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INDIA'S URBAN CHALLENGE

**Framework for an
AID Strategy**

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1 INTRODUCTION AND EXECUTIVE SUMMARY

1.1 INTRODUCTION

This report completes the second stage of a process designed to develop a medium term urban and shelter strategy for the United States Agency for International Development (AID) in India. The strategy will guide the activities of AID/India and the AID's Regional Housing and Urban Development Office (RHUDO) for Asia in the urban sector over the next few years. It will cover initiatives in technical assistance and training as well as capital assistance (through the Housing Guaranty program and other vehicles).

The first stage of the process reviewed the current context for urban and shelter development in India, describing the extent of urbanization, the nature of present urban problems, and the current policy and institutional environment (Lee, 1988). In this second stage, an initial report was prepared that examined emerging urban trends and the implications of those trends for national development and then assessed new policy themes developed in recent Government of India (GOI) urban and housing policy reviews (Kingsley, Telgarsky and Walter, 1989). Based on that analysis, this report suggests a broad framework for AID's strategy (*Section 2*) and indicates a number of "areas of opportunity" for project initiatives within the sector that may warrant attention by AID (*Section 3*). The third stage will look at the most promising of these areas in greater detail and, based on that examination, the fourth stage will define the strategy itself and spell out implied resource and management requirements.

The following paragraphs summarize the main findings and conclusions both of the earlier report on urban trends and their implications and then of this report.

1.2 URBAN PROSPECTS

India's urban population growth has accelerated since 1971 but remains spatially balanced.

- In 1988, about 210 million people (26% of India's total population) lived in urban areas. The 1971-81 urban growth rate was 3.9% per year compared to 3.3% over 1961-71.
- India has a balanced urban spatial pattern (reasonable numbers of cities of all sizes in all regions) and the spatial trend is toward more even spread:
 - Lowest current urban growth rates in the presently most urbanized states--fastest urbanization rates in the states now least urbanized.
 - Largest cities (over 3 million in 1971) grew slowest (3.0% annually), middle sized cities (1 to 3 million) grew fastest (4.6% annually).

Rapid urban growth will be inevitably associated with economic progress in India, but cities will grow rapidly even if economic performance is weak.

- Even with optimistic assumptions about rural development, agriculture will not be able to absorb a large portion of the burgeoning labor force.
- Satisfactory economic growth in India will therefore require further structural change--a larger percentage of activity in sectors that can yield higher incomes per worker (eg, manufacturing, services).
- Given the nature of their operations, most of the activities in these sectors will have to locate in urban areas to succeed. This implies rapid growth of urban jobs and population.
- If economic performance is sluggish, however, constraints on income earning opportunities in rural areas will force substantial migration to the cities anyway.
- These conclusions are supported by the fact that urbanization is now accelerating in a variety of economic conditions. For example:
 - In Punjab, with increasing agricultural productivity but without much exogenous industry,
 - in Karnataka, with healthy industrial expansion but stagnant agriculture,
 - in Bihar, with poor performance in both agriculture and industry.

Evaluation of alternative forecasts suggest that India's urban population will more than double between now and 2010.

- Depending on economic conditions, India's urban population is likely to range between 435 million and 485 million in 2010. A total of 460 million (41% of the nation's total 2010 population) would appear to be a reasonable estimate for planning purposes.
- This implies that about 70% of India's total 1981-2010 population growth will occur in urban areas (compared with 30% over 1951-81). Urban areas

- will have to accommodate about 10.4 million new inhabitants per year over 1981-2010, compared with about half that amount over the 1970s.
- Cities will dominate national economic growth over this period. It is likely that urban areas will be producing the majority of GDP by the late 1990s.

1.3 CONSTRAINTS AND IMPLICATIONS OF URBAN GROWTH

Urban economic development and job generation.

- Under any reasonable urban growth forecast there will be an enormous need for new higher productivity employment opportunities in urban areas. If these jobs are not created in sufficient quantity and resident incomes remain low, it will be extremely difficult to develop a decent urban physical environment.
- Onerous regulations now constrain productivity increases in the private sector. That sector's informal and formal components are highly interactive in India. Policies that tend to segregate them are likely to be detrimental since economic development will occur most rapidly when informal enterprises have the incentives to expand and accelerate job creation.
- Constraints in the process of land development and the lack of infrastructure and services (see discussion below) increase costs for new businesses thereby seriously reducing competitiveness and retarding economic growth.
- The compatibility of urban and rural economic development has not been sufficiently recognized. Substantial growth of domestic urban demand for agricultural products can be the major stimulus for rural development. The lack of sufficient investment in market town facilities to support the transfer/storage/processing/marketing of agricultural products can significantly retard rural development.
- Roughly 50 million urban residents now live below the poverty line (about one quarter of the total). The percent of urban population has been declining in recent years but with further urban growth the absolute number might well increase, particularly if economic growth is sluggish. same or of

Urban land development

- Growth estimates imply that at least 1,000-1,300 square kilometers of land should be developed for urban use each year through 2010--roughly from two to three times the rate of actual development during the 1970s.
- Badly designed regulations (eg, the Urban Land Ceiling Act), the lack of adequate land records, and cumbersome processing for land registration and transfer all now seriously constrain the supply of legal, serviced land in relation to demand, particularly in the largest cities.
- Rigid site planning standards raise costs of land development to unrealistic levels in relation to incomes.
- Land provision by government has been small in quantity and heavily subsidized.
- All of this results in inflation in urban land prices.

- If these constraints are alleviated, land supply should respond to demand at reasonably affordable prices even under the acceleration of urban growth that is anticipated. If they are not, accelerated growth could lead to further price increases and congestion. The poor would be hardest hit by these changes, facing declines in their already meager space standards.

