

VI. CITIES AND DEVELOPMENT AGENCIES WORKING TOGETHER TO FUND INFRASTRUCTURE DEVELOPMENT

Urban populations are expanding very rapidly and infrastructure needs are increasing proportionately. Yet, public sector resources are limited. Consequently, most cities are finding it difficult to expand their infrastructure fast enough to maintain even existing levels of service. However, there are several options for cities to fund their infrastructure development. This section presents two viewpoints on this issue: from the development agencies and the cities, respectively.

Mr. Keshav Varma of the World Bank and Mr. Preben Nielsen of the Asian Development Bank confirm that there is a paradigm shift in the lending policies and traditional approaches of donor agencies. Most of them are increasingly seeing themselves as partners in urban development. They recognize that they do not have more than 5 percent of their total funds for urban development, and therefore need to develop new instruments for lending. These new modalities demand much better performance on the part of local governments, and better coordination among donors.

Mayor Alvin Garcia and Mr. P.U. Asnani talk about the experiences of Cebu City, Philippines, and Ahmedabad, India, respectively, on how they were able to fund their infrastructure services and raise

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revenues through BOT, joint ventures, promissory notes, bond flotation, and support from international agencies. Cities, however, need to establish their credibility first in order to attract capitalists for local investments.

DEVELOPMENT AGENCY PERSPECTIVES

World Bank

Keshav Varma

Manager, Urban Development Sector Unit,
East Asia and Pacific Region

*We have to do
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Decentralization is taking place in most parts of the world today. This trend poses a challenge to the World Bank because as an international institution, we have to do the right job with thousands more partners (complex cities, megacities, regional cities, secondary cities), and new kinds of problems. These require the right skill mix, simplified procedures, innovative instruments, and decentralized operations in our institution. We have to concentrate on building institutions and local capacities. We have to experience and learn best practices at the local level, so that we will know how to replicate and disseminate them in other cities. We should also learn how to manage and apply at the global level, knowledge from the various experiences that we have accumulated.

In response to this challenge, we have created a new instrument called adaptable project lending (APL) because there has to be more flexibility in our lending policy. The APL permits you to continue for 20 years or more on a programmatic concept.

City Development Strategy

We have also developed the city development strategy. This is a strategy in which we partner with cities in developing long-term visions and priorities, and creating capacities that are specific to their needs. There are already 12 cities participating in this exercise, 7 of which are in the Philippines. It is a very proactive exercise, which is giving good results and providing our partners, consultants, and cities with good lessons.

When international institutions gravitate toward enthusiastic cities with credible, respected, and client-oriented leadership, there is a tendency to overlap projects and clutter resources. If you look at Ho Chi Minh in Viet Nam, you will see a progressive city that is showing great results. Because of this, the Overseas Economic Cooperation Fund of Japan (OECF), the Japan International Cooperation Agency (JICA), ADB, World Bank, and other international institutions are heading for Ho Chi Minh. I think it is important that cities also manage international institutions carefully so that they get the best out of them.

Another challenge for all international institutions is to create resource cities. Part of our city development strategy is to try and develop long-term partnerships in creating such cities. These can serve as regional demonstration centers where officials from other cities can come and see what is happening and learn from their experiences. For instance, the cities of Shanghai, Ho Chi Minh, Calcutta, and Surat can act as regional resources for other cities. I think city managers learn best from other city managers, and cities learn from cities much faster than when people from the World Bank come and give lectures and advice.

Sensitivity to environmental and social issues, especially commitment to fight urban poverty and ensure equitable growth and development, is

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another challenge. I have used deliberately the word equity because when I was looking at figures of per capita investment in the developing world, it is totally an unacceptable situation. The investment per capita in the developed world is more than 10 to 15 times that of the developing world. And we will have to invest in urban poverty, equity, and growth and development rapidly, consciously, and continuously.

