

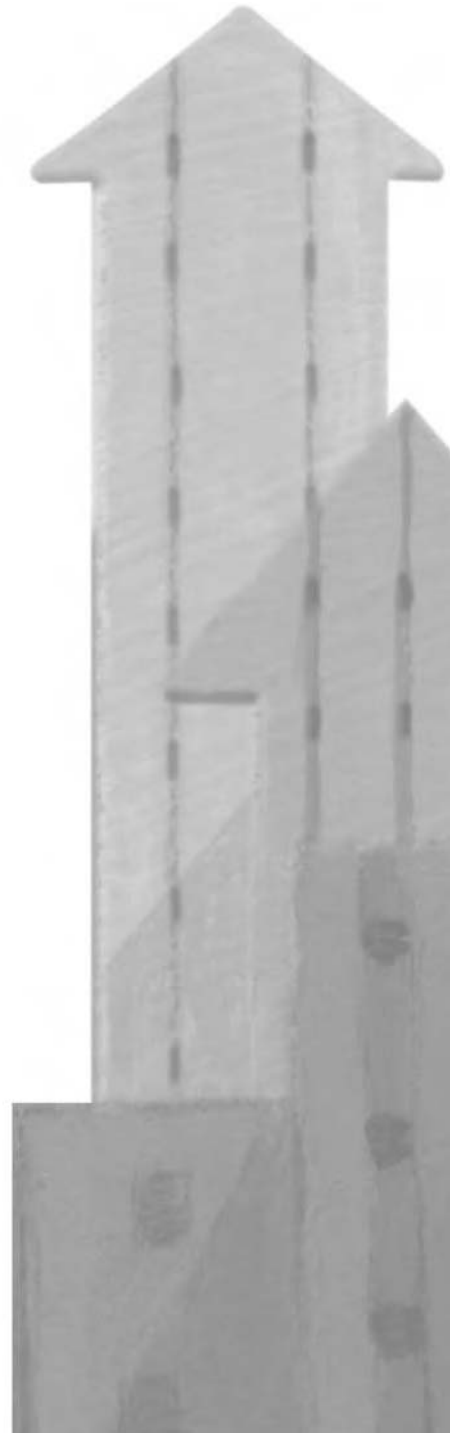
Policy Implications of Workshop Discussions

The workshop solicited from the participants from India more than 400 comments⁴ on policy issues, and themes focused on the following topics: (i) urbanization and inclusive development; (ii) governance; (iii) sources and tools for development financing; (iv) land as a development asset; and (v) development planning. The main impressions, insights, factual information, and policy recommendations gathered from the note taking templates and feedback notes are covered in this section of the report and summarized in the table attached.

URBANIZATION AND INCLUSIVE DEVELOPMENT

In both the PRC and India, the rural and urban sectors of the economy and society used to be distinctly separate. The adoption of an urban-led

⁴ During the workshop, the participants from India were asked to fill out Note Taking Templates that requested them to indicate their reactions to a number of policy issues that were discussed. Reactions and comments focused on five topics. On the last day of the workshop, they were also asked to fill out Feedback Notes on the subjects they considered relevant or not relevant to the policy issues they faced in their respective cities.



development strategy in the PRC, however, has started to blur the distinction between rural and urban. An inclusive approach to development that views urbanization as an energizing element in economic growth includes rural areas on the periphery of cities. The emergence of clustered-cities development also includes rural areas in comprehensive plans. Inclusive development is benefiting millions of rural-urban migrants pushed by poverty from the countryside and pulled by the attractions of city life. Since the great majority of migrants end up in poorly serviced slums and squatter communities, an inclusive development strategy seeks to extend the benefits of development to these peripheral and hinterland areas. It also includes benefits to specific groups such as women, youth, the elderly, and the socially and economically disadvantaged. Finally, inclusive development focuses not only on the economic and social benefits arising from urbanization. It also focuses on externalities and what to do with such issues as environmental pollution, extinction of species, and global warming.

The management of rural-urban migrant flows has been one of the main concerns in inclusive development in the PRC. Until 1979, urban residents in the country made up less than 20% of the total population. This level has sharply risen since the launching of economic reforms, mainly by relaxation of the hukou system that allowed surplus labor from the rural areas to benefit from labor shortages in urban areas. By 2004, about 118 million rural residents had flocked to cities, about 70% of whom went to the coastal areas. Initially, urban immigration was seasonal and cyclical, with people going to cities during the slack agricultural production season and then returning for farm work. In recent years, however, migration has become more permanent with migrants now becoming an impoverished underclass in a number of coastal cities.