Urban housing

- The production of from 2.5 million to 3.0 million housing units per year will probably be needed over 1981-2010.
- Unrealistically high building standards, rent control, and factors noted above that raise land costs have constrained the market such that formal sector private production of legal and affordable housing satisfies only a small fraction of the total need, essentially serving only the middle- and upper-income groups. But, the housing market remains tightly constrained for the middle income groups as well as for the poor.
- Public sector housing production has been sizeable compared to that in many countries, but it has emphasized high cost construction of finished housing without adequate cost recovery. Per unit subsidies have been extremely high and programs have been fraught with management problems. These factors have severely constrained output in relation to needs.
- In this environment, lower income groups (the informal sector) have been energetic and creative in providing basic shelter for themselves in unauthorized, unplanned, and unserviced settlements. But quality is extremely low and normal incentives to incremental quality improvements are inhibited. The costs are much higher than would be required in efficiently planned authorized development.
- The nation's housing finance system is also constrained (although steps toward liberalization are underway).
- Given present constraints, it seems clear that formal public and private sector housing production will not be able to grow in proportion to the expected growth in the number of urban households. The percentage of the population in unauthorized settlements would probably increase substantially and, considering the pressures, average environmental quality would significantly decline.

Urban infrastructure

- Government agencies have been unable to provide sufficient infrastructure to keep up with the need (water, sanitation, power, transportation).
- Over one quarter of the urban population does not have access to piped water supply of any kind, three quarters do not have access to water-borne sanitation, and one third have no access to electricity.
- Infrastructure that is produced by government is heavily subsidized and the subsidies are not well targeted. Cost recovery rates are insufficient and systems are inefficient.
- Government infrastructure costs more than it should because of unrealistically high standards and insufficient reliance on low cost technologies.

- Public infrastructure production is not keeping up with urban growth at present and, without basic reforms, it is likely to fall farther behind in the face of accelerating urban growth. This would imply excess costs inhibiting healthy economic growth and job generation as well as important reductions in the quality of the urban living environment.

Urban management and finance

- While they are the key to providing adequate urban services, India's local governments have actually been weakened over the past two decades due to the usurpation of some local powers by states and special agencies, the lack of adequate incentives to recruit and retain qualified staff, inadequate training, and ineffective management practices. Local governments fell far short of being able to keep up with the service needs implied by annual urban growth increments over 1970s and clearly, they are not prepared to handle the expected doubling of those increments over the subsequent three decades.
- It has been estimated that local government revenues were at best half of what they should have been in the early 1980s to provide adequate services. It appears likely that the gap has been increasing since then and the planned abolition of the octroi (a heavily utilized tax on the movement of goods) will expand it further. A few cities have attempted reforms to improve the yield of two of the most promising sources--the property taxes and user charges--but movement in these directions is not strong or widespread enough as yet to make a significant difference.
- Legal constraints and the lack of adequate apex institutions prevent municipalities from obtaining sufficient loan financing for capital improvements.
- Experience in other countries suggests that these problems should be correctable even given the resource limitations implied by the level of India's economic development. A doubling of municipal revenues as a fraction of GDP would not be unreasonable. Systems technologies which can greatly improve the efficiency of urban management are not yet being applied. Efforts to establish an appropriate institutional network to mobilize funds for lending to municipalities have not yet been made. If these steps are taken, decent basic urban service provision should be feasible under either optimistic or comparatively pessimistic economic growth scenarios.

In summary, two markedly different urban futures are possible for India over the next two decades.

- More than doubling the urban population without removing constraints implies the massive expansion of illegal and largely unserved residential settlements as well as economic retardation.
- Alternatively if current constraints are removed and sensible cost recovery systems are implemented, resources should be sufficient to achieve decent urban physical development--development which would itself further economic growth.

1.4 NEW THEMES FOR URBAN POLICY

Major 1988 Government of India (GOI) policy reviews (National Housing Policy, National Commission on Urbanization) offer promising approaches to addressing the urban challenge.

- They call for major reform of the existing system to eliminate constraints (not just more money for the urban sector under the old system).
- They recognize a leading role for the people (households, informal sector, cooperatives, NGOs, small and large firms) in housing and urban economic development. They propose that government should become more the enabler and facilitator rather than the provider in these areas and strengthen its own capacity to deliver land and infrastructure which the people cannot provide so efficiently for themselves.
- They implicitly recognize two overriding priorities to address urban problems. (If these priorities are not addressed, there is no possibility of effective urbanization given resource limitations).
 - Policy/regulatory reform.
 - Efficient resource management and institutional development.
- These ideas are not yet fully accepted but they are gaining momentum. They form a sound basis for dialogues with the GOI about future AID assistance programs in the urban sector.

1.5 FRAMEWORK FOR AN AID STRATEGY

The time is right for AID to develop a strategy to support efficient urban development in India.

- Momentum of 1988 GOI policy statements creates a promising environment.
- Urbanization will be too important to India's future for AID not to be involved.
- AID could make an important contribution consistent with CDSS themes and without significant change in Development Assistance (DA) budget allocations under the following approach:
 - Concentrate on one of the top implementation priorities above--consistent with the Mission's Science and Technology (S&T) emphasis, *applying systems/information technology and other techniques to improving the efficiency of urban resource management and institutional development.*
 - Opportunities for collaboration and mutuality under this approach would be similar to those AID is taking advantage of in other sectors.
 - *Rely on the Housing Guaranty (HG) program for related capital projects.* With a HG authorization ceiling of \$25 million per year,

no more HG authorizations are likely through end of FY1989. At that point there will be one remaining commitment of \$25 million for the National Housing Bank (NHB). Assuming multi-year phasing of the remaining NHB commitment, there would be an opportunity to begin support for new urban initiative(s) in FY1990.)

The new strategy should be broader than simply adding new urban projects. The strategy should entail three components:

- Integrating urban concerns throughout the Mission's program based on the explicit recognition that urban development should be seen as a potential contributor to economic development (not just as a "social program"). This would entail building urban elements into ongoing Mission projects: (eg, water resource management, energy/power)
- Where possible, supporting themes of 1988 GOI statements in policy dialogues (particularly policy/regulatory reforms) and supporting relevant research and dissemination to bolster the agenda.
- Supporting specific urban project initiatives.

