

Financing the Development of Small and Medium Cities

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Urbanisation in India is currently marked by two fundamental trends: lopsided migration to the larger cities and unbalanced regional economic development. In this context, this paper makes a case for the concerted development of small and medium cities as the key focus in the strategy to ensure sustainable urbanisation in India. As cities plan for the long term, among the most critical components they need are the availability of land and the provision of infrastructure and services for a growing population. This paper suggests the need for land banks and land readjustment mechanisms, and assesses the efficacy of current mechanisms for infrastructure provision in small and medium cities. There is also a rationale and need for the creation of new cities, either on the peripheries of large cities or around industrial clusters, with private participation and financing.

The urban population of India is concentrated in large cities. More than 60% of the urban population lived in Class I cities as of 2001. Chattopadhyay (2008) points out that the rate of population growth in these Class I cities has also been consistently increasing over the past five decades, from 45% in 1961-71 to 62% in 1991-2001. This has been accompanied by a decrease in population growth in smaller urban centres. This trend of migration towards the larger cities is due, in large part, to the economic prominence of these cities. These cities are the engines of economic growth, but are plagued by severe challenges to their civic infrastructure and service delivery capabilities. For this reason, they are deemed to be at the forefront of the urban challenge today.

India is rapidly urbanising and the rate of urbanisation is expected to climb steeply over the next few decades. McKinsey Global Institute (2010) predicts an urban population of 590 million by 2030, as compared to 340 million in 2008. For India to be more inclusive, it is imperative that both economic growth and urban population be more equitably distributed. Therefore, any meaningful long-term vision for India would be incomplete without planning for the cities of tomorrow.

Where Are the Cities of Tomorrow?

The development of small and medium cities will be of paramount importance in ensuring sustainable urbanisation for India. Appropriate planning supported by suitable financing mechanisms can help turn today's moribund small and medium cities into the vibrant cities of tomorrow's India. The development of small and medium cities should also be augmented by the development of new nodal cities that can also serve to ease the population pressures of large cities.

A cause for major concern in India is that rural migrants have been bypassing small and medium towns and settling in the large cities. Therefore, sustained development of small and medium cities is possibly the most potent strategy to counter the current trend of lopsided development. These cities already have pre-existing economic bases, infrastructure and service delivery mechanisms and governance structures. While each of these components may be far from ideal, or even acceptable, they offer a base that can be improved through better policies, planning, financing and incentive structures. Although these cities might suffer from economic malaise and poor infrastructure, it is important to remember that they have, over time, evolved the critical underlying "soft"

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ingredients such as culture and community that are essential to the make-up of any city. Well-planned development of these cities can help disperse rural migration and prevent over-crowding of other metropolitan centres. Without urgent and sustained efforts to develop small and medium cities, it will be impossible to develop a meaningful, effective and long-term urbanisation strategy for India.

An adjunct to the development of small and medium cities will be the development of new nodal cities. India has had some experience with planned new cities, with prominent examples being Jamshedpur from the early 20th century and Chandigarh from the 1950s. The creation of new nodal cities is driven primarily by the need to decongest existing cities and for the development of industrial clusters. While new cities need to be developed in India, their creation must be predicated on a clear overarching vision and a robust rationale. This is because the creation of new cities will require very substantial financial outlays over long time periods. Clearly, new cities by themselves are not an answer to the urbanisation challenges facing India; however, as an adjunct to the main strategy around small and medium city development, they can serve as a lever to direct future urbanisation.

Why Small and Medium Cities?

The need to focus on small and medium cities as the cities of tomorrow is driven by two primary imperatives, namely, the unsustainability of current migration patterns and the need for more balanced, equitable regional growth.

The current trend of rural migration to the larger urban centres and the consequent population explosion has caused these cities to become overcrowded and congested, with poor standards of social and environmental infrastructure provision. They find themselves stretched for capacity and resources, while being confronted with ever-growing in-migration. Such a situation is fraught with growing social, political and environmental risks and requires well-crafted responses aimed at mitigating current migration pressures. The 1,595 municipalities and 2,108 nagar panchayats that constitute the universe of small and medium cities in India can, if appropriately planned, be the natural sinks that absorb a substantial quantum of rural migration, thus easing the growing pressure on larger cities and leading to more sustainable and equitable population outcomes.

