

Urban Economic Policy: Directions for the Future

George S. Tolley and Vinod Thomas

The past quarter-century has witnessed rapid urbanization in the developing world. Today the developing countries contain fifteen of the twenty-five cities with populations over 5 million. Although urbanization is associated with economic growth in the minds of many, the scale of urbanization in developing countries is also viewed with alarm. The observed concentration of poverty, unemployment, housing, and transport problems in some highly built-up urban centers such as Mexico City, São Paulo, Bombay, Cairo, Jakarta, and Manila has given rise to fear of the consequences of present trends.

The rate and scale of the recent urbanization phenomenon have been so large that they are not yet adequately understood. Urban theory offers explanations of the workings of urbanization in developed economies: theories of housing markets, locational decisions, traffic and transport modes, and labor markets have been advanced. Are the same analytical approaches applicable in developing countries as well? Is developing-country urbanization a distinct phenomenon? Are there urban policy conclusions for developing countries that differ markedly from those for the industrial economies of today?

This book has emphasized similarities in urbanization in developing and developed countries but has also brought out important differences. Many of the analytical methods adopted in this work were developed in the context of experience in advanced countries. Basic behavioral and economic explanations behind rent and density gradients and city formation are relevant in developing as well as developed countries, and even the range of parametrical estimates of some key demand variables in the urban economy may be similar. The

forces of urbanization that originate from population growth, urban-rural productivity, and composition of demand increases are also widely applicable. The book has laid out some of these factors in the developing-country context to assist in an understanding of urbanization trends. The authors differ in their emphasis on the relative importance of these forces, perhaps because the experiences of the countries examined vary.

Some of the differences between developed and developing countries are perhaps more interesting than the similarities. Even if the tools of analysis are not necessarily different, the present-day urbanization experience in the developing world brings to focus more complex and difficult, if not different, policy issues. Urban problems in developing countries are more severe than those in the developed countries today because of the former's much faster rate of urbanization at present. In addition, the problems are also bigger than those that the advanced economies experienced when they were developing. The main reason is not that the pace of urbanization is different now than earlier, but that urban populations and agglomerations are larger today, partly because of larger overall population. Moreover, in developing countries today intraurban transport costs are relatively lower than those in previous time periods and allow flatter rent gradients within cities, larger city sizes and more concentration. (Reductions in intracity transport costs may have been greater than those in intercity costs.) Urban centers in developing countries also seem to have been able to achieve greater technology transfer and productivity gains than rural areas, which has caused correspondingly stronger pressures to urbanize in an increasingly interrelated world economy. Individual countries obviously face widely differing cir-

cumstances; factors range from low and stagnant agricultural productivity in many African countries to special city incentives and government urban subsidies that provide added impetus to urbanization in many parts of the world.

Although the urban economy is exceedingly complex, this book has adopted the view that an understanding of economic behavior in the urban context is more useful than is the construction of large-scale urban models. Much more comparative analytic work remains to be done, however, in promoting a better understanding of developing-country urbanization. The urban-rural linkages vary among countries, as do the importance of macroeconomic policy on urbanization and the impact of regional considerations that affect urbanization. Finally, international trade is an important determinant of the nature and composition of production and population within a country. Understanding these phenomena in greater detail constitutes an agenda for further work.

Urbanization Problems in Mixed Economies

Urban problems are best understood in the context of the economic development of nations. Urbanization as such is neither the source nor the enemy of development. The mainsprings of productivity growth make agglomeration and urbanization attractive and bestow net economic benefits, at least for some time. Urbanization can proceed too rapidly, however, and make some developing-country cities too big from the economic and management points of view. Some important aspects of the overurbanization issue are negative externalities, such as crowding, pollution, and transport failure, which represent a drain on the benefits associated with urbanization. Overurbanization, if it occurs, is difficult to correct and may best be addressed through actions aimed directly at the externalities rather than at city size.