Willingness to form partnerships and erect transparent frameworks to facilitate public-private sector partnerships is another important challenge because there are not many resources to really meet infrastructure requirements. For East Asia, the World Bank and the International Finance Corporation have evaluated the infrastructure requirement at about US\$200 billion per year. In the Urban and Water Sector of the World Bank, our total portfolio is only US\$4 billion of which US\$600 million is given to projects per year. The other requirements can be supplied through transparent public-private sector partnerships. I would like to emphasize transparency because in the minds of city mayors and managers, there is the suspicion that public-private sector partnerships do not necessarily lead to equity that would benefit the poor.

The World Bank and many international institutions are strongly focused on privatization to augment infrastructure requirements. In my experience, privatization is good but there is not enough private capacity in the world to take over all the available utilities. For example, the Philippines has over 1,500 municipalities; total privatization is not even 1 percent. Now, even if we expect 25 percent privatization of all utilities in the world, there would still remain 75 percent of present assets. However, we can start working on optimizing the present assets by incorporation of urban utilities. In the PRC, all water utilities and

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utilities concerning sanitation and solid wastes are now corporations, and this is working very well.

Our President recently announced that “development should not only be seen from the point of view of an engineer. Development is something more comprehensive that we should learn to go beyond projects and look at outcomes.” We have begun to integrate several facets of infrastructure investment in order to create an overall impact in the area. We have promoted the integrated provision of environmental infrastructure such as water, sanitation, drainage, and management of hazardous solid wastes.

Lessons from Projects

Let me now share some lessons that we have learned from projects implemented with our partners. One critical factor that ensures high quality of project implementation is the professionalism of the project management team, with clear understanding of development objectives. Commitment to long-term and comprehensive engagement adds value. It is very easy to work with long-term partners, for 10 years or more, because they have mastered our established procedures in project implementation. Long-term engagement also creates an incredibly high efficiency and synergy.

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Our efforts towards enhancing institutional and client capacity also lead to sustainability of projects. Good financial management practices likewise ensure quality implementation. This is another important lesson demonstrated very clearly in the PRC and Viet Nam.

Lastly, it is critically important to discuss each project with political leaders at the national, provincial, and city levels right at the beginning of the project. If they are not clear on the issues and extent of the project, you will not get their support.

In our experience, political will to ensure tariff and institutional reforms is crucial in sustaining project gains.

The city development strategy we are involved with is very interesting but complex. However, our task managers find the job much easier now than before because there are new and assertive leaders in the provincial and city governments, and new environments are emerging.

Asian Development Bank

Preben Nielsen

Manager, Water Supply,
Urban Development and
Housing Division (West)

One of the major strengths of ADB lies in its strict guidelines for planning and financing infrastructure development from both the public- and private-sector perspectives.

Urban agglomerates have become increasingly important to national economic development strategies but necessary investments have typically not kept pace with demand for urban services, generated by urban population growth and a rise in incomes of the middle class. However, this situation is changing with the increasing awareness of the complexity of the urban development challenge, which requires not only massive investment in physical infrastructure but also greater emphasis on the means for achieving more sustainable and equitable urban development. This is the context for ADB's involvement in urban development today. One of the major strengths of ADB lies in its strict guidelines for planning and financing infrastructure development from both the public- and private-sector perspectives. ADB can build on its strengths to further benefit developing member countries, to improve the efficiency of allocation of resources for the urban sector, and to speed up service delivery.

The funding gap for urban development is ever increasing in the face of population growth and deteriorating existing physical structures. The nature of this funding gap can be illustrated by a quote from our recent India Urban Sector Strategy.

In addition to serving as a major constraint to economic growth and productivity, the lack of adequate investments in urban infrastructure, municipal services, and housing is not without social ramifications, especially for the urban poor. According to some estimates, as much as 30 percent of the urban population lives below the official poverty line; the Planning Commission's most recent estimates indicate that the percentage of population below the poverty line in urban areas was 32.2 percent in FY1993/1994. In the 23 cities with populations in excess of 1 million, approximately 28 percent of the people live in slums. The slum population increased from about 28 million in 1981 to about 51 million in 1991 and is expected to exceed 100 million by 2000. The health and environmental implications, sprawling slums, and households' lack of access to potable water, sewerage, drainage, sanitation, and waste disposal facilities are staggering.

ADB'S Role

Now, what can ADB do to help? It can provide not only financing but also advice from its resource base on governance and institutional development and cost-recovery measures.

