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## Europe's Leading Cities – Success Factors and Policy Perspectives

*In Europe, economic activity is concentrated more and more in the major urban centres. At the same time, these cities are in a competition with one another. Across Europe they are contending for investors and qualified workers and searching for the most successful path to a dynamic economic future. Which cities in Europe have made the greatest economic progress in the past? What are the factors that have made some cities more successful than others? And what action can cities take to achieve greater economic growth in the future?*

Currently half of the world's population lives in cities and for the future it can be expected that – driven to a large extent by migration – cities will go on growing. Across Europe, both output and population are strongly concentrated in cities and metropolitan areas. For instance, one third of the Irish gross domestic product is produced in Dublin and in Spain 20% of overall employment is concentrated in the greater Madrid area. However, being a city is not a guarantor for outstanding economic success. A comparison of employment growth rates in 30 European cities illustrates that while Madrid and Dublin realised annual employment growth rates of 4.4% and 3.5% respectively in the period from 1995 to 2004, other cities like Hamburg and Paris had almost stagnating employment figures while Berlin even recorded employment losses (cf. Figure 1).

Obviously the economic performance of European cities has differed strongly since the mid-1990s. The economic success of cities and their position in international and interregional competition depends on a wide variety of factors like infrastructure endowment, quality and quantity of available production factors, qualification level of the population, demographic structure, quality of life and the city's image, to name just a few. The economic performance of cities is also

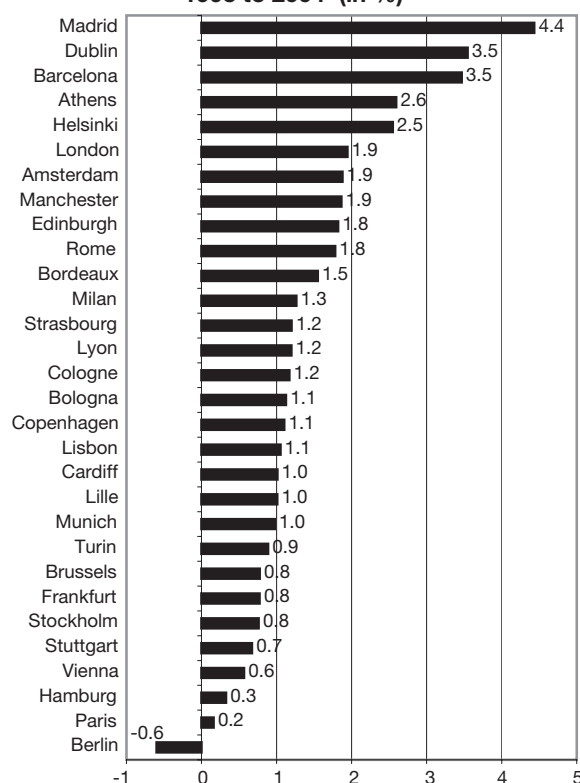
strongly dependent on the macroeconomic growth of the respective country. At the same time, a favourable economic position of cities impacts positively on the national growth rate. This is due to the fact that regions and cities are closely interrelated via trade in goods and services, labour mobility and information as well as knowledge spillovers. These interrelationships are stronger between regions and cities within countries than across borders.<sup>1</sup> Therefore, positive or negative economic trends are more readily transferred between regions within countries. But due to their specific structure and location factors cities deviate in their economic development to different degrees from average national growth rates. Some have distinctly higher growth rates than the country registers on average while others lag behind macroeconomic growth.

Strong disparities in economic growth have to be considered when evaluating the employment growth of cities since 1995. In Ireland employment grew at a rate of 45.6% and Spain realised increases in employment of almost 34.8% in the period from 1995 to 2004. Barcelona, Madrid and Dublin strongly profited from overall macroeconomic growth and exhibited annual employment growth rates distinctly above the average (cf. Figure 1). Finland, the Netherlands and the United Kingdom exhibited high employment growth of 15.2%, 10.4% und 11.9%, which contributed to above aver-

\* Hamburg Institute of International Economics (HWWI), Germany. This article is a summary of the studies by M. Bräuninger, S. Stiller: *Europas Beste – Vorbilder für deutsche Metropolen im Standortwettbewerb*, 2005, and *Europas Beste – Ein Update*, 2007, both published by HypoVereinsbank.