Criteria for selecting urban project initiatives:

- Consistency with S&T themes and approach.
- Potential for system-wide impacts (not just physical projects intended as prototypes)
- Institutionally feasible
- Financially feasible within expected funding constraints.
- Sufficient AID technical experience with the type of project proposed.

The existing NHB (HG-003) project should be retained but one (or more) new urban projects should be added during the CDSS period.

- In supporting establishment of the NHB, HG-003 meets the above criteria well.
 - Wide potential impacts on nation's housing finance system, consistent with themes of 1988 GOI policy statements.
 - S&T themes can be emphasized in TA/Training: applying information and management systems technologies in financial system operations.
- This project alone, however, not enough to seriously address urban development as distinct from housing.
- Other topics in urban development are being seen as higher priorities than housing (eg, urban economic development, land, infrastructure).

1.6 PROJECT OPPORTUNITIES: URBAN ECONOMIC DEVELOPMENT

Overview

- The highest urban priority--it is recognized that adequate physical/shelter development is ultimately unlikely unless incomes increase.
- However, urban economic development is harder for AID to take directly--most important requirements are policy/regulatory reforms
- opportunity for policy dialogue is limited on these topics.
- Direct support for business development is not promising if done through government--have to link with private sector.
- HG funds are limited to below median income shelter and infrastructure thus can't be used for this directly.

Option 1: Direct Support for Business Development through Local NGOs.

- NGOs involved would be local associations of business leaders (Chambers of Commerce).
- DA funds (loan and/or grant) used as seed money with NGOs committing to raising local capital on some matching basis.
- NGO activities would differ in different cities depending on identification of real local demand opportunities not being met. Activities could include:
 - Starting businesses then divesting to individual private entrepreneurs (being done in Bolivia).
 - Working with private owners to renovate/construct space for business use (being done by AID/Jamaica).
 - Program of loans and management TA for small entrepreneurs (done in many places).

(One theme could be enhancing development of the construction building materials supply industries. With rapid urbanization, they should expand significantly. Injecting more efficiency could much improve contributions to jobs and incomes.)

- Associated TA/training would stress application of appropriate technologies to whatever business activities were being promoted
- management systems to strengthen NGO efficiency).
- *Evaluation:* Positive and growing experience with this approach in other countries and it addresses the highest priority. But, DA funds require GOI might not consider it appropriate for AID's major theme.

Option 2: Support for "Efficient" Market Town Development.

- AID has supported market towns before, often failing because of a supply-oriented approach (placing infrastructure alone is not enough to generate economic activity). Demand-side approach would select towns where infrastructure established for agricultural take-off, then provide facilities to support other needs.

- DA funds would be used to provide public infrastructure (and possibly private storage/processing/marketing facilities) based on analysis of technologies that will best support commercialization of the particular agricultural commodities at hand.
- TA/Training focused on selecting/applying the right technologies to the right circumstances.
- *Evaluation:* Supports smaller-town job generation and agricultural activity consistent with AID's traditional rural development emphasis. Good opportunity to support S&T themes. Both should receive support from GOI. Could create a matching package using HG to support residential development in same towns, but again DA funds would have to be the prime mover.

1.7 PROJECT OPPORTUNITIES: URBAN LAND

Overview

- National Commission on Urbanization (NCU) sees the land constraint as the highest priority problem in urban physical development--must be addressed to permit effective housing market.
- Again, solutions require policy/regulatory reforms which are difficult for AID to take on directly.
- HG funds could be used for land development through government if projects set up appropriately.

Option 3: Converting House Building Agencies to Land Development Agencies.

- It will take time to create conditions for a well functioning private land market to develop. In the interim government could act to substantially expand supply of serviced urban land for private use without subsidy. (new Housing Policy recommends existing government house building agencies shift to become land developers).
- HG funds would be used to support agency land development projects (including on-site infrastructure) with appropriate strings attached re: rapid acquisition-development-divestiture process, mix of income groups, sensible cost recovery, efficient project management.
- TA/Training could focus on applying systems approaches to all aspects of agency operations to promote efficiency (including information systems to identify and prioritize potential vacant lands for development).
- *Evaluation:* Important potential if it works. The risks are those associated with converting traditional government bureaucracies to new ways of doing things.

Option 4: Technology to Provide Land Information Systems and Streamline Land Titling/Sales Processing.

- NC recognizes these steps essential to achieving effective private land

market. They would be addressed through a DA TA/Training project with a strong technology emphasis.

- There are many precedents now for use of remote sensing and information technology to produce local land information systems/cadastral. The most high-tech take a very long time to complete--some promising short cuts are being tried in other countries. Such systems are essential as a basis for effective land titling as well as property tax administration. This could be done in one or two cities as a prototype for application elsewhere.
- While legal changes are ultimately needed to clean up land/titling and sales processing, computer based systems approaches could make an important contribution to streamlining in the short term.
- *Evaluation:* These topics now recognized as high priority needs. However, land records are a politically volatile topic everywhere and GOI might not give AID contractors enough access to get the job done right.

1.8 PROJECT OPPORTUNITIES: INFRASTRUCTURE

Overview.

- Infrastructure deficiencies (particularly water, sanitation) also seen as top priority problem by NC and Housing Policy.
- Major thrusts are: (1) set up Urban Infrastructure Development Bank to permit cities to borrow for investment; (2) increase efficiency and cost recovery local infrastructure development and operations and maintenance.
- HG funds again applicable (and possible use of Food for Work funds--see below).

Option 5: Support the Establishment of the Urban Infrastructure Development Banks.

