



PATHFINDER ECONOMIC ALERT

Urban World: Cities and the Rise of the Consuming Class

This article is based on selected extracts from an analytical study from the McKinsey Global Institute (MGI), research arm of McKinsey & Co. The goal of the research conducted by MGI is to provide leaders in the commercial, public and social sectors with the facts and insights on which to base management and policy decisions. MGI research combines the disciplines of economic and management, employing the analytical tools of economics with the insights of business leaders.

Current research focuses on six themes: productivity and growth, financial markets, technology and innovation, urbanization, labour markets and natural resources.

The Pathfinder Foundation (PF), believes that the local urban city planners and urban development authorities with a long term perspective and vision will be benefited from studies of this nature.

Those who wish to receive further information may visit <http://www.mckinsey.com/insights/mgi>

A wave of urbanization propelling growth across emerging economies is a welcome fillip for a world economy that continues to have pockets of acute fragility. Cities have been the world's economic dynamos for centuries, attracting skilled workers and productive businesses and benefiting from economies of scale. But what is different about today's wave of mass urbanization is its unprecedented speed and scale. It is not hyperbole to say that we are observing the most significant shift in the earth's economics center of gravity in history.

The move to urban living is lifting the incomes of millions of people around the world. In cities, one billion people will enter the global "consuming class" by 2025, with incomes high enough to become significant consumers of goods and services. Around 600 million of them will live in only around 440 cities in emerging markets that are expected to generate close to half of global GDP growth between 2010 and 2025.

The incomes of these new consuming classes are rising even faster than the number of individuals in the consuming classes. This means that many products and services are hitting take-off points at which their consumption rises swiftly and steeply. By 2025, urban consumers are likely to inject around \$20 trillion a year in additional spending into the world economy. Catering to the burgeoning urban consumer classes will also require a boom in the construction of buildings and infrastructure. We estimate that cities will need annual physical capital investment to more than double from nearly \$10 trillion today to more than \$20 trillion by 2025, the lion's share of which will be in the emerging world.

How companies and governments react to this tectonic shift will fundamentally shape their future prospects. In this updated research on the urban world, the McKinsey Global Institute (MGI) focuses on the major expansion of consuming classes in cities, particularly those of emerging economies, and examines the impact of their increased demand on investment in buildings and infrastructure, including ports and municipal water supply, all using their updated Cityscope database.

THE GLOBAL ECONOMIC BALANCE IS SHIFTING TO EMERGING CITIES

Until 1500, Asia was the centre of gravity of the world economy, accounting for roughly two-thirds of global GDP. But in the 18th and 19th centuries, urbanization and industrialization vaulted Europe and the United States to prominence. We are now observing a decisive shift in the balance back toward Asia-at a speed and on a scale never before witnessed. China's economic transformation resulting from urbanization and industrialization is happening at 100 times the scale of the first country in the world to urbanize-the United Kingdom-and at ten times the speed

The recession that has hit the United States and Western Europe particularly hard has accelerated the shift in the global economic balance. From 2007 to 2010, the GDP of large Chinese cities rose from 20 percent of that of large cities in the United States to 37 percent. In these three years alone, three more Chinese cities reached megacity status with populations of ten million or more-one new megacity a year. Contrast that with the developed world, whose urban landscape is far more mature.

EMERGING CITIES: NEED INVESTMENT TO BUILD CAPACITY

The world's new urban consumers will have an impact far beyond sales of goods and services. To cater to their needs, cities will need to invest heavily in infrastructure. We estimate that cities will need annual physical capital investment to more than double from nearly \$10 trillion today to more than \$20 trillion by 2025. Urban centers in emerging economies will make most of this investment.

MGI has looked at three sectors in particular detail-building, port container capacity, and municipal water distribution.

Buildings. By 2025, cities will need to construct floor space equivalent to 85 percent of all of today's urban residential and commercial building stock. In the Emerging 440 alone, we see demand for residential and commercial floor space growing by 44,000 square kilometers. The urban building boom will require cumulative investment, including for replacement buildings, of nearly \$80 trillion.

Container capacity of ports. The capacity of ports to handle global container traffic needs to rise by more than 2.5 times from today's level to meet rising consumer demand for products across the globe. The investment needed to expand port capacity to 2025 exceeds \$200 billion by our reckoning, with 85 percent of it taking place in emerging markets.

Municipal water. We expect urban municipal water demand to rise by almost 80 billion cubic meters, equivalent to more than 20 times the water consumption of New York today and 40 percent above today's urban global level. Serving rising demand will require cumulative investment in water supply and wastewater treatment of about \$480 billion by 2025, of which about \$200 billion will be in the Emerging 440.

National, regional, and local governments, as well as businesses, need to manage the consumption and investment boom. Cities have the potential to handle the stresses well. Densely populated urban centers can use resources more productively than dispersed cities and rural areas. Nevertheless, most growing cities can do better in this regard. Cities that under-invest in infrastructure and fail to keep pace with their expanding populations and their demands-or indeed invest inefficiently or in the wrong things- can find themselves hitting barriers to growth. Conversely, if cities manage their capacity building well, there is a large opportunity not only for the world's investors but also to build more productive capacity that is less costly and more efficient in environmental terms for decades to come.

Importantly, the urban planning and infrastructure investment choices made today will determine how well cities are prepared for sustained growth after the expansive urbanization wave passes

THE POLICY AGENDA DIFFERS IN DEVELOPED AND EMERGING CITIES

Rapidly growing cities in the developing world face a complex and challenging managerial task in keeping pace with their expanding populations and their rising expectations. To avoid constraints on their growth, cities need to be able to plan the urban environment for sufficient housing and effective transportation, ensure that sufficient finance is available to support both operational and capital spending of electricity, telecommunications, water, and other services, and through smart regulation, provide an environment that encourages entrepreneurialism and business investment. Cities that fail to meet the aspirations of the millions who are migrating in search of better opportunities run the risk of congestion, pollution, and insufficient public services becoming barriers to growth. Growth has already slowed down in many megacities around the globe because they have not kept pace with the needs of their expanding populations.

This is the Thirty Sixth in the series of Economic Alert articles published by the Pathfinder Foundation. Readers' comments are welcome at www.pathfinderfoundation.org Economic Alert, Economic Flash & Economic Dialogue articles can be viewed at www.pathfinderfoundation.org you can also find us on facebook and follow us on twitter.