Often urban poverty is identified as the urban problem, and quick-fix solutions are sought to eradicate it. The basic reasons for urban poverty, however, relate to overall poverty in the country and to inadequate gainful employment. Nationwide policies for generating long-term income and employment and for promoting a smoother functioning of labor markets are perhaps the best strategy for reducing urban poverty. Sometimes informal sector activities, such as shoestring enterprises and street vending, are falsely viewed as unproductive, and their elimination is associated with poverty alleviation. Again, the level of economic development of the country determines the mix of employment opportunities, and informal activities could represent a valuable

source of employment and incomes which should not be discouraged.

Antipoverty efforts in urban areas are best served over the long term by employment and labor market policies that increase labor productivity and demand more rapidly than labor supply, with special emphasis on lower skill levels. Policies to assist labor mobility across occupations and locations are also vital. In this context the urban employment and poverty record can be improved in many developing-country settings by measures to reduce the natural growth of population and to improve labor force participation and education. Massive rural-urban migration is often held responsible for urban poverty and unemployment, but the migration issue is a complex one in which urban-urban outflows play as important a role as rural-urban migration. The economic incentives to migration derive from the economy-wide context, and measures at an individual city level—such as restrictions on informal activities and squatter settlements and withholding of urban infrastructure for new entrants—are likely to be ineffective and inefficient. Urban subsidies for production and consumption often serve to increase city inflows, and a reduction in such special incentives could help to keep migration flows at manageable levels.

Lessons under Central Planning

China's experience illustrates the difficulty of influencing income gaps between the city and the countryside. China has not relied on migration and seems to have worked much harder on more direct measures than other societies. Through the encouragement of bootstrap operations villagers have been induced to help build an infrastructure of waterworks, roads, level fields, schools, public health care, and administration. The government has tried to help directly by raising prices for agricultural products, but a closer examination shows that the drive toward rapid industrial growth has helped shape government investments and industrial prices to the detriment of agricultural growth. And when it comes to state-subsidized services, including housing, health care, education, and cheap food, it is still the urban sector that has reaped the greatest share of the benefits. That these conditions are found in many other developing societies seems to illustrate the continuing problems of urban and industrial bias even in a society that has overtly renounced such a policy.

China has now begun to correct some of these difficulties. The government has helped induce a rapid rise in rural incomes over the past few years by again raising rural purchase prices, by increasing agricultural investment, and by removing several other bureaucratic con-

straints on farmer activities. The rise in rural incomes may still not be greater than the increase for urban dwellers, but absolute living standards have begun to improve significantly. Some of the gap between city and countryside may be erased less by helping agriculture itself than by allowing peasants to open more small industry in rural market centers. This phenomenon has not been discussed in this book because many of the market centers are excluded from China's urban statistics. Yet with the prohibition on migration to cities, these small market centers seem to be providing an outlet for peasants which exerts a positive influence on rural incomes and possibly leads to a diffuse pattern of urbanization throughout the countryside.

More peasants may also be slipping into cities. With the increasing role of peasant free markets in cities, the reduction in the number of rationed goods in some cities, new construction activities that can use unskilled labor, and a general relaxation of bureaucratic rule, the number of illegal migrants in cities may be growing. Increasing foreign trade may also create pressure for such major port cities as Shanghai to grow in a way that they have not in the past. All these forces may lead to a slightly different Chinese urban structure than we have seen in the past three decades, but much of the basic structure is likely to remain intact. Centralized control over investment, state jobs, and many rations continues to give the government a way of controlling the growth of cities. And much of the new growth of rural market centers would promote a more balanced pattern of urban growth, similar to that witnessed in earlier decades.

Urban Concentration and Urban Policy

The distribution of city size is a subject of intense public debate in countries with divergent economic managements. The issue—a variant on the concern about urban concentration—relates mostly to the alleged polarization of economic activity in one or a few urban centers. Such concentration does often exist, as in many Latin American countries; it is less marked in India. Considerable work has been done on the classification of cities according to the structure of the economic base, but a classification of desirable city size distributions has yet to emerge.

