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April 2012

Urban America: US cities in the global economy

The McKinsey Global Institute

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Urban America: US cities in the global economy

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US cities ...

More than **10%** of global GDP growth to 2025 will come from large US cities

80% of the US population lives in large cities, vs. less than **60%** in Europe

Almost **85%** of US GDP was generated by 259 large cities in 2010, while the large cities of Western Europe contributed less than **65%**

… in an urban world

3/4 of the US lead in per capita GDP over Western Europe is explained by differences in the regions' large cities

Just over **255** middleweight cities are in the United States, vs. just over **180** in Europe

2nd largest city in the world in 2025 will remain New York …

4th largest city in 2025 will be Los Angeles

Executive summary

If the 21st century is the century of cities, as some observers characterize it, urban America begins the millennium in a strong position. Large cities in the United States—and in particular the nation's broad swath of dynamic middleweights—dominate the economy as in no other region of the world.[1] They also loom large in the urban world. Almost one in seven of the City 600, the group of cities that is expected to contribute 60 percent of global GDP growth to 2025, is in the United States. Large US cities are expected to generate more than 10 percent of global GDP growth in the next 15 years, a larger contribution than all of the large cities of other developed countries combined. So although the burgeoning cities of Asia have seized the public imagination, US cities will remain an important part of the US and global growth story over coming decades.

But US cities face turbulent times ahead as the economy strives to recover from the Great Recession. In the next few years, many cities are likely to grapple with the dampening impact of deleveraging on economic activity as the public sector and individuals attempt to pay off high debt levels, as well as persistently high pockets of unemployment. They also face longer-term headwinds including the aging of the population, which will require even more emphasis on boosting productivity, innovation, and skills. Policy makers and businesses need to find ways through these difficulties in order to play their part in the growth and renewal of the US economy.[2]

In the past, the diverse pool of US cities has found many different ways to expand and become more prosperous. There has been no single recipe for success—nor is there likely to be one in the period ahead. In this report, MGI examines the importance of cities in the US economy and compares their role to the cities of other regions. The report describes urban GDP growth patterns over past decades and highlights some of the major trends facing urban America to arrive at a sense of how cities will navigate the challenges ahead.

1 Consistent with the MGI Cityscope database, we define large cities as metropolitan areas with populations of 150,000 or more. The 259 large US metropolitan areas consist of the two megacities of New York, New York and Los Angeles, California, with populations of ten million or more, and 257 "middleweight" cities with populations of between 150,000 and ten million.

2 For readers interested in MGI's work on growth and renewal and employment in the United States, see, for example, *Growth and renewal in the United States: Retooling America's economic engine*, February 2011; and *An economy that works: Job creation and America's future*, June 2011 (www.mckinsey.com/mgi).

US CITIES—PARTICULARLY MIDDLEWEIGHTS— WILL CONTINUE TO DRIVE GROWTH

Today, large US cities have more weight in the US economy than do large cities in any other major region. In 2010, 259 large US cities generated almost 85 percent of US GDP. During the same period, large cities in Western Europe accounted for less than 65 percent of the region's GDP. Among emerging regions, metropolitan China accounted for 78 percent of China's GDP and the large cities of Latin America contributed 76 percent to regional GDP.

