

# Chapter one

# The Need for a New Urban Strategy for the Bank

At the threshold of the 21st century, cities and towns form the frontline in the development campaign. Within a generation the majority of the developing world's population will live in urban areas and the number of urban residents in developing countries will double, increasing by over 2 billion inhabitants.<sup>2</sup> This urbanization creates significant opportunities for national development, and for reducing poverty for all citizens. But realizing the potential gains from the urban transition depends on how well cities and towns manage growth and meet the challenges of providing responsive governance and ensuring services for all firms and households.

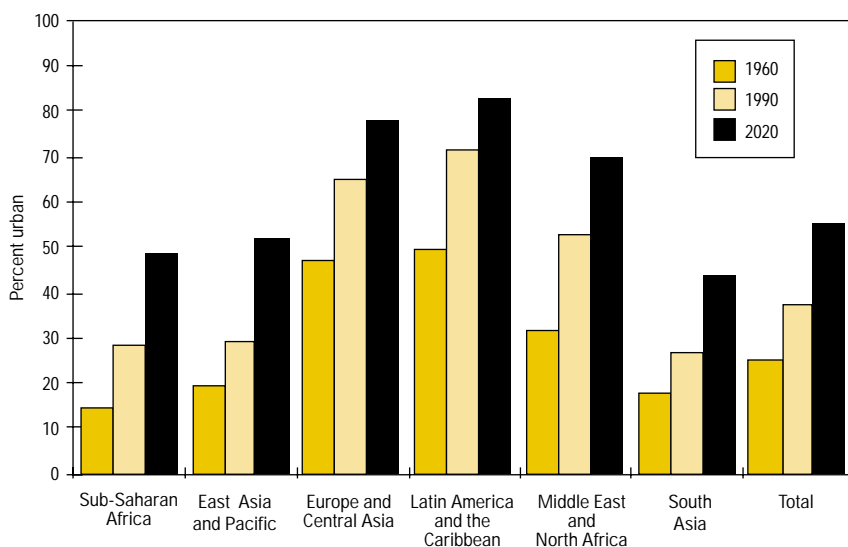
The World Bank's extensive experience with urban assistance has given it a strong understanding of the policy agenda for sustainable urban development and of the institutional challenges facing national and local governments.<sup>3</sup> The Bank is uniquely positioned to become an even stronger source of urban assistance to countries and to the emerging new clients among local authorities. The new urban and local government strategy calls for the Bank to rise to the challenge of achieving greater impact in its urban activities, extending its reach among local governments, and mobilizing the strengths of the Bank Group and external partners in this effort. This document thus takes a broad perspective of urban and local government issues to advocate a common frame of reference for support by the institution. Nevertheless, the detailed operational focus of the strategy is on the Bank's urban development lines of business. Although this body of work does not represent a "sector" in the Bank's parlance, it is unified by two characteristics. First, it concentrates on the *spatial character of economic and social relations*—how the combination of sectoral services and proximity of people and firms in the urban place yields benefits (agglomeration economies) that exceed those of their separate activities. And second, it gives atten-

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<sup>2</sup> This report uses the terms urban areas and cities interchangeably. The definition of urban varies by country and over time, normally referring to settlements with a minimum population ranging from 2,500 to 25,000 people and with a certain concentration of nonagricultural employment and production. City is a legal designation associated with specific administrative or local government structures. Many large urban areas, often called metropolises, consist of multiple employment centers and span more than one city jurisdiction.

<sup>3</sup> This report uses the terms local governments or local authorities mainly in reference to municipalities. Although their precise legal status differs among countries, municipalities are understood here as the lowest organized units within the administrative apparatus of the state.

**Figure 1.1 Within a generation the developing world will be predominantly urban**



Source: United Nations data.

tion to *urban governance and management*, the processes by which local governments, in partnership with other public agencies, the private sector, and the residents, ensure the delivery and financing of essential services and promote the welfare and productivity of the urban society.