- The Ministry of Urban Development's plan is to set up a HUDCO window to do this now, then as soon as possible create independent Banks in more advanced states and a National Bank to lend to municipalities in other states.
- In some ways, this would be similar to AID's HG support for NHB--the HG providing capital the bank can on-lend, with specified policy objectives to be met and TA/Training activities to support those objectives.
- TA/Training would again support the application of information and management systems technology. Two relevant objectives:
 - To establish efficient management and operations within the bank itself, and
 - To increase the efficiency of local governments in operating local infrastructure programs. Options here include: financial planning/budgeting systems; project management systems; information systems to support needs-based infrastructure

maintenance; billing/cost recovery systems.

- There is a possible way to use the Food for Work program to support urban infrastructure and expand list of solid outputs from that program.
 - AID expects \$85 million per year in food aid funding, 10% of which must be monetized.
 - People in small unserviced squatter settlements would provide labor to install their own low-tech water supply, sewerage, and/or other facilities. Local currency from program would be used to pay for materials.
 - Could be organized through Catholic Relief Services and water/sanitation would contribute to child survival.
 - This approach being considered as important AID urban program thrust in Bolivia. Difficulty in getting communities to organize could be more of a problem in India.
- *Evaluation:* Urban infrastructure is truly an important development need and probably would be highest on the GOI list for AID involvement (Secretary of the Ministry of Urban Development suggested this during this mission). The risks not much different than those associated with NHB project. Some municipal development bank projects like this elsewhere have had a serious problem in enforcing debt servicing by municipalities which have negligible prior borrowing experience, but there are lending formulas that can address this issue.

1.9 PROJECT OPPORTUNITIES: HOUSING

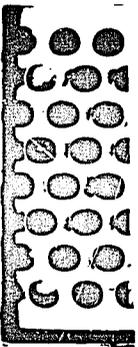
Overview

- We have noted that HG-003 NHB project is a strong and effective commitment to housing sector--more support for that sector should probably not be a priority given other opportunities in the urban sector.
- If other urban options do not work out, however, a new initiative in housing could be devised that would support other innovations discussed in Housing Policy and NC.

Option 6: Efficient Land/Housing Development by Cooperative Societies.

- Recognizing institutional difficulties in shifting attitudes of current government house building agencies and the present constraints on private land developers, it should be helpful to strengthen the role of other NGO actors in the field--stronger cooperatives should be an attractive vehicle.
- HG funds would flow to cooperatives for efficient project development (land/on-site infrastructure and a mixture of plot sizes and housing types). As with the proposals for government projects, there would be emphasis on rapid acquisition-development-divestiture process, mix of income groups,

- sensible cost recovery, and efficient project management. TA/Training funds would be used to strengthen management capabilities of these institutions (application of systems technology to financial management and the management of project development and subsequent maintenance and operations).
- *Evaluation:* This could probably work, but considering constraints on funding it would limit the opportunity for AID to seriously establish a broader role in the urban sector.



2

FRAMEWORK FOR AN AID STRATEGY

This section follows on from the findings and conclusions of our earlier report on urban trends and their implications (Kingsley, Telgarsky, and Walter (1989)). It first considers why current conditions make it attractive for AID to develop a new strategy for assistance in India's urban sector at this time. It then goes on to suggest an approach to strategy development.

2.1 AN OPPORTUNE TIME FOR AN AID STRATEGY

For AID/India to make a serious commitment to expand its involvement in a sector, three conditions should be met. There should be: (1) strong evidence that the problem to be addressed is critical to national development; (2) the likelihood that the government is willing to give serious attention to the problem and approach it in a reasonable manner; and (3) a reasonable expectation that AID could make a significant contribution to the issue consistent with its overall strategy and a realistic view of prospective funding availability. We argue that all three conditions are present to justify a new AID/India commitment to urban development.

The Importance of the Problem

We have estimated that about 70% of India's population growth over 1980-2010 will occur in urban areas. While agricultural development remains critically important, the pace of national income growth over the next two decades will be predominantly determined by what happens in the cities and towns.

Government's Response to the Problem

As recently as three to four years ago, urbanization was not among the GOI's high priorities and an examination of what it was actually doing to address the issue would have raised substantial doubts about the prospects for notable improvements. With the publication of the recent GOI policy reviews discussed in our urban trends and implications report (*National Housing Policy and National Commission on Urbanization (NCU) Report*), and the momentum that seems to be growing around them, we believe that circumstances have changed quite dramatically. The debates are far from over, but it appears that those debates will occupy a much more central place than they have in the past and that there is a good chance the outcome will be movement in sensible directions. What has motivated this change? Many who have recently devoted some thought to the issue no doubt now share the view of the NCU: that urbanization represents a positive opportunity to further national development. Others may well have learned enough only to be fearful--understanding at last that nothing can really be done to stop massive urban growth and considering what it might imply for poverty and civil disruption if nothing is done to address it.

The Opportunity for an Important AID Contribution

Except for the World Bank (which works primarily with individual states), other international donors have not given much priority to urban development in India to date. In theory at least, a strong AID urban strategy at this point could mark AID as a leader in the field. But how realistic is this considering: (a) the guidelines specified in the Mission's new CDSS; and (b) the Mission's extremely constrained budget outlook?

1. *Consistency with the CDSS.* The new CDSS represents a significant departure from past Mission approaches which emphasized resource transfer programs. It states that "...the most appropriate role for US assistance to India in the 1990s is a strategy based on the contributions of science and technology to economic growth, productivity gains and poverty alleviation". AID/India's new urban strategy could be developed as a consistent part of this theme. The new GOI urban and housing policy statements also recognize that resource transfer programs are not the key. One of their two new and overriding implementation priorities (*resource management and institutional development*) is one to which the CDSS science and technology approach can be ideally applied (and is already being applied by AID in other sectors). In fact, solutions to the resource management issue in urban development are unlikely without the application of appropriate *information and management systems technologies*. The CDSS already proposes a similar approach to the resource management issue in other sectors. Applying this as *the cornerstone of AID/India's urban strategy* would also offer the same opportunities for collaboration and mutuality that the CDSS demonstrates exist for those sectors.