Another related and equally important concern that has constantly been voiced is the absence of balanced regional growth. Larger cities have become the magnets of economic dynamism in India, and there is a growing disquiet about the increasing regional imbalances in development. This need for greater regional equity can only be achieved by planning for economic development and infrastructure provision in small and medium cities around the country.

The concerted development of small and medium cities should, ideally, be the pivot around which the urbanisation of India occurs. In order to plan for this development, it is important to understand the state of these cities in India today.

An Assessment of the Current Scenario

Himanshu (2008) indicates that from 1987 to 2000, the ratio of urban population in cities with greater than one million people went up from 18.2% to 25.9%, while that of cities less than one million went down from 81.8% to 74%. Kundu and Sarangi (2005) also point out that there is an inverse relationship between poverty rates and the size of towns, with the poverty rate in large (one million plus) cities at 14.2% and in small cities at 24.2% in 1999-2000. The fact that rural migrants are "voting with their feet" in bypassing the smaller and medium cities in favour of the larger cities is, therefore, a clear indictment of their lack of economic vitality. Kundu and Gupta (1996) point out that small and medium cities are nowhere as attractive as the larger cities for manufacturing companies looking to set up new units. The poor economic profile of these cities has resulted in economic stagnation, and it is this economic stagnation that has repelled rural migration.

One of the reasons for the economic stagnation is the low quality of infrastructure and service delivery in smaller cities. A National Institute of Urban Affairs (NIUA) study by Raghupathi (2005) on the status of water supply, sanitation and solid waste management in urban areas confirms that the coverage of basic services in metropolitan cities is higher than other medium and small cities. For example, in 1999, the per capita domestic water supply in Class II cities was 69 litres per capita per day (lpcd), as against 148 lpcd in metropolitan cities; the population covered by sewerage systems was 51% in Class II cities, as against 63% in metros; and solid waste collection efficiencies in Class II cities are at 75% against 91% in metros. The higher quality of municipal services delivery in larger cities is also reflected in their per capita investments in infrastructure. Revenue expenditures per capita in 1999 for water supply and solid waste management services were at 214 and 189 for metropolitan cities, in contrast to which Class II cities were at 77.86 and 63.15, respectively.

The twin effects of poor economic prospects and low quality infrastructure services have kept small and medium cities at suboptimal levels of growth. This sub-optimality has been further entrenched by the lack of access to institutional funds. There is, in fact, a wide disparity in the availability of institutional funds to large and small cities. Kundu (2002) points out that over 50% of funding from Housing and Urban Development Corporation (HUDCO) had been directed towards large cities, even when one of the stated objectives of HUDCO was to bridge the gap in access to infrastructure funding between small and large cities.

It is not that the government has completely neglected small and medium cities; in fact there have been programmes specifically targeted at them, such as the Integrated Development of Small and Medium Towns (IDSMT), and the Accelerated Urban Water Supply Programme (AUWSP), both of which have now been subsumed under the Urban Infrastructure for Development Scheme for Small and Medium Towns (UIDSSMT). From 1979-80 to 2005, the IDSMT had been

mandated to aid the development of small and medium urban centres through the provision of employment opportunities and improved infrastructure and service delivery, in order to reverse the trend of over-migration to the larger cities. Its remit covered 1,858 towns with populations of up to five lakhs. However, as migration trends clearly indicate, the programme was unable to achieve its objectives in a meaningful manner. The IDSMT scheme was subsumed under the UIDSSMT in 2005.

The UIDSSMT has a more limited focus on development of infrastructure in small and medium towns. UIDSSMT funds have been made available for projects in water supply, sewerage, solid waste management and roads, and as of March 2010, the central government had released Rs 292 crore for 38 projects in about 30 cities. However, the scale and scope of the issues confronting small and medium urban local bodies (ULBs) need to be addressed through a more comprehensive approach.