### The changing context of urban development

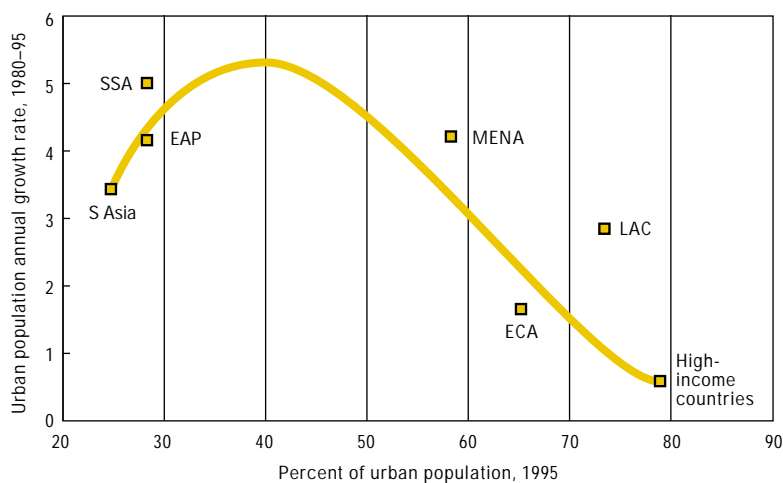
The confluence of four worldwide trends makes reconsidering the Bank's urban strategy both timely and urgent: urbanization, decentralization, globalization, and government renewal.

#### The world is becoming more urban

By 2020 urban residents will constitute the majority in every region except South Asia and possibly Sub-Saharan Africa (figure 1.1). The average urban shares (weighted by country population) in Latin America and the Caribbean and in Europe and Central Asia are approaching those of OECD countries, though the share varies widely within regions. In East Asia, Sub-Saharan Africa, and the Middle East and North Africa urbanization is proceeding rapidly, with urban growth exceeding 4 percent a year (figure 1.2).<sup>4</sup> Over the next two decades more than 95 percent of

<sup>4</sup> Urbanization is defined as the change in the proportion of the national population residing in urban areas. Urban growth indicates the change in urban population size, independent of changes in the rural population. The definition of the minimum urban settlement size varies by country.

**Figure 1.2** Most developing countries are in, or are entering, the high-growth phase of the urban transition



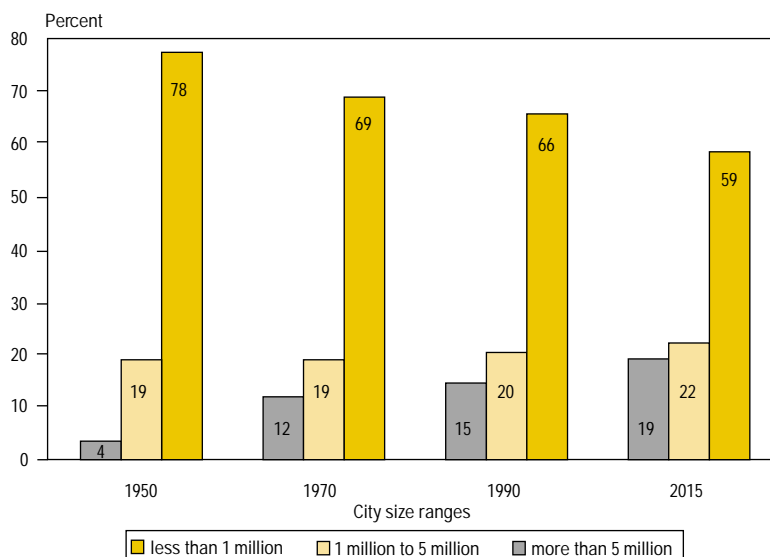
Source: World Bank 1998b.

the population growth in developing countries, even in South Asia, will occur in urban areas. The scale of this urbanization, and its implications for the ability of countries to meet the needs of their people at relatively low levels of national income, are unprecedented. Megacities such as Bangkok, Cairo, and Lima have had to absorb more than twice as many people in the past 25 years as London or New York did at the peak of their growth at the end of the last century (Brockenhoff and Brennan 1998). Developing countries are also confronting these urbanization trends at lower incomes. When urbanization in Latin America was roughly 30 years behind that in North America, its average per capita income approximated that of the United States 120 years ago (Ingram and Carroll 1981).