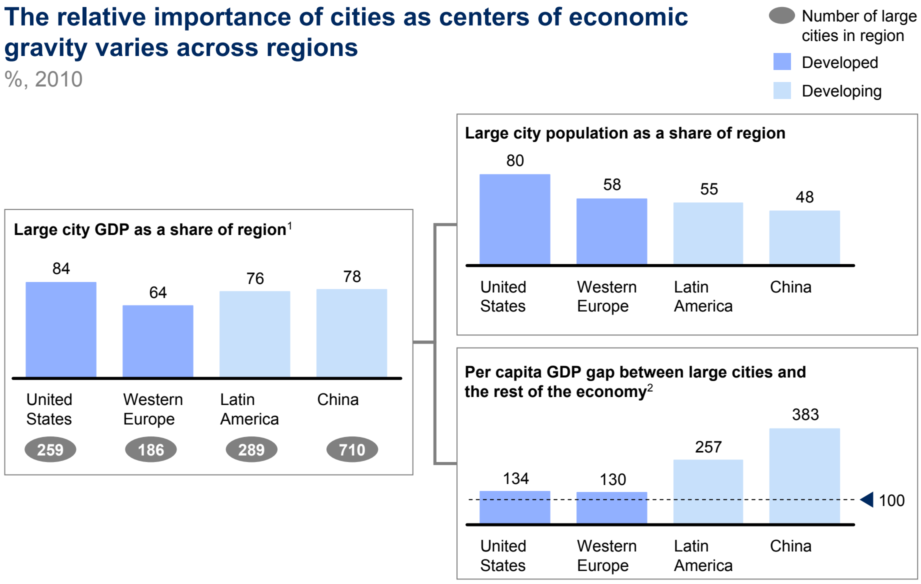
Large US cities have such relative economic weight for two reasons. First, they are home to 80 percent of the population compared with less than 60 percent in Western Europe. Second, they have a relatively high per capita GDP premium. The average per capita GDP of large US cities is almost 35 percent higher than in smaller cities and rural areas; in Western Europe, this premium is about 30 percent (Exhibit E1).

The relative weight of different regions in the world economy changes when we home in on the economic clout of their large cities. Even though Western Europe's GDP exceeded that of the United States by nearly 10 percent in 2010, the combined GDP of large US cities exceeds that of large Western European cities by more than 20 percent.

Exhibit E1

The relative importance of cities as centers of economic gravity varies across regions

%, 2010



1 We define large cities as having 150,000 of more inhabitants in the United States, and Western Europe. In China and Latin America, we include only cities with 200,000 inhabitants plus in 2010. GDP is in PPP US dollars.
2 The rest of the economy comprises cities with fewer than 150,000 inhabitants as well as rural areas.

SOURCE: McKinsey Global Institute Cityscope 1.5; McKinsey Global Institute analysis

It is America's cities that explain why the United States continues to enjoy higher per capita GDP than Europe. The higher share of US urbanites—and the fact that they command a larger per capita GDP premium over US smaller towns and rural areas than do their European counterparts—explains three-quarters of the per capita GDP gap between the two economies.

The nation's largest and well-known megacities of New York, New York, and Los Angeles, California, will continue to prosper.[3] New York is on course to remain the second-largest city by GDP in the world in 2025, and Los Angeles to rise from sixth place today to become the fourth-largest city. But the weight of these megacities in the US economy is not decisive to the overall importance of cities in the United States. London and Paris have a smaller share of the overall Western European population—6 percent, compared with the combined population of the US megacities of 10 percent of the total US population—but they enjoy a significantly higher per capita GDP premium than their US counterparts. Paris and London contribute 9 percent to Western Europe's overall GDP, compared with the 13 percent contributed by New York and Los Angeles.

Instead, the true vigor of America's urban economy comes from a broad base of dynamic middleweights and the relatively high per capita GDP they achieve. There are just over 255 middleweight cities in the United States, compared with just over 180 in Europe. And they generate more than 70 percent of US GDP today, compared with just over 50 percent in Western Europe. In fact, the top 28 US middleweights alone contribute more than 35 percent of US GDP. The dynamism of middleweights in the United States is a characteristic of today's global urban expansion, making them an interesting group to understand for both US and global growth prospects.

US CITIES HAVE VARIED WIDELY IN THEIR PERFORMANCE—THERE IS NO SINGLE BLUEPRINT FOR FUTURE SUCCESS

While the overall performance of urban America has been a strong one, the fate of individual cities has varied widely. Among middleweights in the top 30 cities, considerable changes have occurred in their rankings by GDP over the past 30 years. Cleveland, Ohio, for instance, dropped from 17th place to 27th, while Phoenix, Arizona, rose from 28th place to 13th. Five cities have dropped out of the top 30 completely and been replaced by newcomers.[4]

3 The metropolitan area of Los Angeles includes the Californian cities of Long Beach and Santa Ana, and the metropolitan area of New York includes Newark, New Jersey.