A Comprehensive Approach to Development

A comprehensive approach that addresses economic development along with infrastructure provision and service delivery is essential to ensure the sustainable development of small and medium cities. Addressing one of these components without attention to other can lead to unsatisfactory, suboptimal outcomes for these cities. This is because economic development provides greater incentives for in-migration and this in turn compels timely responses in infrastructure and service delivery. On the other hand, infrastructure provision can be seen as a prerequisite to incentivise economic investments that then lead to greater in-migration. What this illustrates is the intricate and cyclic relationship between economic growth and infrastructure provision, and therefore, the need for a concerted and simultaneous thrust on both these fronts while addressing the development of small and medium cities. Currently, many small and medium cities are stuck in a vicious cycle of poor economic prospects and low levels of service delivery, with each continually reinforcing the other. This low equilibrium needs to and can be reversed through a comprehensive planning approach.

Yet another aspect that needs to be reassessed is the current planning paradigm in India. Rural India and urban India are looked upon as two separate entities with their own independent sets of issues that need to be addressed by separate interventions. However, smaller cities are tied to their rural hinterlands in very fundamental ways and the development of these cities hinges upon the development of the surrounding hinterland. Tacoli (2004) points out that these rural-urban linkages manifest themselves as flows of agricultural and other commodities from rural-based producers to urban markets, and, in the opposite direction, in the flows of manufactured and imported goods from urban centres to rural settlements. Thus, smaller cities are markets for agricultural produce and can also support thriving agriculture-related industrial and marketing units (for example, in fertilisers and machinery) and retail markets for rural customers.

The relationship between the city and the hinterland also encompasses the flow of people as migrants, producers and consumers; the flow of information on prices and consumer preferences; and the flow of finance in the form of credit, savings, insurance and remittances for rural households. These intricate linkages between smaller urban centres and the surrounding rural areas are of paramount importance in planning for these cities. It is therefore appropriate to consider a planning approach that incorporates both cities and their hinterlands. Such a regional planning approach should be implemented at the district level in India as districts are large enough to have a mix of contiguous urban and rural areas but small enough that comprehensive and detailed economic and infrastructure planning remains meaningful.

Therefore, a planning approach that incorporates both economic development and infrastructure provision while covering both urban areas and their surrounding hinterlands will best serve the objective of developing small and medium cities. The district planning councils (DPCs) mandated in the Constitution would be the ideal vehicles to drive forward the agenda for small and medium cities in India.

Financial Incentives

The 74th Constitutional Amendment Act (74th CAA) of 1992 provided a constitutional basis for local governments and required them to prepare long-term plans for service delivery. Specifically, metropolitan areas and districts were expected to constitute Metropolitan Planning Committees (MPCs) and DPCs respectively, to prepare long-term development plans. The 74th CAA envisaged that these comprehensive plans would be developed by amalgamating and consolidating plans for social and infrastructure services prepared at the local government level. Mathur (2007) finds that the performance of these initiatives on the ground leaves much to be desired. While 10 states had constituted DPCs, only Kerala was found to have active and functional DPCs.

These constitutionally mandated DPCs need to be made functional, and their ambit expanded to include planning for economic growth of the district. The plans prepared by the individual ULBs therefore need to incorporate economic plans in addition to the infrastructure planning that is currently required of them. The DPC can then consolidate these comprehensive plans and chart out the hierarchy of actions that need to be taken for the development of the region.

One of the levers that can be used to incentivise the working of DPCs, considering the abysmal performance on this front so far is to link grants from the central to state governments to the operationalisation of DPCs across the state. The 13th Central Finance Commission has recommended a conditional, formula-based annual grant to state governments predicated on the accomplishment of certain governance and finance reforms. The operationalisation of DPCs should be added as one of the conditions for the access of this grant by state governments, considering the critical enabling role well-functioning DPCs can play in the urbanisation of India. This explicit conditionality linked to the grant will help incentivise

state governments to set up and operationalise DPCs in the state.

Financing Land and Infrastructure

There are a few financing mechanisms that take on critical importance while considering small and medium cities. An assessment of these mechanisms follows.

Land Banks and How to Finance Them: While planning for the long-term development of small and medium cities, the most critical component to consider is the availability of land. Long-term planning for infrastructure includes contemplating the provision of space for housing, roads, industries, hospitals, schools, commercial establishments and marketplaces, all of which require land to be built. Smaller cities need to assess the quantum of lands they will have to make available for these requirements, and also determine where these open lands are available. While land banks are crucial from the perspective of planning for future population growth, they can also be tools of immense economic value because they allow local governments to capture increases in land values once these lands have been developed with roads and environmental infrastructure and are released for middle and high income housing, industries and commercial establishments.

