

Theme Paper

URBAN POLICY PERSPECTIVES IN THE CONTEXT OF MARKET REFORM

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Urbanization is strongly linked to economic growth. Economic growth gives rise to the human and economic resources needed to deal with large-scale sectoral and demographic transformations. Towns spring up in the countryside, and megacities appear in virtually every medium-sized to large country. Rapid urbanization can be overwhelming. It can lead to the proliferation of slums and squatter areas as well as an unhealthy environment. It requires improvements in urban governance, management, and finance.

We live in a world where communications, transportation, and technology are becoming cheaper and better. Their progress drives global economic expansion, offering the world's cities new opportunities, but also threatening them. To survive, cities must now become internationally competitive by (i) constantly improving the cost and quality of inputs and infrastructure; (ii) fostering a healthy legal, institutional, and regulatory climate; and (iii) and promoting a public sector that is accountable, transparent, and upright.

Now more than ever, it is important that individuals, firms, and governments adopt best practices and set performance benchmarks.

CROSS-COUNTRY BEST PRACTICES

Cities all over the world respond predictably to incentives or disincentives for the following reasons:

- All cities trade about 40 percent of their output across regions.
- Trade prices reflect world prices, while workers are paid wages that vary according to the local technologies utilized.
- Wages of nontrade-sector workers such as retail clerks and bus drivers are positively correlated with wages in the traded-goods sector.
- Prices of nontraded commodities such as urban infrastructure and real estate development vary, less because of technology and more because of workers' wage levels.

In urban infrastructure and real estate development, the output price should be similar to input price so that the range of development solutions offered to the local population is narrowed down to essentials and common solutions are identified. Comparative urban studies are useful to show how variations in the policy environment result in extraordinarily different performance indicators and behavioral responses among cities.

URBAN STRATEGIES IN THE ASIA-PACIFIC REGION

Urbanization in the region is strongly linked to growth of gross domestic product (GDP). Although the region is only 30 percent urban, the experience of countries such as the Republic of Korea suggests that urbanization will accelerate rapidly. The Asian Development Bank (ADB) expects that half the region's population will live in cities by 2025.

Such rapid growth assumes general macroeconomic stability and economic and demographic growth rates. The Asian financial crisis of 1997-1998 was an example of a periodic economic slow-

down, but it proved to be temporary. Nevertheless, such crises create disruptions requiring macroeconomic and microeconomic interventions to protect the poor and to maintain infrastructure spending as tax revenues fall.

The region's urban settlements are of all sizes, from extended metropolitan regions 50-100 km in diameter to secondary cities and towns that promote spatial dispersal. They support important rural-urban linkages and are responsible for 80 percent of the region's growth.

Urban settlements play different economic functions and bring together dense networks of people and firms. On the supply side, they are supermarkets for productive inputs, including service and labor. They share some features of universities, helping to generate and disseminate knowledge and skills. Their population's purchasing power creates large markets and promotes efficiencies in the scale of production and marketing. Shifting demand patterns induce product innovation, further fueling growth. Cities and towns have many other features, including a degree of specialization dictated by settlement size. Overall productivity and income per capita are higher in the largest centers, but so are costs. Expensive land and housing, and the investments needed to remedy congestion and pollution, encourage big urban centers to "expel" lower value-added activities that can be produced in smaller centers at a lower cost. It is important that public policy foster such behavior, as it promotes alternative poles of development.

CITIES AND MARKET REFORMS

Because of definitional difficulties in classifying areas as urban or rural, the urbanization level in the People's Republic of China (PRC) is not easy to determine. This paper assumes that the country has about 380 million to 400 million urban dwellers, an annual growth rate of about 4 percent, and consistent and rapid economic growth averaging 7-8 percent per annum. With a per capita income of around \$900, the PRC's experience is similar to that of other coun-

tries in the region. However, its urbanization rate is about 30 percent, and at this pace the PRC will be largely urban as early as 2015, well ahead of the region as a whole.

The growth of individual urban areas varies enormously, as does the size of human settlements. Three urban regions have populations in excess of 10 million: Greater Shanghai; Beijing-Tianjin; and Greater Guangzhou. At the other end of the spectrum are the statutory towns, whose populations typically range from 20,000 to 100,000. Partly because of administrative practices controlling population movements, smaller centers grow more rapidly than very large ones. An extended metropolitan region population may grow by 1 percent per year, while the population of many towns grows at double-digit rates. The 81 cities with more than 500,000 inhabitants account for less than 20 percent of annual urban population growth; the 587 smaller cities account for another 40 percent; the 18,402 towns, home to around 100 million people, account for the remaining 40 percent.