The PRC's urban-led development strategy opened up job opportunities for many rural-urban migrants in the informal sector, construction, services, food processing, and manufacturing; however, the sheer volume of migrants became a big burden. Housing for the migrants became a major social problem. In cities like Beijing, Guangzhou, and Shanghai some of the migrants initially found accommodation in rural areas in the urban periphery where farmers rented out bed spaces to them. Some shanty towns formed on the outskirts of Shenzhen and became problem areas for crime, gambling, prostitution, drugs, and other vices. To accommodate migrants, most city authorities opened up employment agencies that found jobs for a fee (in Shenzhen, usually about CNY10 or \$1.4).

Factories conducted training programs for repetitive work on assembly lines. They provided accommodation in barracks-type houses and provided food, uniforms, medical services, and other benefits to workers. Most rural migrant workers were able to earn more in the cities than what they would get from rural agricultural life.

In India, one of the main missions of the JNNURM is poverty reduction for the urban poor in its 63 targeted cities. Better conditions for the urban poor require massive investments. About 58% of urban residents do not have potable water within their premises and sewerage and low-cost sanitation are available to only 35% of residents in class IV cities (those with 10,000 plus populations) and 75% in class I cities (those with populations of 100,000 plus). Enormous amounts of investment are still required in cities that do not fall under the JNNURM.

In recognition of these huge needs, India adopted a national housing and habitat policy that targeted the provision of 2 million additional housing units each year for the urban poor. Individual provinces and cities have also enacted legislation ensuring security of tenure rights to the urban poor. For example, the Kolkata Tenancy Act of 1981, as amended, provided for the regularization of slums on private land and prohibited the eviction of squatters. By 2006, about 2.1 million slum households had been regularized under the scheme. In Madhya Pradesh, under the Patta Act, about 150,000 *pattas* or traditional tenure rights have been conferred to more than 800,000 people. A unique PSP scheme was carried out in Haryana state adjoining the national capital territory of Delhi whereby private developers were given the right to undertake large-scale land assembly for housing and other development schemes. This project accelerated the availability of serviced land and lowered land prices, making it possible for even low-income families to build their own homes. In Lucknow, the city government authorized developers to build houses on government land with the provision that a certain proportion of the houses would be sold to low-income groups at affordable rates. Similar approaches have also been tried in Tamil Nadu, Uttar Pradesh, and West Bengal.

Aside from housing, India has also pursued programs to make basic services accessible to the urban poor. In 1996, the National Slum Development Program financially assisted local governments to provide infrastructure such as water supply, storm water drains, sewers, community toilets, street lights, and paved lanes in areas occupied by the urban poor. In addition, about 10% of financial assistance was earmarked for shelter. In 1992, a scheme for pay

toilets was introduced for pavement dwellers. Another project on community toilets was launched under the *Nirmal Bharat Abhiyan* scheme in 2001 whereby an estimated 20% of the project budget was allocated to the construction and maintenance of community toilets.

A number of local governments in India carried out projects targeting the urban poor. Under the Madhya Pradesh Slum Area (Improvement and Clearance) Act of 1976, water taps, latrines, paved roads, and drains were provided to residents of areas marked as “slums for improvement.” In Pune, the municipal corporation went into a partnership with nongovernment organizations and community groups in a public sanitation program. The Pune partnership invested Rps400 million (\$10.1 million) to build more than 400 community toilets that benefited about half a million slum dwellers. In Delhi, the city government authorized private groups to supply water to individual households in Sangam Vihar, a low-income community that was out of the reach of the water utility company. Although the price paid by the residents for the water was higher than what the utility would have charged, the residents were happy because they had access to water.

URBAN GOVERNANCE IN INDIA

In India, by constitutional mandate and statutory enactments, cities and towns enjoy a lot of autonomy. The 73rd and 74th amendments to the constitution of India decentralized powers to local governments in both urban and rural areas. Local government officials keep their autonomy and local political parties and civil society groups engage in hotly contested local elections focused on partisan issues. In 1993, pursuant to the 74th constitutional amendment, ward committees were to be set up in cities with populations of 300,000 and above, though as of 2004, such committees had been set up in only 12 states.

The key feature of urban governance in India is that it is designed to be responsive to the needs of all citizens. In the nation's capital, for example, the Delhi Municipal Corporation launched the Bhaghidari Initiative in January 2000 that required government agencies in charge of key functions like electricity, water supply, and sanitation to be more sensitive to the needs of their clients. The Bhaghidari process relies on interactive meetings with citizens' groups such as resident welfare associations, market traders' as-

sociations, school welfare committees, and industrial associations. One distinct accomplishment of the Bhagidari initiative is that by opening up their activities to their clients, the service agencies have become more accountable and transparent in their operations.