4 The metro areas that have dropped from the top 30 by GDP from 1978 to 2010 are New Orleans, Louisiana; Milwaukee, Wisconsin; Columbus, Ohio; Indianapolis, Indiana; and Buffalo, New York; and the new entrants to the top 30 are Riverside, California; Portland, Oregon; Tampa and Orlando in Florida; and Sacramento, California.

The GDP growth of a city consists of growth in its population and increases in its per capita GDP. Looking at large cities on these two dimensions, it is the diversity of their performance—not the similarity—that is striking (Exhibit E2). Four features of US urban growth over the past three decades stand out.

- **Different population growth rates explain most of the differences in GDP growth performance among US cities.** Fast-growing cities on average posted growth in their populations of two and a half times the national average even while experiencing per capita GDP growth rates nearly identical to the national average.[5]

- **A favorable mix of sectors is a factor in the fast growth of top-performing large US cities—but is less important than observers often assume.** The mix of sectors of the fastest-growing cities can explain 15 percent higher GDP growth than the average urban GDP growth rate.[6] But in fact this group has outpaced the average by more than 45 percent, indicating that a favorable mix of sectors explains only one-third of their outperformance.

- **Broad economic trends contribute to the diversity of experience across US cities.** Changes in the economic environment help explain why some cities thrive and others don't. We have seen the rise and decline of manufacturing cities; the lift that Sun Belt cities in the South and West have received from their favorable climates; and the impact on Eastern and Western cities from a shift in global economic activity, away from Europe and toward Asia, and from the Atlantic to the Pacific.

- **The diversity of growth patterns among strongly performing US metropolitan areas suggests that there is no single path to economic success.** Cities that have outperformed their peers in GDP growth include rapidly growing "gazelles" such as Austin, Texas, and Raleigh, North Carolina, which have outperformed the US average in both per capita GDP and population growth by building on their high-tech presence and strong collaboration with local universities. Others such as Dallas, Texas; Atlanta, Georgia; and Salt Lake City, Utah—which we might call "affordable metropolises"—have outperformed the average national average GDP growth because their populations have expanded rapidly despite per capita GDP growth that was slower than average. Yet another set of large, established cities such as Boston, Massachusetts, and Washington, DC—"alpha middleweights"—outperform others with significantly above-average per capita GDP and sustain moderate growth by leveraging the strength of their existing economic base.

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5 We define fastest-growing cities as those that have achieved GDP growth that is 25 percent higher than the US average between 1978 and 2010.