While small and medium cities may not be as constrained for land as the larger cities currently, it is imperative that the increasing requirements for land resulting from expected population and economic growth be actively planned for. This is essential considering that the failure to plan for land has been one of the prime reasons for the current state of urban decay in the larger cities. If small and medium cities are unable to plan effectively for timely availability of land for future development, they may be doomed to face the same problems as larger cities do today.

Small and medium cities that are able to credibly plan for their land needs over a 20 year horizon then face the obvious questions relating to the acquisition and financing of these lands. Land acquisition is a time-consuming and sensitive process, requiring the consent of landowners who will be displaced and also agreement on the price paid for the lands to be acquired for development. Attempting to acquire lands in quick time can lead to social unrest, and this underlines, yet again, the value of long-range planning and the time it offers in terms of strategising appropriately for negotiation and settlement of land contracts.

It is essential that local governments reach these negotiated settlements with landowners and start building land banks right away, but they will be constrained by non-availability of financial resources for this purpose. It is therefore imperative to attract private financing to accomplish this. Private financiers will, however, be wary of the risks of financing land banks of small and medium cities predicated on their future development. The central government could have a critical role to play in kick-starting land-bank financing with commercial involvement. The central government can provide a derivative product that guarantees a certain increase in land

values annually (say 1%), and local governments can use this derivative to borrow from capital markets and finance the purchase of lands. The derivative contract provides a minimum return certainty to debt capital market investors by guaranteeing them a minimum land value increase, thus limiting their exposure to the downside risks of the land markets in a particular local government's jurisdiction. Local governments that would otherwise be unable to fund their land banks can, with the availability of such a derivative, plan the purchase of lands for future development. The central government is best suited to guaranteeing minimum land value increases because it has exposure to land markets across the country and will therefore be in a position to diversify the risks of adverse land price movements in specific pockets in the country. While the risk of a secular decline of land prices cannot be completely ruled out, the fact that India is expected to urbanise rapidly on the back of robust economic growth over the next 50 years practically negates the possibility of secular land value declines. The creation of such a derivative product will also incentivise the development of local databases capturing land market values over time.

Concurrent with the creation of land banks is the need to have land development legislation passed by the city council to ensure that the land is developed in keeping with the planning objectives of the municipality. State governments must require ULBs to publicise such legislation through print and electronic media, in order to ensure that citizens are aware of the planned usage of acquired lands and can be vigilant during the process of land development. There should also be provisions for stringent action and punitive fines in case officials deviate from the legislation laid out. Exceptions should only be made for cases where the city council passes an amendment ratifying changes in the development plan legislation after holding public discussions through area sabhas and gram sabhas.

The purchased land banks can then, as per the legislation, be developed with basic infrastructure such as roads and environmental infrastructure. The portions earmarked for sale can be released to the market, thus enabling the municipality to capture land value increases due to its planning and infrastructure provision. The proceeds from the sale of designated lands can be used for the development of public goods such as low-income housing, hospitals, schools and parks.

Innovative Financing of Land and Infrastructure through Land Pooling:

Acquisition of land need not be the only mechanism to ensure availability of land for development. The issues of compensation and opposition from existing landowners can sometimes be very difficult to resolve. One mechanism that sidesteps the need for land acquisition, while making land available for development is Land Pooling and Readjustment (LPR). As Lall and Anand (2010) point out, LPR is a process whereby a local public authority consolidates numerous small parcels of land owned by different parties, and carries out collective planning of this land. The local authority plans the provision of civic infrastructure amenities such as roads, schools, hospitals and parks, sets aside some

portion of land for public sale, and returns the rest to the original landowners.

LPR is a self-financing scheme. Lands are initially assembled and planned for without any compensation to the landowners. The ULB can then provide the basic (roads and environmental) infrastructure as per the plan, either from their internal funds or through debt raised from banks or the markets. The provision of infrastructure raises the value of these lands and this increase in value is the compensation to the original landowners who are now returned a proportion of the land that they provided. (All landowners are returned the same proportion of their initial land.) Although the land block that they receive is smaller in size than the initial land they provided, the value of this block of land is more than the initial value of their larger land tract due to planning and infrastructure improvements. As a part of the plan, some portion of the land is set aside for public sale. The proceeds of the sale can be used to fund other public goods such as schools, hospitals and parks.