In a few metropolitan areas in India, city region governance has been advancing quickly. The provisions of Article 243ZE of the 74th amendment to the constitution of India stipulates that in every metropolitan area having a population of one million or more and consisting of two or more municipalities or *panchayats*, there should be a metropolitan planning committee. The principal task of such committees is to prepare a development plan that should be focused on “matters of common interest between the municipalities or *panchayats* including coordinated spatial planning of the area, sharing of water and other physical and natural resources, integrated development of infrastructure and environmental conservation.” Two-thirds of the members of the planning committee are to be drawn from among the elected members of local bodies, and the state government appoints the remaining third. As of mid-2005, Kolkata had set up its own Metropolitan Planning Committee, with the Metropolitan Development Authority designated as the committee’s secretariat. The states of Karnataka, Maharashtra, and Tamil Nadu had also made some preparations for establishing their own metropolitan planning committees. With the support of the JNNURM reform proposals, other city regions may follow suit.

One unintended effect of decentralization in India has been fragmentation of the responsibilities for urban planning and service delivery among local governments. The census in India revealed that in 1995, about one third of the country’s total urban population lived in 23 metropolitan areas. This proportion increased to 38% in 2006 when the number of metropolitan areas jumped to 35. By 2011, it is projected that there will be 75 metropolitan areas in India. A noted urban specialist in India has indicated that “various studies analyzing geographical, demographic and economic data point out that these agglomerations covering several municipal jurisdictions will be the principal centers of urban population in the future.” He pointed out, however, that these agglomerations are not structurally and functionally able to deal with area-wide problems such as transport, water and sanitation, employment, and environmental pollution because they are severely fragmented (Sivaramakrishnan 2007).

GOVERNANCE OF CITY REGIONS IN THE PRC

The PRC and India approach the governance of city regions differently. In the PRC, the central Government has power to directly influence local governance, while in India, local government bodies enjoy much autonomy. City governments in the PRC are arranged in a hierarchical structure based on political status rather than population size. At the top of the system are four megacities that are directly under the control and supervision of the central Government (Beijing, Chongqing, Shanghai, and Tianjin). Next are 15 sub-provincial cities such as Shenzhen. Then, there are 268 prefecture-level cities and 374 county-level cities. Also included as part of the PRC's urban hierarchy are 20,312 small towns and 12,000 towns designated as urban because of special characteristics (e.g., tourism centers, mining towns). Since allocation of central Government resources is determined by a city's status, most local units in the PRC aspire for a higher status.

In the PRC, the power and influence of the central Government is strengthened by the Communist Party of China (CPC) that had 73.3 million members in 2007. The CPC runs a hierarchical power structure parallel to the formal bureaucracy. In effect, the PRC runs a field administration system, with most local officials appointed by the central Government from the ranks of Communist Party leaders. Direct citizen participation is found only at the village or neighborhood resident committee level where leaders are elected by the people. Even there, however, candidates belonging to the CPC are often the ones favored by the electorate.

Generally, highly centralized governance systems are supposed to be inefficient, inflexible, and intolerant of innovation. The PRC system, however, has developed certain features that seem to make it work. For one, the centralized setup makes decision making fast and efficient; local governments make development proposals that they submit to higher levels of government that are implemented as soon as these are approved by the State Council in Beijing. Funding of development projects is shared by central, provincial, prefecture, and metropolitan governments. Large urban infrastructure projects covering several levels of government are subsidized by the center and provincial governments until earnings from operations and user charges make them economically viable on their own.

Despite the huge size of the PRC government system, the country has found a balance between central control and authority

decentralized to local officials. Thus, the mayors of very large cities have been authorized to approve projects costing \$50 million or less. However, instead of completely devolving authority and power to local government officials, the PRC has simply delegated such powers to them. The center has also instituted explicit and measurable standards of performance and put into place measurable monitoring, evaluation, and audit systems to ensure transparency and accountability on the part of local officials. Erring officials, including some mayors and vice mayors of cities like Beijing and Shanghai, have been punished after being found guilty of graft and corruption.

Unified metropolitan governance systems have been used in a number of city regions in the PRC to achieve better cooperation and coordination. In Shenzhen, for example, the territorial jurisdiction of the municipal government has been expanded several times so that it currently includes 6 districts, 51 subdistricts, and 620 localities run by resident committees. For the effective management of urban infrastructure and services, Shenzhen's jurisdiction has been extended to the adjacent districts of Bao'an and Longgang. The same CCD approach has been used in the governance of Suzhou municipality. Suzhou city proper only has a population of 2.1 million and covers 1.6 km², but the whole municipality has 6.8 million people and a territory of 8,488 km². Within the municipality are the cities of Changshu, Kunshan, Taicang, Wujiang, and Zhangjiagang; and the districts of Canglang, Jinchang, Pingjiang, Wuzhong, and Xiangcheng that make up the whole city region.