<sup>1</sup> A. Niebuhr: *Spatial Interaction and Regional Unemployment in Europe*, in: *European Journal of Spatial Development*, 2003, pp. 1-26.

**Figure 1**  
Average Annual Employment Growth,  
1995 to 2004<sup>1</sup> (in %)



<sup>1</sup> British cities and Dublin: 1995 to 2002; Amsterdam: 1996 to 2003.

Sources: Eurostat, 2007; Centraal Bureau voor de Statistiek, 2007; calculations by HWWI.

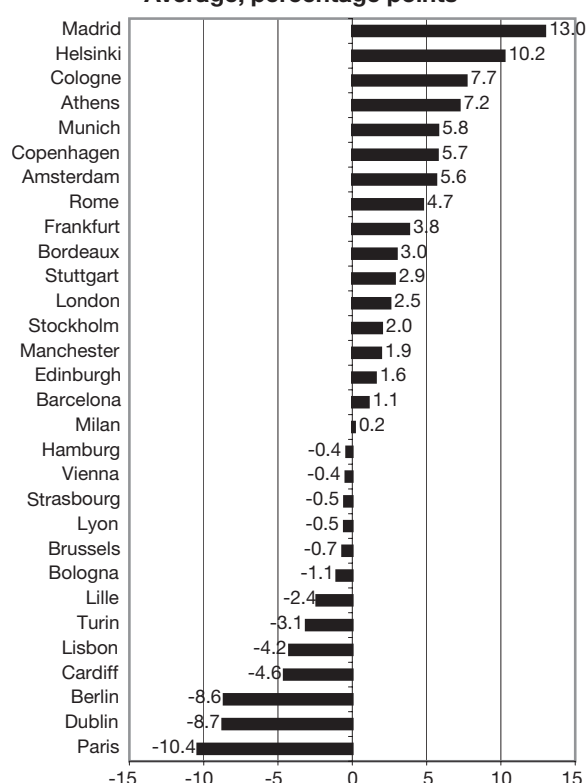
age employment growth in the cities of these countries. In Germany employment grew at a rate of only 3.4% from 1995 to 2004. Hence, overall conditions for economic development and the creation of jobs have been comparatively disadvantageous for German cities in the considered period of time. This is reflected in comparatively low annual employment growth rates in the six biggest German cities (Berlin, Cologne, Frankfurt, Hamburg, Munich and Stuttgart) ranging from -0.6% (Berlin) to 1.2% (Cologne) during the time period 1995 to 2004.

#### Leading Cities in Europe<sup>2</sup>

Due to the strong dependence of city growth on macroeconomic factors cities can be considered to be

<sup>2</sup> We excluded cities in Eastern Europe from the analysis since economic trends as well as location factors in cities still distinctly differ between Eastern and Western Europe. For an overview on the economic development and structure of capital cities in Eastern Europe cf. S. Jasmund, S. Stiller: Capital Cities in the New EU States – Current Trends and Economic Status quo, in: INTERECONOMICS, Vol. 40, No. 5, 2005, pp. 298-304.

**Figure 2**  
Employment Growth<sup>1</sup>, Deviation from National  
Average, percentage points



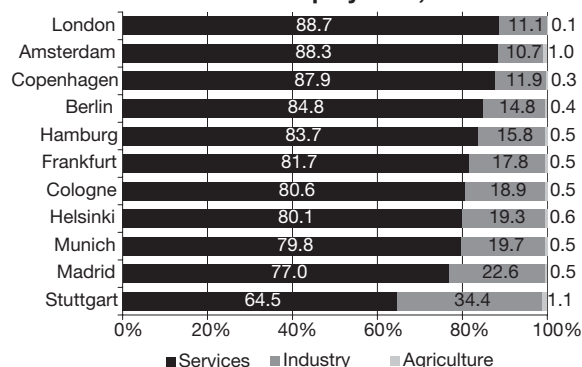
<sup>1</sup> British cities and Dublin: 1995 to 2002; Amsterdam: 1996-2003.

Sources: Eurostat, 2007; Centraal Bureau voor de Statistiek, 2006; calculations by HWWI.

particularly successful if they record a distinctly more positive economic development than their respective national economy does on average. Since employment growth is the main objective in the Lisbon strategy, the HWWI study takes the cities' employment growth deviation from the national average as the criterion to judge success. The extent to which employment growth in cities differs from macroeconomic growth in their respective countries varies strongly among the 30 cities included in the analysis (cf. Figure 2). From this fact we may conclude that location-specific factors play a role of varying importance in each city's development.