LPR has been used in India, especially in Gujarat, where it has been implemented as the Development Plan-Town Planning Scheme (DP-TP) under the Gujarat Town Planning and Urban Development Act, 1976. One of the illustrative successes of LPR is the development of the Sardar Patel Ring Road in Ahmedabad.

While land acquisition may be unavoidable in many cases, LPR can and should be used in those cases where readjustment of land is a feasible option. More cities in India should look to enact legislation that enables LPR, thereby putting in place a self-financing mechanism that permits planned local development for the future, without needing to resort to land acquisition and its attendant complexities.

The Centrality of Grant Funding for New Infrastructure Creation: Infrastructure planning for small and medium cities needs to incorporate a thorough assessment of the status of service delivery in water supply, sewerage, solid waste management, roads and street lighting to understand backlogs in provision for the current population as well as the projected needs for population increases. Because of the large backlogs in infrastructure provision, substantial funding will be required to finance new infrastructure in these cities.

As of now, the UIDSSMT is the programme focused on urban infrastructure provision in small and medium cities. Under the UIDSSMT, the central government funds 80% of a project's cost, with the state government providing 10% and the remaining 10% funded by ULBs through their internal revenues or borrowings from debt markets. However, as of now, smaller ULBs have not approached the market under this scheme. As of March 2010, the UIDSSMT has financed 38 projects worth Rs 292 crore out of the Rs 6,400 crore corpus available to the programme from 2005 to 2012; an abysmal utilisation rate of 4.56% in five years. This magnitude of funds is nowhere close to the scale of investments required to confront the infrastructure challenges of small and medium cities. There needs to be a much more concerted effort directed at financing

service delivery in small and medium cities, just like the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) for larger cities.

Small and medium cities do not have the financial wherewithal of the larger cities and will require greater government-funded grant support in the initial stages of their growth. The UIDSSMT, in its current form, is designed to provide that support. Central and state governments must undertake the task of urging the small and medium ULBs to plan for the long term, design projects based on their needs and access these available funds. The urgency of reforming the condition of these cities needs to be reiterated at all levels of government.

There is an additional design feature that the UIDSSMT can incorporate in order to increase the reach of its corpus of funds and impact a larger number of ULBs than it would otherwise be able to. UIDSSMT funds should be allowed to be leveraged by up to three or four times through the provision of guarantees on pooled bond issues by small and medium cities. This will be discussed in greater detail in the next section that describes the pooled finance mechanism.

A rejuvenated, refocused UIDSSMT programme, with an additional design feature that increases its leverage and allows it to affect a larger number of cities, will be a central component of the infrastructure financing strategy for the cities of tomorrow.

Debt Financing for New Infrastructure Creation: Most small and medium cities lack the expertise, scale and creditworthiness required to access capital markets on their own. These cities cannot look to finance individual infrastructure projects through capital markets because the project sizes are too small to be of interest to capital market investors. Also transaction costs – primarily comprising legal and rating fees – are too high, thereby rendering capital market access unfeasible. Cities will therefore be forced to shelve these projects, unless they finance them completely out of their own balance sheets.

Pooled financing is a mechanism that enables small and medium cities to access financing from capital markets. It works by pooling together infrastructure projects from different ULBs and issuing bonds backed by cash flows from all the projects. This pooling effect helps create a bond issue that is large enough to attract attention from capital markets investors and also spreads transaction costs between multiple ULBs, thereby bringing it down to very affordable levels for each ULB. An additional benefit to investors is the diversification effect that is created by the portfolio of independent infrastructure projects from geographically distinct cities. Pooled financing therefore enables a number of ULBs to come together and borrow under one umbrella and avail the benefits of economies of scale, credit enhancement and diversification, thereby allowing them access to the capital markets at a lower cost than if they had each attempted to access the markets on their own.