In view of our President's recent declaration that poverty reduction is ADB's overarching objective, we are redesigning our catalytic tools. It is well recognized that attacking poverty has to be from several fronts. One area, of course, is stimulating economic growth, which in East Asia earlier led to substantial reduction in poverty. However, in southern Asia, the economic growth model has not worked well and poverty pockets have expanded. There, it may be better to intervene with direct poverty-reducing measures such as a combination of physical infrastructure like water, sanitation, and paved footpaths, with streetlights, social infrastructure like health clinics, CBOs, education, etc., and income-generating measures such as skills training, job advisory consolidation services, and microcredit.

A major challenge of urbanization is to improve economic efficiency and productivity while concurrently reducing poverty and facilitating greater equity. More direct targeting of the poor will be done by ADB with slum improvement programs based on integrated packages of social, economic, and physical improvements. Access to safe water supply, investments in education, health, and population programs focusing on reproductive health are likely to give rise to clear and substantial social and economic developmental returns.

In Bangladesh, India, and Pakistan, ADB is actively involved in slum improvement, particularly in secondary towns or cities. Slum networking and twinning arrangements with exchange of information on impact are aspects strongly supported by ADB. I recall a slum improving project that we attempted in 1997 in Dhaka, addressing the livelihood of about 400,000 squatters on government land. We worked on that project for three years but in the end we utterly failed because the government was not in a position to provide a 10-year non-eviction assurance. This direct

intervention could have uplifted the lives and spirits of the beneficiaries and given them peace of mind to actively pursue employment opportunities. I take this example because although we failed, we realized that we should have dealt directly with the government in promoting the issue of poverty reduction.

In connection with its lending modalities, ADB has advocated strong governance at the local government level. Examples are our urban development and housing projects in India. In these projects we built on the 74th Constitutional Amendment Act, which supports institutional and financial decentralization from the central government to the states and subsequently to the municipal corporations. The reform-minded Indian states we worked with were Karnataka, Rajasthan, Gujarat, West Bengal (in Calcutta, the city of joy), and Madhya Pradesh. In most of these, state finance commissions have been established to empower local governments (through empowered committees and urban development finance corporations) to make decisions concerning local resources and state loans or grants. In other states, we provided technical assistance to form such finance bodies and build local capacity in accounting and human resource development. Similar measures have been undertaken by ADB in Sri Lanka and Nepal. Also in Laos, decentralization is taking place in an orderly manner with the establishment of urban development administrative authorities, which after a learning period will become fully-fledged municipalities.

Public-Private Sector Partnerships

ADB cannot finance everything because of its limited resources, so our contribution on a national scale is like the famous drop in the bucket. Therefore, we

are advocating public-private sector partnerships such as for Kathmandu and Colombo. To protect the poor from excessive charges for water, we advocate provision of a discount up to a certain consumption level. In Kathmandu, the private-sector management contract would be based on a share of profit as well as performance-based bidding criteria.

For water supply systems, which could be privatized, we advocate establishment of independent regulatory agencies with not more than five members. These agencies should have the capacity to contract services to the private sector for monitoring the performance of private utility providers and administering government water-supply policy. This policy would include tariff-setting mechanisms, public hearings, and community and NGO consultations. Public relations campaigns would be also required. Examples are the newly formed Regulatory Water Supply and Wastewater Authority in Lao PDR, which is receiving strong ADB support. Such support is also extended to Karachi and Colombo. In Colombo, no decision has yet been reached on the private-sector contract modality. However, it could be a clean private-sector management contract on a fee basis with a local contractor in association with a foreign tie up, if required, and chosen through public bidding. We also expect performance-based bidding criteria in Colombo.

For securing financing for solid waste management schemes, we advocate that the private sector run the sanitary landfill sites, bulk transport, and transfer stations, while the local councils operate collection services with CBO and NGO support.