The most rapid growth in recent decades has occurred in large cities (1–5 million residents) and in small ones (fewer than 500,000). But the proliferation of megacities (more than 10 million) is the most dramatic trend, particularly in Asia and Latin America (figure 1.3). Between 1995 and 2015, the world's megacities will more than double in number, to 26. Of these, 22 will be in developing countries, most of them in Asia. These cities are much larger than the largest ones known in the recent past (see annex table D6), underscoring the daunting management challenge they pose to local governments.

Less than half the urban growth in any region is due to internal (rural to urban) migration. Most is explained by natural population increase within cities and by the structural transformation and incorporation of formerly rural areas at the urban periphery. In many countries the most rapid population growth is occurring outside the boundaries of existing primary or secondary cities—such as in the Eastern

**Figure 1.3 The developing world's urban population is still concentrated in small cities, but large cities' share is increasing**



Source: UN demographic data.

Seaboard region of Thailand, where intensive investment has fueled settlement and industrial development in advance of even basic urban services. Mushrooming peri-urban areas in Africa and Latin America are becoming massive slums, in some cases beyond the formal reach of municipal governments and utilities. The physical form of growth, with extensive areas of relatively low density development (sprawl) in many of these cities, adds to hardship for households—especially for those with low incomes that are often virtually sequestered in neighborhoods far from urban amenities and productive employment.

#### Governments are decentralizing

Most countries have undertaken political, fiscal, and administrative decentralization over the past decade in an effort to make government more responsive to citizens and to increase its efficiency. Decentralization has been most extensively implemented in Latin America and in the transition economies, has made legislative advances in South Asia and Sub-Saharan Africa, and is proceeding more slowly in East Asia and in the Mideast and North Africa. Implementation is inconsistent even within countries, and greater legal autonomy for local governments has not necessarily meant greater local revenue or expenditure authority. Some countries are finding themselves with a very large number of small municipalities but with no mechanisms in place to foster coordination and economies of scale in management.

### Cities are becoming more global

With improvements in transport and communications, cities are now linked directly to international markets. This trend, coupled with increased intensity in the use of information, financial, and other services by all types of firms, means that cities face more exacting requirements as sites for high-quality services to producers and greater competition for foreign and domestic investment (Harris 1997a; Sassen 1998). Urban areas sharing large regional markets (border zones and port cities, such as those surrounding the South China Sea) are becoming closely networked, sometimes developing interdependencies across national boundaries that are as close as, or even closer than, those with their own hinterland.<sup>5</sup> By reducing the traditional market position of some cities and fostering the growth of others with different locational and production advantages, the liberalization of trade and financial flows is contributing to large spatial shifts of population and output. These changes imply that now more than ever, cities need to provide solid public services and a business-friendly environment to retain their traditional firms or to attract new ones, domestic or foreign.

### Government is being reformed

Worldwide, the role of government is being reconsidered and reconfirmed to strengthen its essential functions of facilitating markets and correcting market failures, promoting economic and social stability, and ensuring distributional equity. This process has included efforts to expand opportunities for citizen participation, to increase innovation, openness, and cost-effectiveness (“reinventing” and “right-sizing” government), and to rebalance public and private sector roles. All these efforts are especially challenging for local government, which is the level closest to the people and most immediately responsible for ensuring an environment conducive to good business and a strong civic society. Reforms of public sector management or private sector development cannot do what is desired for the national economy until they are adapted to the requirements of urban governance and management and implemented at the municipal level.