Nationwide planning for a certain city size distribution does not seem promising, even if such an outcome might look attractive. Even limited efforts to create cities and growth poles have turned out to be excessively costly, as have policies to promote concentration. A macroeconomic policy posture that does not favor or penalize urbanization seems to be the most desirable

approach from an economic viewpoint. Experiences with the concentration incentives in Brazil and the decentralization inducements in Korea and Venezuela which are documented in this book lend support to this view.

The indirect urban effects of economic policies are often ignored and are not well understood. Many countries in Asia and Africa have historically adopted price policies that hurt agricultural productivity and thereby indirectly favored urban production. Consumer subsidies in urban areas have been widespread. Macroeconomic policies have also indirectly and unintentionally promoted a concentration of production of nontradable goods in urban areas. An overvalued exchange rate implicitly taxes tradables and shifts resources to nontradables. To the extent that the agricultural sector contains relatively more tradables than does the rest of the economy (including services), on average, such an exchange rate policy would promote nonagriculture in relation to agriculture.

A reversal of the process of urbanization is unlikely to be feasible, nor is it desirable as national policy if economic development is to be sustained. At the same time, it should be noted that a country might wish to pursue some type of decentralization of economic activities for reasons not readily measurable in economic terms. Often, large concentrations of people and activities present political problems. Another motive is that a larger number of smaller cities may be more desirable, from a defense and strategic viewpoint, than a few densely populated large cities. One problem is how to take account of these goals legitimately rather than letting them be used as mere rationalizations for undesirable or ineffective policies.

A relevant issue seems to be whether and how to marginally affect the degree and nature of urbanization, including the size distribution of cities. Clearly, political, social, and economic pressures influence policy options, and policy choices are seldom straightforward. Nevertheless, the analysis of urbanization in this book yields four types of suggestions for economic policy.

First, policies might attempt to take account of externalities that inadvertently affect urbanization. Externalities—whether negative or positive—are not usually accounted for in the activity of the private sector. Public policy might correct this failure by, for example, adopting appropriate pricing policies for public services and taxing public ills such as pollution and congestion. Such interventions are likely to influence the locational choices of people and economic activities.

Second, government policy could address vital infrastructural issues. Bottlenecks in transport and other infrastructure constrain urban development across regions and affect the size distribution of cities. The key

issue concerns the optimal level and composition of investment in infrastructure. In this connection, improved benefit-cost evaluation techniques and efficient application of policies would be essential.

Third, direct incentives to influence urbanization and city size might be introduced only selectively in cases where net benefits can be shown. Policy experience to date is not encouraging. The challenge, therefore, is to determine in which instances direct government intervention to promote or retard city size is warranted. A fundamental need is the development of rigorous and reliable means of making quantitative estimates of the effects of these policies.

Finally, several urban problems require direct solutions. Policies for greater efficiency in urban housing, transport, finance, and other areas are often needed. The experience with large-scale housing projects and capital-intensive transit systems has been unpromising. The evidence in this book supports smaller and more divisible projects which respond more directly to the demands and financial means of consumers. Expenditures on rehabilitation, operation, and maintenance of urban facilities, in addition to capital deepening, can have particularly high payoffs. Efficient financial and economic management of cities as urban centers reach extraordinary sizes is an increasing challenge. The relation between urban projects and policies on the one hand and management efficiency in cities on the other is

a crucial question. In better understanding this issue, knowledge from other disciplines needs to be combined with economic considerations, and intermediate goals must be contrasted with those connected with long-term economic development.

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Urban problems, already acute in the developing world, threaten to become more severe as population growth and rural-to-urban migration continue. To promote a better understanding of urbanization, this volume offers a framework for analyzing urbanization processes and evaluating policies to cope with urban problems. Among the topics considered are the causes of rural-urban migration, the connection between urbanization and economic development, urban poverty, differences in country experiences, the goals and effects of policies that attempt to influence urbanization, and urban management issues in such areas as housing, transport, finance, and pollution. Approaches in both market and centrally planned economies are examined.

Written by experts from the World Bank and the academic world, the studies build on progress to date and make new contributions that should be of value to policymakers, project analysts, scholars, and, in general, persons interested in urban problems. Introductory and concluding chapters by the editors draw together the findings and bring out policy implications.

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