In the wastewater management sector, where our biggest project is in Samut Prakarn Province, Thailand, we advocate the "polluter pays" principle. In practice, this means that everybody pays a flat rate, an environment charge if you like, through the municipal taxes, plus a surcharge on the water bill if

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you are connected to a sewer, plus a biochemical oxygen demand (BOD) charge related to industries; a standard BOD is measured by category of manufacturing process. By the way, in Samut Prakarn, all underground construction is by tunneling using sophisticated drilling robots and pipe-jacking to avoid open trenching and the resulting traffic chaos, as well as delays caused by resettlement and unforeseen events. The tunnel machines do not strike and work 20 hours a day churning the soil. In Calcutta, where we have just started a study, we may agree with the government to use such machines and avoid resettling 50,000 people.

Other financing modalities include direct user charges, bond issues if credit worthiness is established, and lending from insurance companies, pension funds, and other financial institutions.

ADB has basically three public-sector windows: the Ordinary Capital Resources and Asian Development Fund with current interest rates of close to 6 percent and 1–1.5 percent, respectively, and 25–32 years to pay including grace periods; in addition to market-based lending at LIBOR or SIBOR rates (London or Singapore interbank overnight rate). The private-sector window provides funds for viable private-sector projects of considerable size with both equity and lending. In all cases, the Ministry of Finance or equivalent is the interface for ADB operations. Loan projects need to be approved at the national level before ADB can consider them.

CITY PERSPECTIVES

Cebu City, Philippines

Alvin B. Garcia

Mayor, Cebu City, Philippines

The need for infrastructure is really a chicken-or-egg question. Do you need the infrastructure first, or do you need some kind of development before you put up the infrastructure? Regardless, there is a need to fund infrastructure development to realize the socioeconomic development objectives of cities, whether they are as simple as farm-to-market roads or postharvest facilities, or as complex as a light railway transit, an overpass, or road-widening.

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For the period 1999–2004, Cebu City will require more than US\$330 million to finance major infrastructure projects. These major infrastructure requirements include roads, bridges and transportation, water and environmental projects, telecommunications, power, housing, and property acquisition. At present, we have a 300-hectare reclamation project in the city, which is being covered by a loan from OECF. We are also working with a Malaysian company through a BOT scheme on a dam project to produce about 100,000–150,000 cubic meters of water. Another important undertaking is the waterfront development project. This is an urban renewal project where we are trying to save the port area from becoming an industrial slum, in the tradition of Fishermen’s Wharf in San Francisco or Darling Harbor in Sydney. This is the vision that we have and this would need a lot of financing.

In your country and mine, one of the traditional sources of funds is the national government’s block grant. We have local revenues from business taxes, mayor’s permit fees, real property taxes, and amusement taxes. Local

revenues constitute more than 50 percent of our fund sources. We also have a share in the internal revenue allotment, as well as funds from the Countrywide Development Fund, President's Social Fund, bank loans, and development assistance from donor agencies.

For obvious reasons, local government units have relied mostly on their share of national government wealth. However, this has proven inadequate in responding to their increasing needs. Innovative financing schemes are necessary, and one such scheme is BOT, which I will discuss extensively here.

Innovative Financing Schemes

BOT is a major source of development assistance in Cebu. It is a contractual arrangement between the government and private sector whereby the private sector finances, constructs, and in some cases operates and maintains a facility or project. The private proponent is allowed to charge user fees to recover investments through tolls, fees, rentals, and other charges from facility users for up to 50 years. The project proponent also recovers investments through shares in project revenues, and nonmonetary payments. Government and private proponent share project risk.

In the Philippines, the sectors that are allowed to undertake BOT include power plants, highways, roads, railways, toll roads, ports, airports, transportation systems, telecommunications, information technology, canals, dams, land reclamation, sewerage, drainage, tourism estates, health facilities, etc. The level of authority needed to approve a scheme depends on the cost of the project (Table VI.1). In Cebu City, projects being undertaken under BOT are the waterfront development project, the waste management and

sewerage system, and development of the Mananga and Lusaran dams.

We have also used joint ventures, in which the local government unit puts up a certain property that another company develops. Many of you were in Cebu last year and you stayed at Marriott Hotel. Marriott is located at the Cebu Business Park, which was a joint undertaking of the Cebu Provincial Government and Ayala Land Corporation. The parties infused P1 billion to develop that area, which used to be a 50-hectare golf course that was not earning anything for the provincial government.