Disparities in growth rates partly reflect the evolving nature of the urban economy. Ownership patterns are difficult to gauge, but it can be assumed that 55-60 percent of GDP is in the hands of the non-State sector. The non-State industrial sector represents 70 percent of annual GDP. A historical legacy of the last 50 years, the State sector is saddled with politically appointed managers, overmanned enterprises, heavy welfare responsibilities, high levels of bank debt, and obsolete equipment.

The PRC's market reforms begun two decades ago tend to leave these problems unresolved while encouraging the non-State sector—including foreigners—to operate within a market framework. State-owned enterprises (SOEs) generally tend to cluster in cities, surrounded by non-State enterprises whose weight is progressively greater the smaller the settlement size. Reforms in enterprise governance will tend to erase distinctions based on ownership patterns, but only over time.

The last 20 years have brought many reforms. One of the most significant is local autonomy in decision making and control of local revenues. As a result, Chinese cities now boast better infra-

structure and buildings than most cities in countries at similar levels of economic development. More remarkable is the fact that the improvements are preceded by two decades of virtually no urban construction.

Yet, while urban construction investments average a high 10 percent of local GDP, much remains to be done. For example, air quality is poor in industrial cities, mainly due to domestic and industrial burning of coal, which generates sulfur dioxide and suspended particulates. As more and more people own motor vehicles, high levels of nitrogen oxide have also become a problem.

While the PRC rivals industrialized countries in water consumption, its level of water pollution is high. It has a shortage of fresh and raw water resources, and distribution system losses are probably much higher than the official 10 percent average rate. Water shortages are worsened by the dumping of sewage and wastewater, untreated or partially treated at best, into surface and groundwater bodies.

While most industrial sewage is partially treated, most domestic sewage remains untreated or inadequately treated. Forty percent of urban areas have no sewerage systems; where systems do exist they are often ineffective. Two thirds of municipal treatment plants either do not operate or operate below capacity, principally because of inadequate funding.

Solid waste is also a problem. Investment in treatment plants is declining. Landfills and other storage areas are often inadequately designed and managed, causing ground- and surface-water pollution.

Urban traffic congestion has worsened. Road space per capita is low and urban public transport suffers from insufficient capacity. Now that economic growth and transformation have ushered in the age of suburbanization, urban transport must be developed for the metropolitan, long-distance commuter.

Finally, while a massive effort has long been underway to build urban housing, much shelter is unaffordable without heavy subsidies, especially in larger urban centers. The needs of migrant workers, who may add 10-20 percent to the local population, go unattended in the formal housing market. The housing problem will be

worsened by the urban poverty brought about by ongoing economic restructuring.

All these problems are complicated by rapid population growth.

GENERAL STRATEGIES FOR REGIONAL SUSTAINABLE URBAN DEVELOPMENT

Institutional, Legal, and Regulatory Frameworks

Urban settlements in all countries operate within a given institutional, legal, and regulatory framework. Regions can choose from a wide range of solutions. Some countries have federal systems, with well-defined local government rights; others such as the PRC have unitary systems, where the central Government determines the degree of local autonomy.

All countries have elaborate and varied legal and regulatory systems. Some openly embrace privatization of public services. Many differ on the level of public disclosure of public activities, for example, and the degree to which community participation is mandated. The diverse systems provide a menu of alternative strategies.

Urban Governance

Successful urban governance is guided by four basic principles: (i) accountability of public sector staff; (ii) community participation; (iii) predictability of laws and regulations in terms of contract law, dispute-resolution procedures, and clear allocation of responsibilities; and (iv) transparency in public-private dealings.

The decentralization and devolution occurring across the region strengthens the links between providers and users of urban public services. However, accountability does not come easily, and local resources and management capacity are often inadequate to the task.

Decentralization goes hand-in-hand with vertical and horizontal coordination. The central Government remains responsible for the legal and regulatory framework and for assigning responsibili-

ties across different levels of Government. Horizontal coordination is needed not only within each level of Government but across jurisdictional boundaries, as in Metro Manila and the Jakarta Metropolitan Region, for example.

Governance has also improved in the area of community participation. At one level, community participation requires urban governments to operate openly, even in urban planning, and to actively seek its citizens' inputs. It also requires them to pay attention to issues involving the politically weak.

The region's urban poor face difficulties in competing for essential services and acquiring shelter. They need access to education, credit, legal land tenure, and better services. Private sector involvement in local services requires, first and foremost, developing an understanding among government officials that the services are essentially commercial in nature and are therefore operated based on market approaches. Candidate services include water, public transport, markets, and solid waste management.

Finally, it bears underlining that strong local governments are critical to better urban governance. Proper institutional, legal, and regulatory frameworks are not enough; urban reform requires the active participation of local governments. Even in partnership with private sector providers, local governments must still possess the skills and resources for planning, monitoring, and finance.