2. *Addressing the Budget Constraint.* Unless there is a marked change in recent trends, the Mission's Development Assistance (DA) budget clearly could not support any major new capital program over the next few years. But an alternative is available for work in the urban sector--*the Housing Guaranty (HG) program*. AID/India has had a successful experience with the HG program during the 1980s, first in support for the private Housing Development Finance Corporation (HDFC) and now with a new loan

(HG-003) for the National Housing Bank (NHB). HG funds can be used to support the development of land and infrastructure (as well as house construction) for below-median income households and could be packaged with other funds to support an even wider variety of urban development needs.

The HG instrument itself has become more flexible in the past few years with the introduction of a new "sector lending" approach. Whereas in the past disbursement of HG funds was most often conditioned on the delivery of physical project outputs (eg, the completion of a specified number of housing units in public projects) disbursement in the sector lending approach may be based on progress toward broad policy changes quite unlinked to the projects on which the loan funds were actually spent. For example, in a new sector lending program in Indonesia, HG funds will be used to support infrastructure improvements for low-income settlements. The loan document, however, will call for policy changes in areas like strengthening municipal financial management capacity and taking steps toward the development of private capital markets which can ultimately replace public bank in lending for infrastructure.

No country can receive more than \$25 million in HG authorizations per year. No new authorizations are likely before the end of FY1989. After that, only one additional commitment remains to be authorized: \$25 million out of the total \$50 million promised to NHB under HG-003. Assuming that some stretching out of that residual over the five year project period would be sensible anyway, additional HG authorizations could be devoted to new urban initiatives as early as FY1990. At this point, we know of no constraints in Washington that would prevent the Mission from securing a continuing stream of HG authorizations at the \$25 million level for the next several years, assuming solid project designs are prepared. Some DA funding would be required to credibly link any HG program to the central theme suggested above (the application of technology to the resource management issue) but the amounts required for doing so should not be substantial in relation to the Mission's overall budget.

2.2 AN APPROACH TO STRATEGY DEVELOPMENT

Applying these ideas to develop new projects represents only one aspect of a complete strategy. We believe that the new AID/India urban strategy as a whole should incorporate three elements: (a) integrating urban development into the broader Mission strategy; and (b) contributing to the changing policy environment; in addition to (c) beginning specific new urban project initiatives.

Integrating Urban Development into the Broader Mission Strategy

Discussion of housing and urban development in the CDSS appears only in the section on poverty alleviation. We believe the evidence presented in this report suggests that it would be most advantageous to AID to regard urban development primarily as a contributor to national economic development and not just as a "social program". When it is viewed in that way, it becomes clear that more of an urban orientation could benefit many other elements of the Mission's agenda. As the final urban strategy is developed, a comprehensive review of all of the potentials for such integration should be undertaken.

At present, two examples are suggestive.

- Continuing work in water resource management could be improved by integrating the analysis of potential urban water needs (and programmatic solutions) with the analysis of water requirements for rural development. Looking at either side alone obscures understanding of true problems and opportunities.
- Most of the nation's power requirements originate in cities. Power system improvements have not been prioritized based on knowledge of the comparative economic growth potentials of different urban areas, yet these factors will ultimately determine the efficiency of the system as a whole. In some cities economic circumstances have created pent up demand for power--investment there will have a sizeable effect on job and income generation. The same investment in a city not yet ready for takeoff may lead to idle capacity with comparatively few economic benefits. Analysis of comparative economic potentials of cities could be of great assistance in efficient planning of improvements to India's power systems.

Contributing to the Changing Urban Policy Environment

We have noted that basic policy and regulatory reforms are among the highest priorities in establishing an environment conducive to efficient urban development. We have also noted that recent GOI policy proposals have endorsed such reforms, but that the battle is not yet won. A period of debate must occur before official national approvals, and even more struggle can be expected in the process of securing endorsement and implementation at lower ministerial levels and in the states and localities. Support for the new policy directions should be an element of AID/India's urban strategy. GO relationships with external donors do not permit the sort of policy dialogues that would allow AID to negotiate directly with government officials about these issues. However there are other means by which AID can support India in its search for better policies (1) sponsoring additional well focused research (that would more clearly identify the cost and benefits of the alternatives) and technical advisory missions; and, perhaps more important, (2) disseminating the results of this research and other studies already available to those with influence within and outside of New Delhi. AID would not be put in the position of advancing reform proposals on its own. Rather, it could further the momentum for change by providing support for indigenous institutions with skills and orientations suited to the research and dissemination tasks ahead.

Selecting Urban Project Initiatives

In considering the possibilities for new urban projects, it is appropriate first to review the criteria that should be employed in project selection, consistent with the framework and policy themes discussed above. Next, we look at the Mission's current urban program commitments in relation to those criteria and consider whether the addition of new urban projects would be desirable over the next few years.

Criteria for Project Selection. Given the framework we have described, any urban project supported by AID/India should meet the following criteria:

- It should be oriented primarily to the S&T approach emphasized in the CDSS.

- It should have the potential for creating "system-wide impacts" rather than just offering physical project prototypes that might or might not be subsequently replicated.
- It should be financially feasible (within the tight AID funding constraints that are now applicable).
- It should be institutionally feasible (ie, there should be a reasonable likelihood that current institutional and bureaucratic constraints will not prevent the achievement of project goals).
- It should embody a field in which AID already has the technical skill needed for effective project management or could acquire such skill within reasonable time and cost constraints.

Existing Urban Project Commitments. At present, AID/India's only urban project commitment is the completion of the HG program with the NHB. As noted, this program is an outgrowth of successful prior lending programs with HDFC. In a difficult environment (determined by the GOI's highly regulated financial system and use of directed credit), HDFC was able to establish a rapidly growing market-oriented program of lending to households consistent with sound commercial principles. The new HG with NHB is intended to extend this approach to a broader network of institutions. The NHB is an apex bank that will on-lend to a number of private and joint sector companies that will then extend mortgages to households. Monitoring is built-in to assure conformance to market-oriented lending standards agreed to by AID. Technical assistance and training associated with the project will employ systems technologies and other means to promote efficient management both by NHB and the network of primary lenders that will be established. Clearly, this program meets our criteria well and should be continued. It has the potential of major impacts on the nation's housing finance system as a whole consistent with the themes of the 1988 GOI policy statements. It also provides good opportunities for the application of S&T themes to an important area of national policy. The experience of AID/India in the field of housing finance has grown considerably with these programs and AID now has a comparative advantage among donors in this area in India.

