of direction reflecting the aims of those powerful groups, such as the elite at the top of corporate hierarchies, who seek to strategically control the process of development, Sacchetti and Sugden (2005). The city, when allowed to work successfully, provides the environment we seek for a democratic dynamism rather than an imposed dynamism reflecting the wishes of an elite minority.

But is the city dying? Has the development of new technology allowing easy and cheap communication rendered the city obsolete? There are two possible effects: electronic communication substitutes for face to face contact and/or electronic communication complements face to face contacts. The first would reduce the role of the city, the second would enhance it. It has been found in large US cities that complementary is the dominant effect, Gaspar and Glaeser (1998),

Glaeser (1998)⁴. The future of the city would seem secure if this is indeed true. And Gaspar and Glaeser (1998) note the high level of agglomeration in Silicon Valley⁵.

Going back to Jacobs view that diversity matters for creativity and development it is necessary to recognise that the most recent empirical results do not support that view. Henderson (2003) estimates productivity at the plant level using urban panel data and finds city specialization, rather than diversity, matters. Yet knowledge spillovers between industries relate to new products or new varieties of old products. Perhaps the **plant** level productivity estimates of Henderson are not able to capture this **qualitative** effect. It clearly requires a hedonic index of productivity, which is increasingly being used in national productivity estimates, for example Cowling and Vernon (1996).

Lastly if we move briefly from the typical world of economic enquiry in considering the unique role of the city in innovation and development we might take the case of Wittgenstein's Vienna, see Janik and Toulmin (1996), who paint a fascinating picture of fin-desiecle Vienna. Vienna was obviously very unequal so we are not talking of a democratic dynamism in an inclusive sense, yet the city supported an intellectual ferment among an intellectual minority who interacted on a day-to-day basis across, as well as within, disciplines: philosophic, artistic, scientific, architectural,..... This is reminiscent of the ideas and observations which permeate Jane Jacobs work, but where the focus is on people at large, in the ordinary business of life and work. In the case of Vienna, a small fraction of society but

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⁴ Some limited personal and anecdotal research reveals a possibly interesting hypothesis: the first reaction of office staff was that substitution was the reality but that complementarity was the optimal response. This might suggest that networks of **direction** may move in a suboptimal manner in response to electronic developments - the true worth of the city may be lost sight of in our corporate world.

⁵ Of course this observation may fit the argument of the previous footnote: it is exactly where we have diffuse developments like Silicon Valley that proximity is seen to be essential.

enormous intellectual diversity, with people meeting on a daily basis in the city's coffee houses for discussion and argument.

But, back to earth. We are faced with cities today which have suffered over the past thirty or forty years from a dramatic process of deindustrialization and many cases of economic decline.

The Jobs Gap

The workings of the, more or less, "free market" has left a major urban problem within both the US and Europe in addition to the hugh problems elsewhere in the developing world. As a telling example of the depth of the urban problem Ivan Turok and Nicola Edge (1999) calculated that since 1981 the 20 major cities in Britain have lost half a million jobs, equivalent to about 25% of their male labour force. We would expect Britain to be an extreme case within Europe, given that we are associating job loss with the "free market", but it is clear that unemployment in Europe as a whole remains high and particularly so in large metropolitan areas. However, it is also true that the decline in jobs in British cities is not entirely represented in the growth of urban unemployment. There has been substantial growth economically inactive male population in British cities: despite having one of the lowest unemployment rates among the OECD countries, Britain also has one of the highest rate of worklessness. Currently, about one in six working age households have no adult in paid employment (Kemp et al (2004). The larger industrial conurbations in Britain have been the worst performers as far as the decline in unemployment and inactivity is concerned: Glasgow, Coventry and Merseyside, excluding Liverpool stand out as the worst for the 1990's, wee Webster (1999). This decline in job prospects has been associated with lower life expectancy and an increasing gap between the industrial cities and less urban areas: again Glasgow shows the worst performance with the lowest life expectancy in Britain for both males and females. No industrial cities feature among the areas with highest life expectancy, Office of National Statistics (2004).