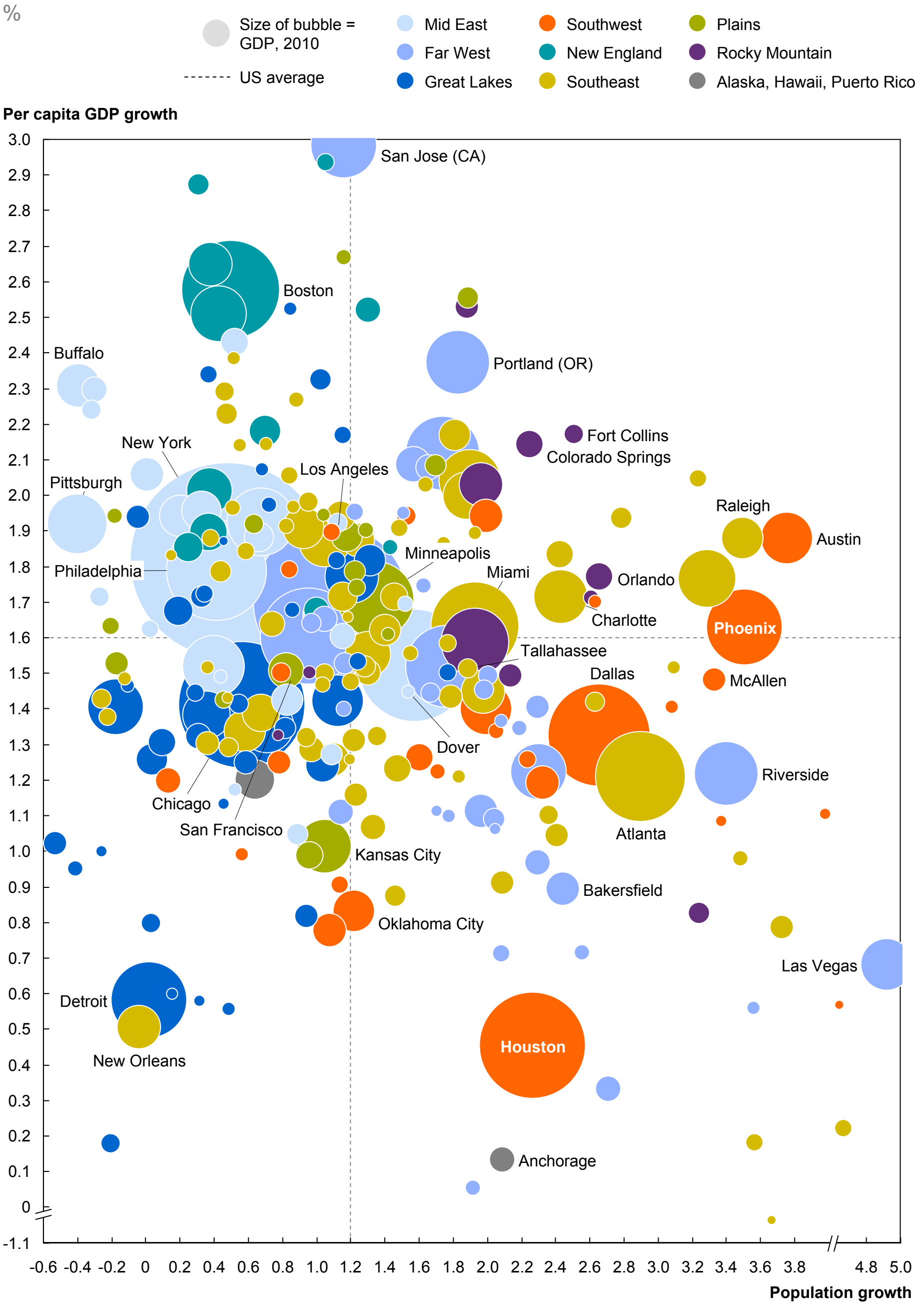
6 The sector breakdown is based on a 20-sector split of the economy.

Exhibit E2

The growth patterns of individual cities have varied widely

Compound annual growth rate, 1978–2010

%



NOTE: For metropolitan regions, we use the first name of the region: e.g., New York for New York-Newark.
SOURCE: Moody's Analytics; McKinsey Global Institute analysis

POLICY MAKERS AND COMPANIES NEED TO NAVIGATE DIFFICULT TIMES AHEAD

In the years ahead, US cities will face a number of strong headwinds against growth. In the short term, many urban centers will need to grapple with high unemployment and deleveraging. In the longer term, cities will need to deal with declining population growth, demographic shifts and aging, and less labor mobility than in the past. These are likely to constrain purely population-driven growth strategies and further increase the intense competition for talent.

Yet large US cities have time and again demonstrated that they collectively have the resilience and capacity to adjust to new situations. There is no reason this will not be the case in coming decades, too. As in the past, the trump card for urban America as it navigates its way toward growth and renewal will be the diversity of strategies and experiences of individual cities. While there is no single blueprint for all cities to follow, there are workable approaches that have proved effective for policy makers and businesses.