The Case for New Urban Project Initiatives. In some ways, it might seem tempting for the Mission to continue with and extend its work in housing finance as its sole project contribution to the urban sector in India. Our analysis, however, suggests that this would be the loss of a significant opportunity. We conclude that AID/India should seek to initiate new project opportunities in the urban sector in the near future.

There are several reasons: (1) the momentum of the HG program in housing finance is already substantial and should be able to achieve its objectives with budgets that will still leave significant funding potential for other uses within the HG maximums; (2) A program in housing finance alone is not enough to make AID a serious player in the broader urban agenda now expected as an outgrowth of the 1988 NCU report and housing policy statement; (3) the 1988 statements have identified that other topics represent higher priorities in addressing the urban challenge than housing (in particular, urban economic development, land, and infrastructure)--indeed that the nation's housing problems themselves cannot be dealt with effectively until constraints in these other fields are alleviated; and (4) AID (particularly its Office of Housing and Urban Programs) has

developed considerable expertise in addressing these other priority topics in other countries--experience that could be applied to urban development issues in India as we have described them.

A final point should be clarified. Even under the most optimistic assumptions, the HG funds potentially remaining available after expected commitments to NHB are met will be negligible when considered in relation to the massive amounts of capital needed for urban development in India. AID's CDSS approach, however, is based on the recognition that AID's influence should not be measured in proportion to the size of its resource transfers. The new GOI policy themes in urban development also recognize that without "system changes", even significant increases in capital funding will not solve present problems. If focused on critical issues and applied efficiently, funding in amounts AID could provide should be sufficient to support important changes in India's urban resource management.

3

PROJECT OPPORTUNITIES

This section suggests and reviews six new project opportunities AID/India might consider as a part of its urban strategy. More options could be devised and others could be created by mixing elements of those we suggest. However, we believe these six represent the major areas of opportunity that are consistent with the priorities and themes of the strategic framework presented in Section 2. For each option, we outline the project's purposes, activities, and funding and then offer a preliminary evaluation. Neither the project descriptions nor the evaluations, however, are considered in sufficient depth to support final selections. In the next stage of strategy development, these options will be screened further and one or more of them will be examined in greater detail as the basis for decisions in the final stage.

In the discussion below, the options are grouped by major policy topics: (1) urban economic development; (2) urban land; (3) infrastructure; and (4) housing.

3.1 PROJECT OPPORTUNITIES: URBAN ECONOMIC DEVELOPMENT

We have argued that the highest urban priority should be economic development--without adequate growth of employment and incomes in urban areas, it is unlikely that adequate development of cost-effective urban services and shelter can be afforded. The major constraint to more dynamic urban economic growth is the regulatory environment. However, this is a difficult task for AID to take on directly; AID has only limited opportunity for a policy dialogue with the GOI on such topics. Restrictions on the use of HG funds, though loosening in recent years, still remain tied to below-median income shelter and infrastructure provision and thus cannot be used directly to support economic development. Past experience also indicates that direct support for business development

is not promising if carried out through public sector agents--the most effective demonstrations of local economic development, such as the Chamber of Commerce in Santa Cruz, Bolivia, or the Kingston Restoration Company in Jamaica, have relied primarily on a strong role for the private sector (see Peterson *et al* (1988) and Dubinsky (1987)).

With this in mind, there appear to be two areas where AID could successfully become involved in urban economic development: (1) direct support for businesses through local NGOs; and (2) market town development. Of course, such programs would not be supportable on a national basis given the Mission's limited resources. However, a program confined to one state which shows interest in such a program could be an achievable target.

Option 1: Direct Support for Business Development through Local NGOs

Capital Outlays. In this option, Mission Development Assistance (DA) fund (loan and/or grant) funds would be used as "seed money" to help local businesses start and expand. Local NGOs (associations of local business leaders for the most part, such as Chambers of Commerce) would be committed to raising local capital on a matching basis and would help identify how the program should be structured and implemented, and play a major role in implementation. Depending on local needs and capacities, activities would differ from city to city; they might include:

- establishing businesses followed by divestment to private entrepreneurs;
- working with private owners to renovate or construct space for business use;
- programs of loans and management technical assistance for small entrepreneurs who wish to expand their operations;
- with growing cities, small enterprises in the construction and building materials industries have a good opportunity to expand--improving their operation could only create jobs and income, but also reduce the costs of construction through more efficient supply.

Enhancing the Development of the Construction and Building Materials Supply Industries. This could be one attractive theme for projects in this area. Rapid urban growth will imply a rapidly expanding market for activity in these sectors. Yet construction and building materials supply industries in urban India at present are structured in a manner that can really take advantage of this opportunity. A combination of actions (regulatory changes, easier access to credit on reasonable terms, training and technical assistance) might encourage the establishment of new businesses in these industries which would operate more efficiently and accelerate the creation of job opportunities for low income groups.

Technical Assistance and Training funds would focus not only on management and financial systems to strengthen the participating NGOs, but also on injecting appropriate technology into those enterprises taking part in the program. Where the construction and building materials emphasis is selected, research and TA could focus on techniques to enhance production efficiencies and the local production of materials and components that are presently available only by importation from the mega-cities.

Evaluation: This approach has been successfully used elsewhere and addresses the main problem facing urban centers. However, it relies mainly on DA funds and is not certain to be acceptable to the GOI as a major AID theme.