Origin of the Problems of the Cities

There are many more or less proximate explanations for the problems facing European cities in recent times, but these are generally underpinned by their underlying economic structure, a structure largely created by the activities of the major corporations⁶. This has been the major theme of our work over the last twenty years or so, Cowling and Sugden (1994) 1998) (1999) and Sugden and Wilson (2002): Rothschild (2005) provides a quite succinct and up to date account of this new world and explains why it creates the need for a new approach by policymakers.

In practice so called free market systems are planned through strategic decisions of the dominate corporations. Moreover, strategic decision making in these firms is in the hands of an elite. A systemic consequence is that free markets are plagued by strategic failure where these decisions necessarily prevent the attainment of socially desirable outcomes, prevent the achievement of the public interest. Thus transnational corporations, which are the generality today, manage trade in their own interests and "free trade" protects the negative freedom of these privileged elite from government intervention but emasculates the positive freedom of others to determine their own economic development. But we should not concentrate on markets. The subversion of decision-making within the firm in the interests of the few can mean that the wider interest within the city if ignored in strategic decisions. Thus corporations may pursue a globalisation strategy which may involve relocation of production from the older industrial cities to the newly industrialising cities of the emerging countries without the views of those workers in the old centres of production playing a role. We should not be surprised if the outcome is the deindustrialisation of European industrial cities with the inevitable consequences for jobs. Transnationals are capable of

⁶ Obviously the intensity of the problems vary across cities: some might see relatively prosperous cities like London or Paris or Milan as having a problem, yet closer inspection yields areas of relative deprivation even within a general prosperity.

producing pain as well as pleasure in the context of the free market, as it has developed.

A Double Dualism

As a rough approximation a double dualism has been created in the world. Within the market economy we have a core, the OECD countries, and periphery, the rest of the world: as Hymer (1972) put it we have a law of uneven development established, partly the result of the transnational corporations. "The tendency of the system to produce poverty as well as wealth, underdevelopment as well as development" (p114). Our point is that as well as being true at the global level between the developed and underdeveloped nations, the transnational corporations have also produced a similar gap within the developed world. We have undevelopment as well as development within the AICs and even within London and New York and Paris as well as within the UK and the United States and France.

So within the core we have another core-periphery: "Why are we so rich and they so poor?" also takes on an intranational dimension, but also an intranational one, and perhaps increasingly so. The centrifugal and centripetal tendencies connected with this new globalism, with production leaving the old manufacturing cities of the core for the low wages of the periphery, and control over this process being concentrated within the core, provided the backdrop for the decaying old manufacturing cities unambiguously damaged by this process, with very few winners. However side-by-side them are the so called command cities (or global cities, Sassen S (1991), centres of corporate strategic decision-making, corporate headquarters are concentrated in a few of the big cities of the world: New York, London, Tokyo, Paris have the largest concentrations. These cities have gained from centripetal developments in terms of headquarters

⁷ Sassen (2000) defines global cities as "strategic sites for the management of the global economy and the production of the most advanced services and financial operations" (p.21)

employment and employment in business services related to headquarters functions, but also from the employment creating effect of the (sometimes huge) salaries received within headquarters, which are spent locally on services', medical, entertainment and such like. Yet the prosperity of these cities lies alongside the poverty of significant minorities, especially male manual workers or former workers, largely untouched by the wealth generated within the command city. We have seen the resentment built up by the juxtaposition of this rising local inequality, for example in the riots within the banlieue of Paris.