Key approaches for policy makers

- **Know thyself and tailor strategy accordingly.** Cities need to understand their strengths and weaknesses, as well as the impact of demographic and other trends on their prospects, and set their strategy accordingly. Large metropolises need to compare themselves and benchmark against an increasingly global urban landscape. Smaller cities need to prioritize to make the most of their unique strengths.

- **Excel in execution.** The way policies and strategic plans are carried out is critical to success. Involving the private sector and a broad range of stakeholders has a proven track record.

- **Be connected.** Rather than seeing other cities as competition, building connections to other US and global cities can be a source of strength and new ideas.

Key approaches for businesses

- **Be granular in the search of growth.** In a diverse US urban landscape, companies need a detailed understanding of where the growth opportunities are and need to ensure that they are sufficiently nimble to respond to changing circumstances.

- **Engage actively in the search for talent.** Skills, particularly technical ones, are going to be in increasingly short supply. Businesses need to understand which cities can offer the most attractive workforce and production assets.

- **Collaborate with cities to carve out a competitive environment.** Companies should work with cities, many of which are keen to attract business, to inform local leaders of their needs and what policies would be most conducive to a competitive urban environment.

□ □ □

Despite the severe challenges they face, US cities start from a more robust platform than their peers in other developed regions. The strength of urban America lies in its diversity and the broad swath of middleweight cities—an urban profile that we are beginning to see play out across the urban world.

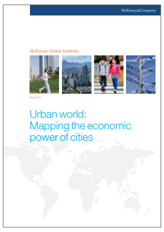
Related McKinsey Global Institute publications

Building globally competitive cities: The key to Latin American growth (August 2011)

Latin America is a bright spot in the post-recession global economy, with growth rebounding strongly in much of the region. In the years ahead, cities will be critical to regional growth. Latin America is the most urbanized region in the developing world, with 80 percent of its relatively young population living in cities today, a share expected to rise to 85 percent by 2025.

An economy that works: Job creation and America's future (June 2011)

To regain full employment—finding work for the currently unemployed and accommodating 15 million entrants into the labor force this decade—the US economy will need to create 21 million jobs by 2020.

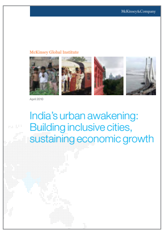


Urban world: Mapping the economic power of cities (March 2011)

Six hundred cities—the City 600—are projected to generate more than 60 percent of global GDP growth to 2025. Within this group, companies need to adjust their strategy to include the 577 fast-growing "middleweight cities."

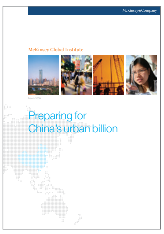
Growth and renewal in the United States: Retooling America's economic engine (February 2011)

More than ever, the United States needs productivity gains to drive growth and competitiveness. As baby boomers retire and the female participation rate plateaus, increases in the labor force will no longer provide the lift to US growth that they once did. To match the GDP growth of the past 20 years and the rising living standards of past generations, the United States needs to accelerate labor productivity growth to a rate not seen since the 1960s.



India's urban awakening: Building inclusive cities, sustaining economic growth (April 2010)

India has a young and rapidly growing population—a potential demographic dividend. But India needs thriving cities if that dividend is to pay out. New MGI research estimates that cities could generate 70 percent of net new jobs created to 2030, produce around 70 percent of Indian GDP, and drive a near fourfold increase in per capita incomes across the nation.



Preparing for China's urban billion (March 2009)

The scale and pace of China's urbanization continues at an unprecedented rate. If current trends hold, China's urban population will hit the one billion mark by 2030. In 20 years, China's cities will have added 350 million people, more than the entire population of the United States today. By 2025, China will have 221 cities with over one million inhabitants—compared with 35 cities of this size in Europe today—and 23 cities with more than five million. For companies in China and around the world, the scale of China's urbanization promises substantial new markets and investment opportunities.

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