Table VI.1. BOT Approval Bodies for Local Government Projects

Cost of Project	Approving Authority
Up to P20 million	Municipal Council
P20-50 million	City/Provincial Council
P50-200 million	Regional Development Council
Above P200 million	National Economic and Development Authority

The city government has issued promissory notes to build socialized housing projects, before they can proceed with the project. The Philippines may be unique in having a national law that requires real estate developers to allot for socialized housing purposes, 20 percent of the total cost or 20 percent of the area being developed in a project. The city has to certify that this requirement has been accomplished. The result is that most first-class subdivision estate developers do not want to proceed with such projects. The city is offering to developers the choice of depositing the required

amount with the city, whereupon the city will undertake the socialized housing work. We give promissory notes to this effect to the developers.

Other innovative schemes that we have implemented are economic enterprises and donations through sister city networks. We expect to earn US\$1.43 million this year through economic enterprises such as the Pardo Public Market, while donations from sister cities worldwide complement our efforts in meeting infrastructure needs, including school building improvements and transport facilities.

I would like to focus the last part of my presentation on the characteristics of official development assistance (ODA) or soft loans and how they can be reformed to become more responsive to the needs of local governments.

ODA is generally oriented towards the national or central government. Donor agencies cannot provide direct loans to a municipality or city without the approval of the national government. For instance, I was given a grant by JICA for night-soil treatment but our central government turned it down because they said that the City of Cebu had a lot of ODA already. However, it cannot be given to another city because of the absence of prefeasibility studies, which is another requirement. ODA should be more autonomous so that donors can make decisions without central government interference. To address the issue of prefeasibility requirements, perhaps the ODA playing field should be leveled by first building the capacity of each municipality or city for project development and preparation before any ODA or financial window is opened to LGUs.

Lastly, I am proposing an ODA fair in the future where all funding agencies (ADB, World Bank, JICA, OECF, CIDA, etc.) can get together and present their grants/loans portfolio to LGUs, which can then develop appropriate project proposals for

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submission to the donor agencies. Under your guidelines, I can organize this ODA Fair.

Ahmedabad, India

P.U. Asnani

Vice President, City Managers' Association of Gujarat and Director, US-Asia Environmental Partnership, Ahmedabad, India

The process of urbanization in Asian countries is creating a very serious problem for urban managers and district authorities, for the principal reason that the rate of urbanization is so fast that infrastructure development cannot keep pace with development. This has resulted in chaos in urban areas in terms of environmental pollution, traffic congestion, lack of water supply and sewerage services, and very poor infrastructure for solid waste management.

Local bodies have to tackle these problems themselves. They cannot depend on central or state governments and they cannot put out their hands further than the higher authorities. The urban local bodies should set their house in order, raise financial resources through the improvement of internal finances, and create an internal capacity to enable them to access the market to finance infrastructure development.

I will share with you the way that the Ahmedabad Municipal Corporation turned its finances around to raise funds for infrastructure development.

The city of Ahmedabad is a very old city. It is the seventh largest city in India, with a population of 3.2 million on an area of 190 km². It suffered a serious financial crunch from 1984 to 1994, when it had a Rs220 million (US\$6.28 million) overdraft, and had accumulated cash losses of Rs350 million (US\$10 million). During that time, the elected body

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was superceded and all executive powers were vested in the Municipal Commissioner.

Eighty percent of the Ahmedabad Municipal Corporation's income is derived from *octroi* collections and property taxes. Octroi collections are levied on goods imported into the city while property taxes are levied on both residential and nonresidential properties. Unfortunately, the collection rate was very bad because antisocial elements were bringing goods into the city without paying the duty, and most properties were not taxed because they were not on record.

Setting the House in Order

We felt that raising taxes could not solve the problems of the city. The first and foremost thing was to set the house in order and this we did by adopting the following strategies:

Octroi collection

- Antisocial elements engaged in octroi evasion were arrested with the help of the police department.
- A market-research cell was developed in the octroi department to prepare valuation books on the basis of prevailing market rates so that all goods were properly valued and assessed with the help of chartered and cost accountants.
- A system of random physical verification of goods entering the city was introduced to prevent under-invoicing and under-valuation of goods.
- Thirteen additional vigilance squads were introduced for round-the-clock checking of vehicles entering the city.