Judged by the above-mentioned criterion, Madrid and Helsinki have been particularly successful. These cities been able to generate a large net increase in the number of jobs and have also been markedly more successful than the rest of their respective countries (cf. Figure 2). We may thus conclude that these cities have developed their location-specific factors so well that

**Figure 3**  
**Sector Share in Employment, 2004<sup>1</sup>**



<sup>1</sup> For London 2001.

Source: Eurostat, 2007; calculations by HWWI.

they have been able to benefit from national success to a disproportionately high degree. The economic development of German cities also positively deviated from the German average growth rate. Cologne outpaced overall economic growth by 7.7 percentage points between 1995 and 2004. Stuttgart, Munich and Frankfurt all surpassed the overall German growth rate although employment growth in these cities was distinctly lower than in Madrid and Helsinki. Several other cities surpassed their countries' average growth by margins ranging from +7.2 percentage points (Athens) to +0.2 percentage points (Milan). On the other hand, some cities fell far below the national growth rates, among them Berlin (-8.6 percentage points), Dublin (-8.7 percentage points) and Paris (-10.4 percentage points).

### Location Factors at a Glance<sup>3</sup>

Despite the success they have all had, the above averagely growing European cities strongly differ in several respects, e.g. regarding their population size, population density and whether or not they are a capital. Helsinki and Amsterdam are smaller European cities while Madrid with a population of 5.8 million and London with 7.3 million inhabitants are among to the biggest European cities. Nevertheless, although each city has its individual profile and combination of location factors which contributed to economic success,

<sup>3</sup> This overview of location factors is based on a detailed analysis of location factors in European cities in: M. Bräuninger, S. Stiller: Europas Beste – Vorbilder für deutsche Metropolen im Standortwettbewerb?, published by HypoVereinsbank in 2005.

<sup>4</sup> This result is confirmed by an internationality ranking of European cities according to which London is 2nd, Amsterdam 3rd and Madrid 4th with regard to internationality. C.f. C. Rozenblatt, P. Cicille: Die Städte Europas – eine vergleichende Analyse, Bundesamt für Bauwesen und Raumordnung (ed.), series, No. 115, Bonn 2004.

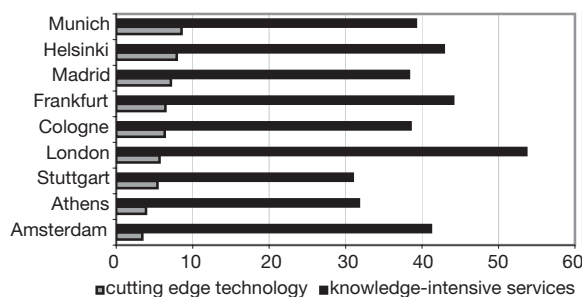
common features can be found for Europe's top metropolises. These characteristics are highly relevant location factors for all European cities and are developed especially strongly in Amsterdam and London and – in most aspects – also in Frankfurt and Madrid:

- high internationality (high international integration of the city's economy, attractiveness as a tourist destination, good integration into international traffic flows etc.);<sup>4</sup>
- the role of the city as a national mainport with international airports of outstanding importance within Europe;
- the major role played by the finance, transport, commerce and communications sectors and the tourist industry in a city's economic performance;
- the outstanding national (e.g. in Amsterdam) and international (in London) relevance of their stock markets;
- the high proportion of foreign nationals in the population;
- continuous population growth.

Currently, the most economically successful European cities are marked by distinctly different sector structures. Some of them (e.g. Amsterdam, London and Copenhagen) exhibit a far higher than average importance of the services sector for the city's economic performance and employment record (cf. Figure 3). However, cities' economic success does not necessarily depend only on an expanding services sector. In contrast to Amsterdam and London, where about 90% of national business life revolves around the services sector, Helsinki (still) has a relatively broad industrial base which is crucial to development. The outstanding economic success of Helsinki during the past ten years is closely related to regional clusters of skill-intensive industries and knowledge-intensive services concentrated around Nokia. There is a close correlation between Helsinki's economic success and the city's structural change towards a knowledge-based economy and society. Education, science, research and technologies form the basis of the economic success of the Finnish metropolis. The conditions prevailing in Helsinki as a business location include:

- its good record on R&D and human resources expenditure within Europe;

**Figure 4**  
**Employment in Knowledge-intensive Industries, 2006**  
 (% of total employment)



Source: Eurostat.