URBAN DEVELOPMENT FINANCING AND TOOLS

Both the PRC and India recognize that investment in urban infrastructure and services is necessary to achieve overall economic and social development, although the PRC has focused financing of infrastructure and services in a few selected city regions. Basically, there are six sources of financing for urban infrastructure in the PRC: (i) national funds for construction approved by the National People's Congress at the start of each budget year that are managed by the NDRC; (ii) domestic loans from banks and non-bank financial institutions; (iii) enterprise bonds floated by authorized units approved by the NDRC; (iv) direct and indirect foreign investments such as those from joint ventures or loans from international financial institutions like ADB and the World Bank; (v) self-arranged

funds by local government bodies or authorized enterprises guaranteed by the central Government or the central bank; and (vi) other funds such as those arising from enterprise operations, user charges and penalties, fines, and fees.

Since 2000, government-owned or -controlled enterprises in the PRC, including joint ventures, have been allowed to issue project bonds to finance infrastructure. By 2005, enterprise bonds had reached CNY435 billion (\$59.9 billion), which amounts to about 3.2% of the domestic bond market that also included treasury bonds, T-notes, financial bonds, and commercial paper. These enterprise bonds have to be invested in fixed asset construction projects approved by the NDRC or its local offices. Bond issuers are required to get credit ratings from approved rating companies and bonds are underwritten by financial institutions. Typically, bonds mature within 10 to 20 years at interest rates ranging from 4.0% to 5.8%. Proceeds from the bonds are taxable.

In India, the central and state governments provide grants and other financial assistance to local governments to fund urban infrastructure. Currently, JNNURM has committed \$6.7 billion for 63 selected ULBs over 7 years until 2012. Recently, cities like Ahmedabad and Nagpur have been allowed to raise funds from the primary capital market through issuance of municipal bonds. All bonds in India are issued through structured obligations. Municipal bonds are usually accompanied by an escrow mechanism to ensure pay-back (a form of risk mitigation). Unlike in the PRC, revenues from municipal bonds are generally tax-exempt, but they can be taxed on a case-to-case basis. A survey on the financial performance of municipalities in India has found that the situation needs to be strengthened. The gap between revenue and expenditure will be improved through the reform agenda under the JNNURM, such as tax collection, efficient accounting, and strategic investment planning including increased access to capital markets. A high proportion of local funds is devoted to current operating expenditures and maintenance of municipal services.

The 74th amendment to the constitution of India decentralized fiscal authority to local governments which can now fix tax rates, charge fees for services, borrow funds for selected purposes, and choose contractors for projects in line with procurement rules. State finance commissions have been set up to examine the financial situations of local governments, and recommend ways of improving them. An important innovation concerns the system of financial reporting of India's local governments, i.e., it has been based on a single-

entry (cash-based) system that tracks expenditures against budgetary outlays. In Maharashtra, Tamil Nadu, and the cities of Ludhiana, Jaipur and Surat, a double-entry accrual-based accounting system has been adopted to reflect more accurately the fiscal situation of municipalities. City governments have also prepared accounting manuals, charts for specific accounts, and formats for various activities. Local financial reporting systems have been changed to match national accounting standards and practices.

PSP has been recently recognized and encouraged strongly in India under the 11th Five-Year Plan period, but private enterprises have been participating in urban infrastructure operations since the 1990s through contracts and franchise agreements. Government authorities competitively invite private sector companies to design, construct, finance, operate, and maintain urban infrastructure projects through BOT, concession, or franchise agreements. However, joint ventures between public and private companies are still quite rare. In the few joint venture cases that exist, the Government created a special purpose vehicle to manage the Government's equity in the project, which usually ranges from 11% to 26% of total value, up to a maximum of 49%. Management of the joint venture project is carried out by the private partner. After the concession period, the project reverts to the Government where it may be re-bid for a new PSP agreement.

In contrast to India's market-based system, the local governments of the PRC initially relied on SOEs to build urban infrastructure. The activities of the SOEs were financed by direct budgetary allocations, loans extended to SOEs using land as collateral, and bond issues. Later, the SOEs were encouraged to enter into joint ventures with private firms for projects in very large cities, provided the stake of private investors in projects did not exceed 49% of project value. PSP arrangements did not require private partners to return project assets to the Government after the end of the concession period. However, in smaller cities, PSP modalities such as franchises, concessions, BOT, build-operate-manage, and other arrangements were allowed, and private-sector investors were permitted to own 100% of projects. The project assets, however, had to be transferred to the Government at the end of the concession period.