Pooled financing has been successfully attempted in several countries, and can constitute a significant means of financing

smaller municipalities. India has also seen activity in pooled bonds. There have been a few pooled finance issues in India in Tamil Nadu and Karnataka. The first pooled bond issue for Rs 30.4 crore happened in 2002 and it pooled together projects from 13 ULBs in Tamil Nadu. The bond was rated AA by Credit Rating and Information Services of India Limited (CRISIL) and was backed by underlying project revenues from these projects. Four layers of credit enhancement were provided to cover for any shortfall in expected investor payouts, thus enhancing investor security. The components of credit enhancement included: (1) escrow of property tax and other specified collections of the ULBs, (2) a bond service fund of Rs 6.9 crore funded by the Government of Tamil Nadu, (3) a United States Agency for International Development (USAID) guarantee of up to 50% of the principal amount, and (4) interception of State Finance Commission (SFC) devolutions.

Banks and insurance companies invested in the primary bond issue; there has been considerable trading activity in the secondary market since the issue. Provident funds constitute the bulk of investors now. Investor interest in this bond issue helped make a strong case for the development of the pooled finance bond market in India.

Encouraged by the response to these pooled finance issues, the Government of India set up the Pooled Finance Development Fund (PFDF) aimed at infrastructure provision in small and medium towns. This made available a sum of money under the Credit Rating Enhancement Fund (CREF) that could be accessed by states for providing credit enhancement on their pooled finance issues. The PFDF also made available a grant for implementing accounting, e-governance and collection efficiency reforms at ULBs. In addition to these funding provisions, the PFDF guidelines also mandated that any pooled bond issue looking to access credit enhancement should be issued tax-free, with an interest rate cap of 8%.

The second Tamil Nadu pooled bond was planned to be an issue of Rs 45 crore. However, the AA-rated issue failed to generate interest among investors due to the coupon rate of 7.25%. Despite the tax-free status, the interest rate cap of 8% had made it uneconomical for investors to subscribe to the issue. The bond issue did not find many takers and was shelved.

The PFDF scheme which was expected to kick-start the nascent pooled financing movement in India has in fact ended up stymieing the market due to the interest rate restriction it mandates. This guideline needs to be reconsidered, and while its intent in preventing small and medium cities taking on high cost debt is understandable, an interest rate cap would be better designed as a spread over a benchmark rate, like the government securities rate. A change in this guideline could help revitalise activity in the pooled finance market.

While the change in the interest rate guideline is a key requirement, the market can be further vitalised if small and medium cities that participate in pooled finance issues are allowed to access UIDSSMT funds for credit enhancement. This can be critically important from the point of view of the internal finances of these cities. As seen in the Tamil Nadu bond issue, four levels of credit enhancement were required to

structure the issue, including an escrow of property taxes and other revenues, as well as intercepting SFC devolutions to the ULBs. The ability to use UIDSSMT funds as credit enhancement can help free up the restrictions on usage of internal revenue levers of municipalities and release these resources for critical ongoing expenditures on operation and maintenance of infrastructure. UIDSSMT should allow for the usage of at least a portion of its funds for pooled finance credit enhancement because it enables the funding of multiple projects across cities and provides for the UIDSSMT funds to be leveraged by commercial debt from the capital markets. Therefore, what would otherwise be a number of individual projects requiring to be financed independently and completely through UIDSSMT funds can now be financed jointly through pooled financing mechanisms which enable the sparse usage of UIDSSMT funds purely as credit enhancement and make it possible for UIDSSMT to fund many more infrastructure projects in small and medium cities.

Pooled financing, as a concept, has been proved with successful bond issues in Tamil Nadu and Karnataka. While the concept is attractive as a means for small municipalities to access financing, it also (perhaps, more importantly) has tremendous benefits in terms of helping these ULBs build capacities, improve the quality of their processes and systems, and become stronger, more creditworthy entities. Therefore, it is essential that the interest rate guidelines be changed to ensure that this market is active and smaller municipalities have the opportunity to access the debt capital markets.

Development of New Cities

As an adjunct to developing small and medium cities, attention also needs to be given to creating new cities. In certain scenarios, creation of new cities can be a very useful way of spreading economic growth and diverting migration away from the large cities. One factor to keep in mind is that since new cities need to be created from scratch, massive financial outlays over long periods of time will be required to develop them. Therefore, in view of the time and cost implications involved, the need for a well-substantiated rationale underlying the creation of new cities cannot be overstated. While the need for new cities is unquestioned, it is essential that the decisions on specific cities be based on robust arguments and thorough analyses.

New city development in India will primarily be driven by two factors: (1) the development of industrial clusters, and (2) the decongestion of overpopulated cities through planned development of their peripheries.