- its high ranking in Europe with regard to the population's level of education and the qualification level of the working population;
- the well-advanced specialisation of the economy in knowledge-intensive services and industries;
- the agglomeration of R&D facilities and users of new technologies such that the "critical mass" for the development of clusters has been reached and proximity and information spillovers can be profited from particularly well.

Like Helsinki, cities such as Madrid, Munich and Stuttgart – and to some extent also Cologne – have a broad industrial base and specialise in skill-intensive industries which contribute to job growth (cf. Figure 4). Their high performance is documented in the European Innovation Scoreboard in which Munich is ranked at position 3, Helsinki at position 4 and Stuttgart at position 6.<sup>5</sup> The greater Madrid area is the leading innovation region in Spain. Additionally, the education level of employees in these cities is distinctly higher than the average in the respective countries, constituting the basis for the development of knowledge-intensive economic branches.

#### **Structural and Demographic Trends Impact Cities' Perspectives**

All in all, it can be ascertained that while Europe's most successful cities exhibit different structures they show some decisive similarities regarding success factors. Common to most of them is their prominent status as economic hubs and mainports within their respective economies as well as their hosting of large

<sup>5</sup> C.f. H. Holländers: European Regional Innovation Scoreboard, Trendchart Innovation Policy in Europe, <http://trendchart.cordis.lu>, 2006.

universities. A relatively high proportion of foreign nationals and a high labour market participation rate by foreigners are also characteristic attributes of some of the cities, e.g. Amsterdam, London, Munich and Stuttgart.<sup>6</sup> The participation of foreign workers in economic activity has potentially positive economic effects on the development of a city. Foreigners can promote innovativeness, productivity and urban growth if they can offer skills and knowledge which complement the qualifications of the indigenous population.<sup>7</sup>

The above-mentioned factors constitute major determinants of future economic growth. In addition, the future development perspectives of cities are shaped by structural and demographic changes. The advancing knowledge economy – which supports specialisation in knowledge-intensive industries and services – will be of increasing importance for city development. Especially creative activities and skill-intensive branches are believed to offer high growth potential for cities.<sup>8</sup> Regarding future economic perspectives cities offer high location advantages due to the existing agglomeration of economic activity, as the ready availability of labour and specialised services and to educational institutions.

However, continuous economic and population growth not only entails agglomeration economies for cities. Numerous strongly growing European cities – like London, Amsterdam and Madrid – are increasingly faced with location disadvantages which result from the geographical concentration of economic activity and population within these cities. These cities have above-average living costs, rents and property prices as well as an overloaded traffic infrastructure. For the future, forecasts imply that the population in Europe's leading cities will continue to grow, e.g. around 10% in London, Helsinki and Madrid up to the year 2020. These demographic trends have to be met by urban development concepts aiming at supporting the economies of agglomeration and reducing the diseconomies of agglomeration, for example by expanding the transport infrastructure and by giving over new inner-city areas to residential and commercial uses. Simulta-

<sup>6</sup> A. DameLang, M. Steinhardt, S. Stiller: Europe's diverse labour force: The case of German cities, mimeo, 2007.

<sup>7</sup> An overview of the economic impact of cultural diversity can be found in A. Alesina, E. La Ferrara: Ethnic Diversity and Economic Performance, in: *Journal of Economic Literature*, Vol. 43, No. 3, 2005, pp. 762-800. For an analysis of the relation between regional innovation outcome and cultural diversity for German regions see e.g. A. Niebuhr: Migration and Innovation. Does regional diversity matter for R&D activity?, HWWI Research Paper 3-1, Hamburg 2006.

<sup>8</sup> C.f. KEA European Affairs: The Economy of Culture in Europe, Brussels 2007.

neously, cities will be faced with the challenges of an ageing population and workforce, which will have far-reaching implications for city development and labour market issues.

### Need for Tailor-made Policies

Generally, the development of a city is the outcome of a particular combination of location factors, the economic structure and adjustments to general demographic as well as structural trends. However, there is limited scope for political initiatives at the regional level. Many factors, such as a city's geographical position or its role as a capital, which are relevant for urban development, can hardly be influenced – if at all – by political intervention. Other major factors, such as the economic and demographic structure, can only be changed in the long term. Nor can change be made in isolation. Regional policy is always a function of fundamental national parameters which either slow or accelerate economic development and decisively influence the international competitiveness of urban centres.