A Way Forward

It is clear that existing policies directed at the cities have been less than adequate. Tactical policies vary but usually involve alternative for subsidising investment measures corporations or for small firms. Typically corporations take the money and move on when it becomes attractive to do so - we have seen this in cities around the industrial world - and small firms have very low survival rates in the hostile environments created by the dominant corporate players - they only survive when they play to the rules set by the giants⁸. We are clearly confronted with decaying or decayed manufacturing cities and decaying areas in "command" cities: but connected problems which we argue have their roots in strategic economic failures related to the dominance of major corporations in the market economy. At the heart of the free market systems we have seen systemic failures which have reduced the fundamental dynamism of cities. It would therefore seem essential to explore possibilities of creating development paths for cities which avoid such failures. The obvious response is to try and tackle the source of the failures head-on: to look at ways of involving more of those affected by strategic decisions in the process of making these decisions - to design

⁸ Occasionally we see small firms succeeding but they are typically acquired by their larger rivals and become, often uncessful, diversions of these corporate giants, see Ravenscraft and Scherer (1989)

ways of democratising strategic decision making. This would be a long term project and highly political. In part this would need to be sought within the hierarchical structures of the big corporations and would need the monitoring of the activities of these firms. A further dimension of policy would be the nurturing of an alternative structure of production characterised by symmetrical horizontal relationships rather than asymmetric, hierarchical relations seen within the dominant mode of production today: some form of small firm production. Thus we would seek to convert the present essentially tactical approach to the problems and potential of the cities into a much more strategic role for economic policy aimed at restructuring the city economy to enable the full realization of its potential.

New Industrial Districts

Clearly, the presence of small firms is no guarantee of socially optimal outcomes, nut intuitively, democratic strategic decision making appears more feasible if an economy comprises of smaller firms. Moreover it is noticeable that much recent literature has focused on allegedly successful groupings of small firms, especially with respect to innovation, in the industrial districts of Italy, see e.g. Becattini et al (2003). The idea of groupings of small firms is appealing because it is often argued that technology requires production on a large scale to minimise cost and it is notable that in some significant cases small firms have been able to cooperate to achieve these economies without there having to be concentration of production in one large scale hierarchical organisation.

Yet, there has been evidence recently that some of the industrial districts (for example in Italy) have been experiencing real problems, related to globalisation and the emergence of new competition. This may be in line with the evidence from US cities provided by the econometric analysis of Glaeser et al (1992). As we have remarked they found evidence that city success (in terms of employment growth)

was linked to industrial diversity within the city, in line with Jacobs (1969, 1984). In a recent debate about Jacobs on the role of the city in economic growth Polese (2005) argues that agglomeration is not the essence: but Jacobs is a richer analysis than this would suggest.

Agglomeration is not sufficient for growth and development, diversity is necessary and this springs from a diffuse industrial base, which is suppressed by corporate control. Simply talking of cities as sites from which dynamic agglomeration economics will spring does not identify the essence of the problem. Growth and development requires a more democratic element than corporate control allows, witness the quote we give from Jacobs (1984) on the title page. We need to explain diversity and not just treat it as an independent variable in growth economics. It would seem that in the long-run -Glaeser et al were looking at a 30 year period - success requires the stimulation of variety. Faced with repeated shocks cities need to change their industrial structures and a diversified industrial base contributes to this via the cross-fertilisation of ideas as Jacobs has suggested. Looking historically, for example at the industrial revolution in England, Jacobs saw Manchester as failing to maintain its success of the 19th century: it was too specialized. She saw Birmingham as the city of the future with it's more diffuse and diversified industrial base. Yet Birmingham has not sustained it's success in the late 20th and early 21st century. Following it's loss of control over industrial development with the takeover of its industrial base by transnational corporations, so that strategic decision making has moved elsewhere: Birmingham now has the highest unemployment of the 8 biggest regional cities in Britain. London is now unique in having the diversity required for dynamism.

With these sorts of observations in mind it would seem constructive to consider the possibility of creating city structures within themselves reminiscent of industrial districts, less specialised in the usual sense, but having a coherence within the city, mingling many different aspects of the city to create new industries on which future development of the city might be based. This would involve intersecting webs of small firms, involving different lines of production with some elements of complementarity, for example media, IT and telecommunications: a large group of production units which taken individually are quite small but which taken as a group constitutes a production process on a large scale. The aim would be for units to cooperate by providing mutual support in a process which also promotes the emergence of new and rival production units: a system combining elements of rivalry and cooperation within it, yet constantly evolving. To achieve this will require policy operating with a light touch, eschewing monopoly positions, maintaining open access to knowledge and critical financial support, allowing for constant change. Financial support would not imply subsidy for the large and dominant, but credit at critical times for the evolution of the small and new: something like a Grameen bank tailored to the needs of the European city⁹, creating a culture where the emphasis is on people, individually and collectively evolving and trusting their ability to find many and varied development paths.