The need for resources to finance urban infrastructure and services has prompted some Asian countries to consider asking for assistance from international finance institutions, such as ADB. In August 2005, ADB approved four new financing instruments and modalities: (i) the multitranche financing facility, (ii) the nonsovereign

financing facility, (iii) the refinancing and restructuring facility, and (iv) the local currency loan facility. The first three of these modalities were approved on a pilot basis. In 2005, the local currency loan facility was mainstreamed. The three other pilot approaches are designed to run until August 2008, although a proposal to mainstream the multitranche financing facility has been submitted to ADB's Board of Directors.

A major concern in Asian countries in urban infrastructure finance is the need for government sovereign guarantees for loans. In the PRC, it is usual practice for the Government to guarantee foreign and domestic loans because local governments are not allowed to incur loans without approval of the central Government. In India, nonsovereign financing has become more widely possible as project selection criteria, due diligence processes, project risk evaluation, product pricing, and security packages have improved, following concepts of sound banking principles. Sectoral and governance reforms, such as those carried out under the JNNURM, have also helped to make nonsovereign financing more popular in India.

LAND AS A FINANCING RESOURCE

A distinct advantage in the PRC that is not readily available in India is the availability of land as a financing resource. In PRC cities, land is often the most important asset used for financing urban infrastructure and services. By law, land by itself has no intrinsic value—it is the use of the land that makes it valuable. According to Article 18 of the PRC's Administration Law on Real Estate (1994), all fees paid by developers for being granted land use rights are turned over to the State Treasury and incorporated in the budget, specifically earmarked for construction of infrastructure and land development. A revision of the same law in 2004 allocated 30% of the land fees to the Ministry of Finance and 70% to the relevant local governments. Land is usually leased for 50–70 years. According to the PRC's circular on the collection of land fees, the land use revenue must be paid in full upon approval of the conversion of the land to urban use.

Aside from land use fees, the PRC charges a land use tax based on the area of the land in a transaction. If a house is built, there is a housing tax equivalent to 1.2% of the value of the house, after a deduction of 10% to 30%. There is also a real estate tax applicable only to land used by foreign enterprises. A value-added tax is imposed on the increase in value arising from transfers of state-owned

land, buildings, and other structures. There is also a business tax and a deed tax on the transfer of real estate. Finally, there is a stamp tax on contracts and certificates linked to transfers of real property. Administration of urban real estate taxes in the PRC is still undergoing a number of reforms. For example, privately owned apartments in multistory structures are not subject to condominium status such as in North America or Europe. Thus, collection of taxes and fees from individual owners rather than from state councils becomes more cumbersome.

Although most local governments in the PRC have used land for financing urban infrastructure and services, they admit to some limitations for this modality. For one, reliance on land for financing tends to encourage development of short-term projects. This is because the unlocked monetary value of the land is finite and funds are only available for a short period. Unless the local government has access to other resources that can augment the proceeds from land, it will be forced to invest mainly in short-term projects.

The situation in India is quite different from the PRC as most land is privately-owned and when the Government needs to use it for public purposes, the Government has to purchase the land at fair market value or use the state's right of "eminent domain." Encroachment of Government projects on private land, however, can lead to prolonged litigation and high resettlement costs. Some forward-looking local governments in India have engaged in "land banking," which involves purchasing land for future use while it is still relatively cheap. However, in many cases, private land owners immediately raise the price of their land upon knowing the government's intentions. Farmers and other disadvantaged people whose land is taken over for development projects have staged demonstrations against such moves, at times resulting in violence. Also, most local governments do not have surplus funds to engage in large-scale land purchases for land banking. Recognizing the need to make more land available for urban development, the Government of India has suggested repealing the Urban Land Ceiling Act (ULCA) and rationalizing the Stamp Duty Law (reducing the rate from 13% to 14% to around 5% of the land transaction value) as mandatory reforms that state governments can adopt to encourage the use of urban land for development.

In both the PRC and India, capturing the increase in land value caused by the provision of urban infrastructure and services is an important source of financing. Realistic assessment of land values adjacent to a newly constructed road, for example, can generate

significant real estate taxes. A tax or penalty on unused or idle land can be an important source of income. It can also force owners to develop their properties and thereby increase real estate tax proceeds. In some countries, like the Republic of Korea, the Government can agree to develop private lands and then take over part of the developed land in exchange for its efforts. Land swaps can also be arranged, whereby land needed for public infrastructure can be exchanged for land of equal value elsewhere.