Analysing Europe's successful cities makes it clear that there is no patented way to success, as basic factors such as historical and local preconditions differ greatly from city to city. A strong dependency on national economic trends is in most cases also a relevant factor for cities. Very different cities succeed with different strategies in surpassing macroeconomic growth. Nevertheless, there are identifiable "main roads" that could lead to above-average growth for cities. They can make themselves fit for their economic future by continuing to concentrate on providing international service functions. London and Amsterdam are role models for such success. Both cities are writing impressive success stories by having adjusted to international demands and linking up to a globalising economy by offering highly specialised services. Another way for cities to achieve economic success lies in innovative production. Building on a strong, internationally competitive and research-intensive industrial sector, business locations have become strongly linked to the complex global production chain. Helsinki and Munich are good examples of this type of economic integration.

Despite identifiable "main roads", there is no "magic formula" for adequate policy measures at the city level. In fact, specific tailor-made policy measures are required for each city. These have to consider the regional advantages of specialisation regarding research, production and services as well as the specific endowment with production factors, e.g. the skills of

the labour force. However, regardless of the specific structural and locational conditions of each city, those policy measures will be successful which improve the overall conditions for economic development with regard to education and research, internationality, soft location factors and demographics.

In the course of the advancing change towards a knowledge society the importance of education, science and research will go on growing for European cities. Therefore, investments and policy measures relevant to this issue are of the utmost importance. Additionally, a high quality of educational institutions and research institutes contributes to the competitiveness of cities and their attractiveness for (highly) qualified labour. The consistent way in which Helsinki has pursued its aim of establishing a knowledge society is a good example of a successful regional policy of this kind.

The relatively high internationality of a city is reflected in its success in attracting labour and capital from abroad. A city's international competitiveness as a service provider for tourism, trade, transportation and traffic will increasingly gain in importance due to the expansion of these industries in the course of ongoing globalisation. A city's international economic functions, including services related to international economic activities, can be enhanced by policy measures. The improvement of the infrastructure (e.g. airport, ports and capacities for exhibitions), support for internationality in the education system and the expansion of the cultural diversity of the population and the labour force all stimulate the internationalisation of cities.

For successful participation in the international competition for highly skilled labour the importance of "soft" location factors is steadily increasing. Soft location factors include aspects influencing the quality of life, like attractive possibilities for spending one's leisure time, low crime rates and attractive residential quarters.<sup>9</sup> Additionally, the image of the education system is a highly relevant factor for attracting students from abroad. And the outstanding reputation of a scientific institution or a university is the decisive factor for the location decision of researchers.<sup>10</sup> Students and scientists from abroad play an important role in international research and business networks which

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<sup>9</sup> Cf. A. Niebuhr, S. Stiller: Zur Bedeutung von Standortfaktoren – Was macht einen Standort attraktiv für qualifizierte Arbeitskräfte und Kapital?, in: E. Hönekopp, R. Jungnickel (eds.): Internationalisierung der Arbeitsmärkte, Nuremberg 2004, pp. 233-257.

<sup>10</sup> Cf. S. Mahroum: The International Mobility of Highly Skilled Professionals, doctoral dissertation, Universität der Bundeswehr, Hamburg 2000.

might impact positively on a city's development, e.g. by stimulating innovation.

For all cities, irrespective of their economic specialisation, the endowment with qualified labour will be a crucial factor for future economic development. On the one hand, Europe's labour force will shrink due to overall demographic trends while, on the other hand, the demand for skilled labour will increase due to ongoing structural change towards knowledge-intensive jobs. From an economic perspective, the immigration of highly qualified workers is an increasingly important aspect of urban development. Generally, forecasts of the population growth in European cities are mainly

based on the assumption that they will continue to attract migrants from other regions of the country and from abroad. In this context it is important to stress the fact that the location decisions of foreigners are not only related to economic conditions but are also affected by the level of "openness" in a city.<sup>11</sup> Besides the attitude of the local population the main influence on this is the integration approach chosen by the local authorities which will – in the course of the ongoing internationalisation of labour markets and the challenge of growth impeding labour shortages – become a policy field of increasing importance in the future.

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<sup>11</sup> Cf. R. Florida: *Cities and the Creative Class*, 2004.