Nodes at Over-Congested City Peripheries: One of the strategies to combat the current overcongestion of larger cities is the development of nodal cities in the proximity of these congested urban centres. These nodal cities will have well-developed transportation networks that connect to the larger city, which will still be the economic magnet. The nodal cities will provide land to house people who are currently living in unsustainable conditions in the main cities. While housing

and transportation are the prime concerns in developing nodal cities, it is important to remember that these nodal cities will need to be provided with all social and physical infrastructures such as schools, hospitals, parks, commercial space as well as environmental infrastructure.

It is expected that the node will be intimately dependent on the economic activity of the larger city and that at least initially, the only economic activities local to the node will be the service economy revolving around the households living in the node. Over time, it will be essential to ensure that these nodes are able to develop more economic activity within their borders and become more sustainable cities on their own.

Planned nodal cities have been developed in many countries. In India, Navi Mumbai is an example of a nodal city that was planned and created with the express purpose of decongesting Mumbai and providing quality housing at affordable prices to its residents. A survey by Tata Institute of Social Sciences (TISS) in 2000 revealed that 43% of the families settled in Navi Mumbai had migrated from Mumbai. Sankaran (2010) points out that in order to provide economies of scale, a node should provide housing and associated services for a minimum of 2,00,000 families on a land parcel that is at least 2,500 acres.

Development of such nodes will be predicated on the availability of land and the ability to attract private financing. As discussed earlier, the availability and acquisition of land are thorny issues, but of fundamental importance. Again, wherever feasible, self-financing land-pooling mechanisms like Gujarat's TP-DP scheme must be adopted to ensure that land can be made available for node development without resorting to acquisition. However, in cases where land pooling is not an alternative, lands will need to be acquired. Since the development of new nodes will be spearheaded by state governments and larger cities which are entities with reasonable financial wherewithal, they should be in a position to finance the purchase of lands through a mix of bank loans and their internal revenues. Once some of this land is provided with basic roads and environmental infrastructure, saleable lands as mandated by the masterplan can be made available on the open market. The sale proceeds can be used for the development of further social and physical infrastructure, as per the plan.

Yet another financing mechanism that can be made available for the financing of nodal city development is the issuance of long-term bonds. Node development bonds can be issued by large cities or state governments and backed by a partial guarantee from the central government. The partial sovereign guarantee will serve as a signalling device to the market and help improve the credit rating of such bond issues, thus enabling funds to be raised at lower costs. Also, the partial guarantee (as against a full guarantee) will ensure that the central government will only bear a certain portion of the risk associated with the project and that the major portion of the risk will continue to rest with the local or state government. This will serve as an incentive for local governments to carry out the node development programme as planned, thus ensuring that their interests are aligned with the central government and bond investors.

Development and Financing of Industrial Cities

Another class of new cities need to be created around industrial clusters or large-scale industrial units. Heavy industrial units in the mining and manufacturing sectors tend to be large-scale operations set up in distant locations owing to the availability of raw materials or the magnitude of costs involved. Typically, these units also require the availability of a large labour pool for their functioning. And moving a large labour pool to a distant location will mean the attendant provision of housing, schools, hospitals, parks and recreation services. Such a scenario offers the perfect opportunity for the convergence of private and public sector interests in the planned creation of new cities.

Industrial cities are not new in India. For example, the city of Jamshedpur was conceived in 1907, after the decision to set up Tata Iron and Steel Company (TISCO) in that location (Sankar Chattopadhyay 2008). In fact, the planning and construction of the city, including houses, water supply, roads and schools, was carried out by the company without any financial support from the government. Even today, Jamshedpur remains the only city in India where civic amenities and services are provided by a private utilities company, Jamshedpur Utilities and Services Company (JUSCO), owned by Tata Steel (Sankar Chattopadhyay 2008).

As this example illustrates, the private sector can have an expanded role to play in financing infrastructure creation and service delivery in industrial cities. Since the rationale for the city is provided by a large-scale industrial unit or an industrial cluster, there is tremendous incentive for the company or companies to participate actively in planning and developing the city. All the major social and physical infrastructure investments can be financed through a mix of public and private funds, with the private sector contributing substantially. Private finance need not be in the traditional form of commercial debt, but also in the form of long-term equity investments in the city's infrastructure. Industrial cities therefore offer unparalleled opportunities for the leverage of private financing and expertise in the cause of planning and development of cities.