Urban Finance

Adequate urban finance is critical to the success of urban reform. The scale of municipal infrastructure requirements is growing rapidly. ADB estimates that \$38 billion were spent in 1998, but that \$292 billion will be needed by 2020 to sustain urban productivity and improve the quality of life. Yet, tax capacity is weak, user charges are widespread but low, and localities are dependent on uncertain upper-level transfers.

Many steps merit review. As noted, various public services can be treated as commercial in nature. Marginal cost pricing must reflect the costs of additional capacity along with fees to cover op-

erations, maintenance, and environmental damage control. For the poorest consumers, there are ways to create targeted cross-subsidy programs that leave the overall commercial thrust intact.

Along with direct-cost recovery, there is a need to examine the potential to increase indirect taxes that capture some of the value-enhancing contribution of public services to landowners. Unlike their counterparts in Asia, the PRC's local governments make limited use of this option.

Finally, local public utilities, if properly commercialized, can become candidates for longer-term financing. They would be able to borrow funds from banks or issue bonds. Transparency is a critical element. The financial viability of the entity involved must be beyond doubt. Credit-rating services must be developed to ensure it.

Improving Urban Management

The first step in improving urban management is institutional strengthening and capacity building. The roles and functions of each Government level and the rules for private and community participation must be clearly defined. Cross-sector coordination issues must also be addressed.

Governments should enable rather than provide role definition. They should (i) set policies and priorities, (ii) monitor private providers of public services, and (iii) control negative externalities such as pollution and congestion.

Key Urban Sector Issues and Regional Experience

Regional experience suggests various ways to tackle urban issues in Asia. The following is a summary of generic prescriptions worth examining.

URBAN INFRASTRUCTURE AND ENVIRONMENT

Expenditures in urban infrastructure and environment must be maintained. Demand management is crucial to the success of

any strategy. Existing environmental regulations must be monitored and enforced. User charges can be significantly increased to cover the costs of operating existing capacity, enhancing capacity, and controlling environmental degradation. Public utility companies can operate on a commercial basis, which requires increasing user charges and imposing new fees on polluters. Fuel taxes can be increased in order to decrease urban congestion.

URBAN LAND MANAGEMENT

One problem of urban land management—scattered and environmentally unsound peri-urban development—is reviewed below. Another issue, however, is the fact that land and property in core city areas are not traded or redeveloped as often as they should be. In other words, although some neighborhoods are preserved, most are not put to their maximum and best use.

Macroeconomic reform of SOEs should be combined with the implementation of local enabling measures. In larger cities, especially, additional measures should be taken to foster urban redevelopment. Reforms will allow expanding sectors and firms to move into new space while adequately compensating users of vacated obsolete space.

Why doesn't this process happen spontaneously? The reason is poorly defined property rights. Most land in cities, even the most advanced, is held in the form of very limited land-use rights. It cannot be freely transferred or mortgaged. The transition to a land-lease system with ample property rights is expensive and time consuming. However, in city centers filled with polluting factories or low-density housing of no particular cultural or historic value, the transition is worth attempting.

Another facet of urban management concerns the institutional aspects of environmental control, particularly strengthening urban environmental management systems. It includes (i) promoting close coordination between central and local agencies, (ii) requiring environmental impact assessments of all major urban projects, (iii) adopt-

ing environmental audits, and (iv) integrating environmental concerns into spatial planning.

Governments can take the following steps:

- Allow greater institutional autonomy and private sector participation wherever possible.
- Improve financial management. Tariffs should fund operations and management expenditures, finance debt servicing, and contribute to invested capital.
- Use benchmark or performance indicators to evaluate public service companies' work.
- Maximize the benefits of existing infrastructure. In transportation, for example, give priority access to public vehicles. Spend enough on recurring maintenance to preserve the value of invested equipment until it becomes obsolete and must be replaced.
- Use new investments to target multiple objectives such as guiding city expansion into preferred areas and away from environmentally sensitive zones.
- Seek longer-term financing for long-lived assets once commercial criteria are adopted and user charges reflect full cost recovery.

Other advice involves housing, which, in the urban sector of the PRC, has institutional characteristics rarely found elsewhere in Asia. In small cities and towns, most residents own their homes, which they have built or otherwise acquired on their own. In larger cities, sale of SOE-owned apartments at subsidized prices, together with the sale of commercially priced commodity housing, is boosting homeownership. Yet many households still rely on heavily subsidized commercial rental housing. Even if all rental housing were virtually given away, the problem of who pays for tomorrow's housing would remain, raising issues such as the high cost of formal housing in large cities.