Over the long-run, the city needs to adapt and change in response to a multitude of shocks: a diverse industrial structure allows it to do this. Short-run bursts of city growth have been made in the past by specialized cities, but to be sustainable appears to require this diverse base: Jacobs was right in the long-run. The evidence suggests, at least for US cities, that important knowledge spillovers occur between industries, in the long-run at lease, rather than within industries. The essence of Jacobs is diversity and we must ensure that this is the essence of our policy. Such policies, by supporting a

⁹ It has just been reported that the Grameen Bank has just opened for business in New York, **Financial Times** February 16/17 (2008). It seems that what was designed for a very low income country, Bangladesh, may have relevance to the needs of small business within the most advanced country.

variety of industrial processes will also serve to support a variety of talents and thus avoid any tendency for people to be excluded from the development process. These special sorts of industrial districts would act as havens away from corporation dominance and repression, allowing experiments to take place, ideas to be hatched, communications between people with ideas to take place. To avoid decline, to promote success, a city needs continuous stimulus and must remain open to the entry of firms and ideas.

Self-sustaining High Skill Ecosystems

As part of a system of new industrial districts it would be interesting to explore the possibilities of developing high skill ecosystems along the lines suggested by Finegold (1999). He bases the framework of such systems on successful biomedical and computer hardware and software firms clustered in California, and identifies requirements: a catalyst, ongoing nourishment, a supportive hose and a high degree of interdependence among actors and suggests policy options for the UK. He sees the UK possessing many of the ingredients (universities, telecoms, science parks, culture) but some weaknesses (outflows of scientific stars, seed corn funds, poor links between firms and universities. A new technopolis in Finland, Oulo, would seem to have some of the necessary ingredients, Financial Times, September 4th 2007. Obviously creating successful high skill ecosystems will not solve low skill equilibrium problems of the UK, but Finegold argues that the policy solution is not to curtail them but rather to improve educational levels for those unable to benefit and to redistribute the wealth created to create a living wage jobs for the lower skilled in sheltered parts of public and private service sectors.

Multinational Webs of Cities

To be critical of the existing transnationalism of the major corporations is not to advocate a narrow, national or intranational approach to policymaking. The development of multinational webs of small firms is part of an alternative development path where people, and thus economies and societies, are able to realise their full potential (Cowling and Sugden, 1999 and Sugden and Wilson, 2002). Instead of internationalising production by hierarchical control and the concentration of decision-making, as transnational corporations have done, the suggestions we are making would provide an alternative process which would be non-hierarchical and would foster a diffusion of decision-making: a grass roots, multinational process of evolution. Many European cities are facing similar problems; Edinburgh/Dublin; Glasgow/Hamburg; London/Berlin; Paris/Milan; and similar opportunities. Cooperating on a way forward through small firm webs at the level of production could lead to a wider and deeper cooperation of societies and cultures. Such a process could lead to the gradual reshaping of the economic basis for the city.

From Dependence to (Collective) Self-Reliance of Multinational Communities

It is crucial that initiatives be pursued simultaneously at city, regional, national and pan-European levels. Democratic involvement in the economy needs to be developed at the city level but must extend outward to the European level otherwise actors (like the bit corporations) with a pan-European perspective and competence will undermine any local autonomy. The transnationality of the major corporations enables them to pit community against community in seeking their own ends. It is necessary to counter this power by creating an alternative powerbase with strong grass roots throughout Europe. Thus, in a long and difficult strategy, we can seek to transform a system of dependence into one of collective, self-reliance of multinational communities, "self interest as properly understood" through civic engagement, deToqueville, (2003).

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Institute for Economic Development Policy Discussion Paper Series

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