The four global trends—urbanization, decentralization, globalization, and government reform—underscore the increasing importance of cities and towns in national development. Local governments, traditionally the public sector’s weakest link in most countries, are the ground troops in responding to the imposing demands for jobs, infrastructure (both new investment and rehabilitation and upgrading of existing systems), finance, and effective governance. Managing such challenges in the face of demographic and global economic pressures has been difficult even in relatively well-run economies, as shown by the recent financial crisis in East Asia (box 1.1).

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<sup>5</sup> *Gipouloux (1997) argues that cities’ “strategic importance now lies less in location than in capacity to master factors such as finance, production, and innovation. . . . city functions, not city size, are important to economic position in the global economy” (p. 16).*

### Box 1.1 Cities are particularly vulnerable in times of crisis

In a recent workshop urban managers and central government officials from China, Indonesia, the Philippines, Thailand, and Vietnam reported that the region's financial and economic crisis is having particularly strong effects on the urban economy, underscoring the vulnerability of urban populations. Job losses in the formal sector (especially in construction and finance) were an early outcome. But more pervasive and devastating have been income losses due to reduced demand for manufactures and transport and other services, the main sources of livelihood for urban residents, and price increases, especially for food, utilities, and essential imported goods (such as drugs), resulting from sharp exchange rate depreciation. Moreover, in some countries the crisis coincided with *El Niño*, whose effects on agriculture compounded the food price increases faced by urban consumers (the food price index in Indonesia jumped 50 percent in nine months).

In Indonesia, which had reduced both rural and urban poverty significantly between the 1970s and the mid-1990s, it is estimated that the urban poverty rate almost doubled between 1996 and 1999, rising from 5 percent to about 9 percent, far more than the increase in rural poverty (World Bank 1998f). In Indonesia, the Republic of Korea, and Thailand, analyses of household income and expenditure data show that urban areas have been most affected by the crisis. In Bangkok and Manila the social stresses of the crisis are manifested in increased crime, domestic violence, and child prostitution as the traditional coping mechanisms of families and communities become overstrained. Migrating back to rural areas is not an option for most long-established urban residents.

The officials noted that the economic crisis spotlights the weaknesses in the institutional and revenue capacities of local governments, which confront the daily fallout of the crisis, and is strengthening the political support for decentralization. Flaws in the financial regulation and functioning of urban housing and real estate markets have been made painfully evident by their sharp collapse, yet many firms and households remain unable to acquire developed land or vacant housing.

### The implications of urban change for national development

Urbanization represents an opportunity for advancing national goals of sustainable development. Urban development can lead to macroeconomic and microeconomic benefits and improvements in social welfare and environmental protection. But realization of these gains depends on the policy framework affecting cities and the quality of urban management (see also annex A).

#### Macroeconomic and microeconomic impacts of urban development

Urban areas account for a disproportionately high share of national economic production and are the main sources of economic growth in most countries. National economic growth is closely correlated with urbanization (although Sub-Saharan Africa has been a notable exception to this rule since the early 1980s, in terms of measurable income growth). In many countries urban population growth has been

stimulated by policy distortions that dampen rural-urban terms of trade, artificially raise urban real wages and public employment, subsidize credit for urban investment, underprice infrastructure services, and concentrate public spending in urban centers as seats of political power. Such policies, often termed evidence of “urban bias,” are actually counterproductive in that they undermine good management of urban growth; removal of such policies should therefore be part of sound national urban policy. As more governments liberalize markets and reform the public sector to correct such imbalances and as urban consumers pay more realistic rates for the resources they consume, urbanization can be harnessed to promote more equitable growth of incomes in the nation as a whole.

Urban development contributes to national economic growth by allowing increasing returns to land, labor, and capital. Thus savings, investment, and wealth accumulation (through real estate, productive, and infrastructure assets) become concentrated in cities. Firms locate in cities to benefit from agglomeration economies and greater access to information and technology. The advantages of large urban areas over smaller cities and towns in total factor productivity have been established empirically, but the quality of urban markets and the transactions costs resulting from poor urban regulation determine how well these advantages are realized.