- All octroi check posts were equipped with wireless telecommunications systems for rapid communication.

Property tax collection

- A series of coercive measures was taken against property tax defaulters.
- Water supply and drainage of defaulters were disconnected.
- Warrants were issued for attachment of movable and immovable properties.
- Properties were put to auction for tax recovery.

Table VI.2. Comparative Increase of Octroi and Property Tax (Rs million)

	1993-1994	1996-1997	% Increase
Octroi	132	227	72
Property tax	47	94	100

Only one week after taking these measures, the city's income went up by 50 percent. After a month, the income went up by 100 percent.

Only one week after taking these measures, the city's income went up by 50 percent. After a month, the income went up by 100 percent. The recovery of property tax also increased substantially. The comparative figures of both octroi and property tax in Table VI.2 show the results. For the first time in 10 years, the Corporation registered a surplus, and by 31 March 1995, the Corporation's 10 years of accumulated deficits and loans were paid out. I must say that the credit goes to Mr. Keshav Varma. He was the Commissioner of Ahmedabad during that time, when the city experienced a massive transformation.

Table VI.3. Project Profile of the Ahmedabad Municipal Corporation

Project	Cost (Rs million)
Bridges and Flyovers	50
Roads	38
Water Project	310
Drainage Project	50
Solid Waste Management	10
Pay-and-Use Toilets	10
Narmada Linkages (water charges)	130
TOTAL	598

Immediately after realizing financial improvements in the Corporation, we started corporate planning. In India, most mayors are transferred or changed every year so they think of only a one-year plan. We decided to prepare a five-year plan for the city with a budget of Rs598 million for development projects (Table VI.3), which the Council unanimously approved.

In spite of our improved finances, we thought that they would not be adequate to carry out all developmental activities. We decided to access loans and grants from government, financial institutions, and debt markets, and undertake privatization. The money from our accumulated surpluses was used toward debt servicing.

When we decided to access the debt market, we had to show that we were able to repay debts. The Corporation received very good technical assistance from USAID to obtain a credit rating. We enlisted the services of a credit-rating agency to assess our inherent strength and financial position.

The city of Ahmedabad was the first in South Asia to obtain a rating of A+.

The rating was based on the financial soundness of the Corporation, its organization structure and management, the economic scenario, analysis of projects and project reports, and proposed payment mechanism.

The city of Ahmedabad was the first in South Asia to obtain a rating of A+. After six months, the rating was improved to "AA", which did not require an external guarantee because the rating was higher than that of the government. At that time, the Corporation went to the debt market to raise US\$25 million for its infrastructure development through municipal bonds. Details are given in Box VI.1.

The municipal bonds were issued on 16 January 1998 and closed on 27 January 1998. The response from the 5,106 investors was overwhelming, which was a manifestation that the city had established very high credibility in the eyes of the people. The amount that we received was more than we wanted.

Ahmedabad is one of the few cities in India today where the annual budget exceeds Rs10 billion. On this budget, the city is operating a wide range of municipal services, including water supply, sewerage, city transport, medical services, and medical education. All these activities are in the fold of the urban local body, which is managing them from its sources without any government funding, loans, assistance, or grants.

Our experience has shown that it is possible for an urban local body to raise finances from internal resources by improving its internal management system .

Box VI.1. Terms of the Ahmedabad Bond Issue

Issue size:	Rs1 billion, of which Rs750 million is on a firm allotment basis
Underwriting commitment:	Net public offer of Rs250 million fully underwritten
Face value:	Rs1,000 at par
Redemption:	In 3 tranches of Rs333, Rs333 and Rs334 at the end of the 5 th , 6 th , and 7 th year, respectively
Interest:	Interest @ 14% per annum payable semi-annually on the outstanding principle
Deemed date of allotment:	1 February 1998
Credit rating:	AA
Security structured:	Charge/mortgage on Corporation properties
Structured obligation:	Escrow on octroi revenues of the Corporation