Option 2: Support for "Efficient" Market Town Development

AID has supported market town projects in the past, but has not achieved great success. The failure of these projects seems linked to a "supply" oriented approach, where the placement of infrastructure drives economic development. Rather, we feel a "demand" approach would generate better results, where towns which show evidence of unfulfilled demand for services hindering development are selected. In this fashion, lack of services which constrain both agricultural and urban needs can be alleviated.

Capital and TA/Training Outlays. Once towns with latent demand are identified, DA funds would be used to provide public infrastructure, primarily economic in nature (ie, storage facilities, communications, power), and support commercialization of local agricultural production. Technical assistance and training would be focused on selection of appropriate technologies for services and support for increased commercialization of agricultural production.

Evaluation: This project ties in well with AID initiatives in S&T and its traditional rural development orientation, while promoting job creation and income growth in secondary urban centers. Again, DA funds would be required, but a combined package with HG funds for infrastructure could be considered.

3.2 PROJECT OPPORTUNITIES: URBAN LAND

According to the NCU (1988), land constraints represent the highest priority problems in urban physical development. Unless these constraints are removed and land is supplied more responsively in relation to demand, breakthroughs will not be possible in infrastructure and shelter provision.

As noted in our report on trends, satisfactory solutions to today's urban land problems will require policy and regulatory reforms. The GOI has not traditionally welcomed direct donor involvement in decision making about such issues. However, the trends report also indicated that the GOI has established some momentum toward appropriate reforms on its own. It should be supportable for AID to concentrate on other aspects of the land problem where it could have a more immediate impact. Two options appear most promising:

Option 3: Converting House Building Agencies to Land Development Agencies

Ultimately, a well functioning private land market should be the most effective mechanism for meeting India's land policy goals. Yet creating the conditions for such a market require reform of many present laws and bureaucratic habits: e.g., the processes of registering and transferring land titles, the processes and standards involved in reviewing applications for land subdivision and development. It will take many years before these

tasks are complete. In the meantime, more efficient land development activity by government could do much to enhance supply. This is in fact the role recommended in the 1988 *National Housing Policy* statement.

Capital Outlays. In this project, HG funds would be used to support low cost land development schemes by existing government agencies--agencies that in the past have focused mostly on the construction of subsidized *pucca* housing. These developments would entail various adaptations of the sites and services approach. The agency would acquire and layout the land, provide essential on-site infrastructure, and convey plots to the users. Houses would be built by the users themselves or by private builders. Most such developments would include a mix of plot sizes: larger plots would be sold to commercial enterprises and high and middle income households at a profit to permit cross subsidies to support allocations for low income groups. Standards would be set to be affordable to the range of new residents. Areas for low income groups would involve very modest plot sizes and services or be built on the planned squatter settlement approach being tested in Nasik (discussed Section 4 of the trends report). One variant of this basic approach should be encouraged--one where the agency gains control of the land but contracts with private firms to do the rest of the work on a turnkey basis. This would help to build the capacity of private land developers and give them experience in efficient development techniques.

To receive these HG loans, agencies would be bound to a set of strong conditions to ensure that they: (1) use efficient land planning techniques based on market analyses; (2) employ efficient management practices including project management systems to minimize the time required for development and divestiture; (3) select site planning and infrastructure standards appropriate in light of the incomes of the intended residents; (4) design developments to secure a mix of income groups; and (5) do a serious job of project financial planning and cost recovery. Conditions might also be set to expedite the pace at which the agencies phase out of direct house building activities.

Technical Assistance and Training. Mission DA funds would support TA/Training that would apply systems approaches to promote efficiency in all aspects of project development. Computer systems are already available to assist in: (1) market analysis; (2) design and cost analysis of alternative site plans; (3) project scheduling; (4) project financial planning and monitoring; and (4) record keeping associated with property sales and cost recovery for services. Local land information systems could also be developed to support more efficient identification and prioritization of sites, and to expedite agency land acquisition procedures.

Evaluation. Projects like these would address a high priority need and would further a central theme of the new housing policy. A number of Indian agencies already have experience with projects of this kind. Their main problem could be bureaucratic resistance in other agencies. Agency staffs trained and experienced in designing and building housing may oppose initiatives that place little reliance on these skills. Also, more efficient management systems may arouse fears about job security.

Option 4: Technology to Provide Land Information Systems and Streamline Land Titling/Sales Processing

The private land market can never function properly without efficient government procedures to record titles and process title transfers. Such procedures cannot be made efficient without credible cadastral systems--information systems that identify all private land parcels and their ownership in a locality. The first recommendation of the NCU (1988) concerning land is that, "A comprehensive data base on urban lands must be built".

Technical Assistance and Training. This project would rely solely on Mission DA funds for TA/Training and associated technology transfer. It could be implemented in one city, or a limited number of selected cities, as prototype experiences that could later be implemented elsewhere after appropriate modifications. There are two possible components:

A. The Land Data Base. This would probably entail obtaining accurate geographic/land use information through aerial photography/remote sensing with automated interpretation and data base creation. The project would yield a new set of base maps as well as computer based information keyed to location identifiers on those maps. Information developed in this way would have to be related to parcel information merged from existing cadastres, supplemented by field surveys as necessary. The project would also include preparation of complete systems documentation, designs for processes of accessing and utilizing the information that fit the needs of different legitimate users, and training of appropriate staff. (For a discussion of the costs associated with alternative ways of developing such systems, see Bernstein (1986)).

B. Land Titling System. This component would be centered around devising a more efficient system for processing and recording land title transactions. Many elements of the process would be automated and related to the land data base. Analysis would be undertaken to explicitly monitor processing speeds. The work could also include the development of public information programs to educate the public on the new system and a review of processing rules and fees to identify and deal with disincentives to registration. (For a discussion of the present system and ideas for improvements along these lines see World Bank (1986)).