Local governments might well be forced to provide residential land and connective infrastructure at concessional prices, re-

covering the losses from recurrent charges on land and property from all owners and marking a shift away from the policy of collecting fees from owners all at one time.

The Government must actively anticipate social housing policies. The ongoing restructuring of SOEs in larger cities is making tens of millions of workers redundant. How will their future housing needs be met? The answer is not obvious, especially since the central Government and local governments do not approve of informal settlements, where housing is developed incrementally. Governments might have to subsidize formal settlements where space and amenities are limited.

Social housing policies form part of the PRC's larger initiative to deal with urban poverty. For decades, the country could boast that it had little urban poverty. Now those days are over, as economic restructuring takes place in the context of continued urban growth.

CROSS-JURISDICTIONAL COORDINATION

Problems arise when urban growth spills over from one jurisdiction to another. In the PRC, urban development is often peri-urban. A low-growth metropolitan core area is often surrounded by smaller cities and towns growing at much higher rates. Two problems can be identified:

- Environmental degradation. Peri-urban development is not environmentally sustainable.
- Dispersed, low-density urban development. It consumes valuable land that the Government wishes to preserve for agricultural use.

Coordination may take various institutional forms. For example, most rural areas are now nominally supervised by a large city or metropolis. Supervision powers can be augmented to include active planning, monitoring, and enforcement.

Under the same rubric of cross-jurisdictional coordination, more should be done to improve rural-urban linkages. Rural settlements must rely on a network of urban centers, particularly towns, through which they can obtain inputs and new technologies as well as sell outputs, and increase nonagricultural employment. The China Center for Town Reform and Development is one vehicle that promotes rural-urban integration.

At the local level, a “strong mayor” system guarantees a reasonable level of coordination. At the central level, however, there is no unified urban “voice.” Various agencies such as the Ministry of Construction, the State Planning and Development Commission, the Ministry of Finance, and the State Environmental Protection Administration all vie to play a key role in local development. Government could benefit from the establishment of a cross-ministerial Leading Group on Urbanization, headed by a vice premier with the authority to ensure that decisions are enforced.

THE FUTURE OF CITIES

The Impact of Market Reforms

Market reforms have had a profound impact on the PRC's urban centers. The privatization of the rural sector had a huge impact on towns, which acted as intermediaries between rural and urban areas. At the local level, outside the larger cities, a non-State sector emerged, largely independent of the State. Its emergence was just one facet of the move to a market economy. Furthermore, local governments were given considerable initiative to grow and then to reap the rewards from taxes and fees.

Generally, the process helps spread the country's wealth. Until very recently, the income disparity between the top 10 percent of households and the bottom 10 percent, and between the average-income households and the bottom 10 percent, was low by international standards. But now it is clear that the urban unemployed and the laid-off are growing at the alarming rate of 10 percent on average.

High growth also generates large-scale pollution, while the needs of the market economy blunt the urgency with which environmental degradation should be addressed. The lessons drawn from the past apply all the more today. There will never be sufficient resources for a remedial environmental management strategy. Preventive policies are needed—not only the economic instruments mentioned above (user charges and fuel taxes, for example), but also innovative urban planning techniques that guide land development away from environmentally sensitive areas and environmentally harmful practices.

The high-growth scenarios predicted for the PRC suggest that lessons from the region's experience bear reemphasizing:

- New forms of financing must be accessible.
- Consumers must bear an extra burden.
- Private participation must be encouraged.
- Longer-term financing instruments must be developed.

Future growth will lead to a constant, high turnover in land use, from the metropolitan core to the peri-urban and rural zones. Urban planning—which is now top-down, static, and long-term—must be restructured. It must become much more flexible and adaptive, and it must embrace community participation in decision making to avoid social instability, unrest, and inequity.

Regional urban planning will play a key role in the future. To give but one example, unemployment rates in some regions such as the northeast are likely to be double the national average or worse. Some metropolitan areas, built up under the command economy without concern for economic viability, may have to be downsized by easing interregional migration. Here, it is not clear that regional lessons apply. However, developed economies have experimented with tools that merit review.

A WAY OUT

The world can be viewed as a giant laboratory. Almost every conceivable scheme has been tried somewhere at some time. Now it is time to take stock of such experiments and to map a way out of the urban dilemma. This paper argues that the lessons fall into at least three categories: (i) urban governance; (ii) urban management; and (iii) local finance options. For specific urban areas, particularly those affected by the move to a market economy, more tailor-made solutions may be needed. The key point is that most, if not all, potential solutions can be evaluated by examining cross-country experience. Not being at the frontier of urban development has definite advantages. Being a “follower” allows a country to avoid obvious mistakes in developing an urban strategy.