Urban workers are more productive in large urban areas because there are more opportunities to match skills to jobs and to use additional capital inputs—but bad urban management can impede labor mobility. Housing, urban transport, and land use policies often limit residential mobility and thus access to jobs. Large pools of workers and many employers are excluded from the benefits of urban agglomeration by their spatial segregation into vast periurban areas, while regulations can force many small firms into the informal sector. Women and youth are particularly disadvantaged by poor and unsafe transport that makes schooling and jobs difficult to reach.

Problems with urban land markets have economywide repercussions, as the recent experience in East Asian economies shows. Even in these apparently robust economies public infrastructure was underdeveloped relative to private and informal investment in property markets (leading to a scarcity of serviced urban land); regulation of urban land markets, financial discipline in underwriting real property investments, and property taxation were inadequate (encouraging speculative land-holding); and accounting practices permitted the recording of real property at inflated and unrealistic values.

Synergy between the rural and urban economies is a particularly important channel through which growing urban areas contribute to national development. “Urban” and “rural” are interdependent markets linked by exchanges of people, goods, services, capital, social transactions, and information and technology that benefit residents in both locations. Ensuring the food security of urban populations may require deliberate policy attention, since urban consumers depend more heav-



ily on a marketed food surplus than do rural residents.<sup>6</sup> Policy must also address competition for resources, especially land and water, between urban and rural areas. But many of the concerns of rural development intersect with the urban agenda, including the need to support agriculture with services and markets, to foster nonfarm employment, and to manage the growth of small towns, which often form part of a wider municipal governance structure covering both rural and urban settlements.

Migration between rural and urban areas is a vital source of alternative employment for the agricultural population and transfers innovation as well as remittances—in fact, migration is a carrier of growth. In many countries improved infrastructure and changes in agricultural practices are permitting more fluid labor exchange, including seasonal and even daily commuting. Distinctions between cities, towns, and rural areas are becoming almost obsolete as economic activity spreads outward into vast semiurbanized and rural industrialized regions in response to global trade opportunities and technological changes. Integrated development of intercity corridors can be a deliberate subregional policy to address rural poverty, as was recently determined in work on a city strategy for Haiphong, Vietnam. The potential interdependencies between urban areas and their hinterlands can be exploited more fully to the benefit of both regions—for example, by ensuring efficient markets for agricultural goods, labor, and transport.

#### Social impacts of urban development

Efficient urban development can play a major part in combating national poverty. And cities and towns have traditionally been beacons of hope to migrants and sources of opportunity for poor individuals and families to improve their welfare. But poverty is a growing problem in urban areas and is spreading from the old centers to the periphery of cities. Roughly half a billion poor people live in the towns and cities of developing countries, many in unhealthful and deteriorating conditions without basic services. Already in Latin America and in Europe and Central Asia poverty is predominantly urban and the trend is in this direction in most other regions. Even in East Asia the share of poor people who live in towns and cities is expected to rise from a fourth today to as much as half by 2025 (according to precrisis projections). The continuing growth of slums in Indian cities and of the *favelas* in Rio de Janeiro is visible evidence of the failure of urban policies in many places to provide routes out of poverty. One knowledgeable local observer has said of Rio de Janeiro that the city “is not importing poverty [from the countryside], it is producing it.”

The high rate of relative poverty, or inequality, in urban areas reflects the inability of some citizens to participate in society and in activities that lead to improved welfare and personal security. The urban poor are especially vulnerable to economic shocks. They lack the access to services, safety nets, civil protections, and

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<sup>6</sup> *The required growth of marketed food supply increases considerably faster than overall population growth in the presence of urbanization, because urbanites typically buy 90 percent of their food from the market. In some developing and transition economies, urban agriculture is an important supplemental source of food for urban consumers (Brown and McCalla 1998).*

political representation enjoyed by upper-income groups, and they face greater risks of bad health, crime and violence, and natural disasters—a pattern of cumulative deprivation. Children are especially susceptible to all these risks in the urban setting, where more women work outside the home and adequate child care is often lacking. Long-term urban residents typically cannot rely on village resources as a fall-back, although there has been some limited return migration to rural areas in the East Asian crisis economies. Urban living conditions, especially in large and fast-growing cities, are deteriorating relative to those in smaller towns and rural areas, and the urban-rural gap in mortality, morbidity, and other health and nutritional indicators is narrowing. Some urban residents are now the worst off. These changes are overturning conventional views of urban advantage and creating a potential for increasing social problems.