New and innovate service delivery mechanisms can also be attempted, such as private provision of municipal services by JUSCO in Jamshedpur (Sankar Chattopadhyay 2008). In fact, because of the close association of the private sector with planning and service delivery, these cities can become the laboratories for innovations in the financing and provision of municipal services. New ways of thinking about private participation in city development can emerge out of these experiences. These could have relevance for the rest of the country too.

Conclusions

Urbanisation in India is currently marked by two fundamental trends – lopsided migration to the larger cities and unbalanced regional economic development. Both these trends need to be reversed.

This paper makes a case for the concerted development of small and medium cities as key to the strategy for ensuring sustainable urbanisation in India. The development of these

cities can disperse rural migration and ensure more balanced regional development. However, smaller cities are hobbled by problems of poor economic prospects and low levels of infrastructure provision; government programmes aimed at these cities have failed to achieve any meaningful change in this scenario. There needs to be a new approach to the planning of these cities.

Theory suggests that smaller cities are fundamentally linked with their rural hinterlands and these rural-urban linkages encompass human, financial and market connections. Any planning exercise for these cities should incorporate their surrounding rural areas and therefore, a regional planning framework that includes economic development and infrastructure planning for an entire district may be the way forward. Constitutionally-mandated DPCs may be the best vehicle to undertake this planning exercise. Although the performance of DPCs on the ground so far leaves much to be desired, improved performance can be incentivised by linking conditional grants from the centre to state governments on the composition and operationalisation of DPCs in the state.

The next important question relates to the financing of infrastructure and service delivery for these small and medium cities. As cities plan for the long term, one of the most critical components they need to plan for is the availability of land. Small cities should look to create the land banks that they will need for future development by acquiring these lands upfront. These land banks can be financed with the help of a derivative product provided by the central government that guarantees a minimum increase in land values (say 1%). Small cities can use this guarantee to borrow from banks that would otherwise be unwilling to lend to them and thus finance their land banks.

However, land acquisition can be a complex, time-consuming process and wherever feasible, mechanisms such as Land Readjustment and Pooling (LRP) can be used to make lands available for development without needing them to be acquired. LRP is a self-financing mechanism that allows for landowners to work as partners with local government and enables comprehensive planning of land and infrastructure provision. LRP should be legislated in the town planning acts of all Indian states.

The financing of new infrastructure provision in small and medium cities will be dependent on grant funding for the short term. The UIDSSMT programme should be given high priority

and cities should be encouraged to prepare project proposals for funding. The UIDSSMT financing mechanism can be modified with a new feature, making available a portion of UIDSSMT funds to be used as guarantee funds for pooled bond issues. This can ensure that UIDSSMT funds are leveraged to a greater extent than they are currently and reach a larger number of cities.

There also needs to be a concerted push to revive the moribund pooled financing scheme that allows multiple small cities to pool together their infrastructure projects and access the capital markets with bond issues to raise financing. Despite a few successful pooled bond issues, there has been a distinct lack of activity in this market. This can be attributed to a guideline that requires that tax-free pooled bonds be issued at 8% or less. This stringent requirement makes new bond issues economically unviable. It must be revised so that the interest rate cap is a spread over a benchmark rate, such as the government securities rate.

The development of small and medium cities is essential to sustainable urbanisation, and it can be augmented by the development of new cities. New city development can take the form of development of nodes near large existing cities in order to ease the population pressure on the latter. These nodes are designed to decongest the larger cities. One way to finance the development of such nodal cities is through the issue of long-term local government bonds backed by partial central government guarantees.

New cities can also be developed around large industries and industrial clusters. Since these industries are private ventures, there is tremendous scope for involving the private sector in planning the development of these cities and getting them to substantially participate in financing the creation of infrastructure, even as equity partners. Such cities can also experiment with other innovative service delivery and financing mechanisms that could have tremendous relevance for the country at large.

Urbanisation in India is gathering momentum and in order to be able to plan for a sustainable urban future, immediate attention needs to be paid to the small and medium cities of the country. It is only through the focused development of these cities as the cities of tomorrow can India develop a meaningful long-term urbanisation strategy.

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