Evaluation. This project could also make an important contribution in an area now recognized as critical to urban development objectives. In addition, among all the options we have reviewed it would best exemplify the Mission's technology transfer theme. However, three possible drawbacks should be recognized. First, the project would rely solely on DA funds--probably more DA funds than would be needed to credibly cover the TA/Training needs of other options linked to HG loans. Second, information on land ownership and use can be politically volatile. Supposedly for national security reasons, the GOI has been reluctant to release aerial photographs even to its departments that are non-defense related. In short, it might be difficult for the consultants on this project to gain access to the information they need to complete the work properly. Third, there would be the inevitable bureaucratic resistance (and possibly some legal barriers) to substantial changes in the processing system for land titling.

3.3 PROJECT OPPORTUNITIES: INFRASTRUCTURE

As noted in Sections 4 and 5 of the trends report, a realistic approach to urban infrastructure problems will require: (1) more cost-effective technical solutions; (2) substantially improved management of government delivery systems; and (3) workable cost recovery. Also, the NCU has given a very high priority to establish a new system of financial institutions to lend funds to municipalities for infrastructure.

Option 5: Support for the Establishment of the Urban Infrastructure Development Banks

In an interview during this mission, the Secretary of GOI's Ministry of Urban Development noted plans to respond to the recommendations of the NCU and other agencies to develop a system of urban infrastructure banks. Initially, a window would be set up in HUDCO for this purpose, but as soon as possible, independent institutions would be created. Efforts would probably be made to establish state level banks in the states with the most capacity to operate them and one national level bank to lend to municipalities in other states. Similar "Municipal Development Funds" have been established in several countries in recent years and while not all have performed effectively to date, lessons are being learned about how to structure them to avoid the problems of the past (see USAID (1988)). In this project option, AID would loan capital funds to one or more of these banks and focus its TA/Training resources on the resource management theme emphasized in AID's strategy in Section 2.

Capital Outlays--HG Funds. In this component, HG funds would flow to more of these banks to be on-lent to municipalities for infrastructure serving households with incomes below the median. The loans would be conditioned on agreements with the banks to: (1) adopt efficient loan management practices themselves; and (2) provide conditions to municipal borrowers requiring them to: (a) take steps to generate sufficient revenues to meet their debt service obligations; (b) adopt effective project identification, appraisal, budgeting, and management practices; (c) target resources to lower income groups; and (d) utilize workable cost recovery systems. This approach is thematically similar to AID/India's current HG loan to the NHB and is exactly the same as that followed in a HG loan which will support Indonesia's municipal development program (USAID (1988d)).

Capital Outlays--A Food for Work Component. If AID/India found it desirable to do so, the HG loan could be complemented by additional funds from the Food for Work program. This program will be operating at a substantial scale in India over the next several years as indicated by the CDSS (USAID (1988b)). The annual level of funding is likely to be \$85 million, 10% of which must be monetized. In the context of this component, people in small unserved squatter settlements would provide labor to install their own low-technology water supply, sanitation, and possibly, community facilities. Local currency from the program would be used to pay for materials and work could be organized and implemented through the Catholic Relief Services (CRS) although they would require new staff and training. This concept would offer several advantages: (1) it would expand service provision in the neediest areas; (2) it would make a strong contribution to child survival, an important aim of the food aid

particularly if water supply was emphasized; and (3) it would broaden the range of solid outputs from Food for Work and thereby strengthen support for that program. This same approach is being considered as an important AID urban program thrust in Bolivia (Peterson *et al* (1988)).

Technical Assistance and Training. Here the focus would be on the application of systems technology to resource management. It could be applied in two ways: to establish efficient management and operations in the bank itself, and to increase the efficiency of local governments in operating local infrastructure programs. Our trends report identified the latter as among India's highest priorities in the urban sector. Applications could include: financial planning/budgeting systems; project scheduling and management systems; information systems to support needs-based infrastructure maintenance; and billing/cost recovery systems.

Evaluation. A new AID initiative to support urban infrastructure would clearly be in line with sector priorities and would no doubt be welcomed by GOI. If support for the establishment of new infrastructure banks is chosen, AID experience with the establishment of NHB should prove quite helpful and should lessen the risks involved. Two concerns should be recognized: (1) municipalities without much prior borrowing experience have had poor records in keeping up with debt service payments in other countries; (2) again, some bureaucratic resistance to major efficiency improvements could be expected. There are established means of addressing such concerns, however.

3.4 PROJECT OPPORTUNITIES: HOUSING

In Section 2, we stated that the current HG program with NHB represents a strong AID commitment to the housing sector and that the time seems right for AID to diversify its involvement in the urban sector by establishing new initiatives in other priority fields. Still, if other options such as those reviewed above do not prove fruitful, an additional project in housing could be warranted.

Option 6: Efficient Land/Housing Development by Cooperative Societies

We have noted that there will be institutional difficulties in shifting the attitudes of government housing producers away from production and that there are many present constraints that prevent satisfactory contributions by private developers to the housing needs of moderate- and low-income households. In this environment, there is a real need to strengthen the role of NGOs in housing and the cooperative societies could be an attractive vehicle in this regard.

Capital Outlays. Again this option would be funded through the HG program. Funds would flow to cooperatives to develop projects that would entail land development, on-site infrastructure, and a mixture of plot sizes and direct house-building as appropriate. Many of the principles and objectives would be the same as those specified for government agencies in option 3: rapid acquisition/development/divestiture, efficient project management, mix of income groups, appropriate/affordable technologies, and sensible cost recovery systems.

Technical Assistance and Training. The focus here would also be similar to the ideas suggested for government agencies in option 3. The goal would be to help the cooperatives build the capability to produce efficient developments that work without (or with minimal) subsidies. The theme would again be the application of systems techniques to the tasks of site planning and market analysis, project management, project financial planning and control, and cost recovery.

Evaluation. This could be a legitimate and valuable initiative for AID. However, considering constraints on HG funding, starting with it would probably prevent a true diversification of AID's agenda in the urban sector.

Annex A

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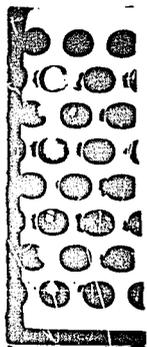
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Annex B

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