#### Environmental impacts of urban development

Urban development can have both positive and negative implications for the environment, just as for social welfare and the economy. The balance depends on how it is managed. Cities are the main site of the built environment and embody national and local culture in buildings, in the design of public space, and in urban form. In the Mideast and North Africa alone, 70 cities have been designated of historical interest not just to their countries but to the world. So urban development can enrich the environment of human settlement—or create blight that dangerously impairs the quality of life.

The environmental problems of urban areas (the “brown” agenda)—air, soil, and water pollution, noise, and traffic congestion—have more direct and immediate implications for human health and safety, especially for the poor, and for business productivity than do “green” environmental issues. Worldwide, airborne particulates pollution has been associated with at least 500,000 premature deaths and up to 5 million new cases of chronic bronchitis each year. Lead pollution from motor vehicles leads to hundreds of premature deaths, reduced intellectual capabilities in children, and other health damage in large cities. Microbial diseases due to poor sanitation and dirty water cost billions of dollars a year in lost lives and poor health, especially in the poorest cities. Brown issues are associated with urban activity, but they affect areas outside cities by contributing to global climate change and threatening coastal zones. Another consequence of poorly managed urbanization is the settlement of unsuitable and risky locations such as floodplains and hill-sides, which adds to the worsening human toll of urban disasters.

Policies to curb future environmental deterioration resulting from motorization and urban economic activity will have limited effect if focused narrowly on sectoral issues within transport, energy, or industry. Effective solutions must address broad issues, including transport demand, land use planning, industrial development and location, and household income growth and distribution—all central to the urban development agenda.

### The importance of urban development to the global, and to the Bank's, development agenda

The centrality of urban issues to national and global goals for sustainable development has long been acknowledged in the international arena, most recently at the 1996 Habitat II Conference on Human Settlements. What happens in the developing world's cities and towns likewise matters in realizing the World Bank's corporate goals of reducing poverty, promoting market-based growth, building durable institutions, and protecting the environment. Working with municipalities is key to promoting the Bank's strategic objectives of improving development effectiveness, increasing the participation of civil society, forging partnerships, and reducing corruption—all primary requirements in helping local governments deliver on their promises to the people. The opportunities for exploiting rural-urban synergies and for helping countries realize the promise of urbanization offer a prime example of the holistic, intersectoral development challenge posed by President Wolfensohn in his speech at the 1998 Annual Meetings of the World Bank and the International Monetary Fund.

Urban and local government work is also good business for the Bank. There is growing demand for Bank assistance in this area, not only from national governments but also from a newly empowered set of clients—municipalities themselves. The number of urban development projects planned for fiscal 1999–2000 reflects a 50 percent increase over the annual number approved in fiscal 1993–98. Projects in other portfolio categories (especially water and sanitation and urban transport, but also energy, environment, and public sector management) that have an explicit urban spatial or local government focus are becoming as numerous as urban development operations, and are growing just as rapidly. Demand for assistance in the traditional, core activities of the Bank's urban program—basic services for the poor and other infrastructure, housing, municipal development and finance, environmental management, and disaster mitigation—remains strong. There are also many new or changing emphases—such as local economic development, real estate market reform, capital market access, private sector participation, cultural heritage, and disaster management—that call for new responses and more concerted collaboration across sectors and disciplines in the Bank. All these factors create impetus for revisiting the Bank's urban strategy.