Financing India’s Future Urbanization

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An Iron Law of Urbanization

- It is an iron law of economics, without a single exception, that as an economy gets richer, the share of agriculture in income, employment and land declines. This in turn is based on two other iron laws: Engels' law on demand side and "Malthusian" law on supply side.
- Based on this logic, we project that if India marches towards high income status by 2050, more than 80% of its population will live in urban areas by 2050.
- More than 800 million new urbanites will emerge, vast majority of whom will be migrating from rural areas.

India’s opportunity

- Since most of India’s urbanization is in the future, it is India’s opportunity to learn from others and get urbanization process right from the scratch.
- In my book India 2050 and subsequent writings, I propose two sets of new urban spots: (a) new smart towns as extensions of each tehsil capital with about 50,000 persons each which would cater to surrounding 100 or so villages and (b) new smart cities as extensions of district capitals which will on average absorb about 0.5 million people each and be the knowledge and industrial hubs.
- These will be like new special economic zones with all the good practices we want for urban planning and economic and social policies which would also give red carpet to businesses.
- For existing cities, efforts would go on along the lines updated JNNURM with special focus on vertical growth of buildings.

Where will the funding come from?

- For existing cities, vertical growth will be money spinner.
- For financing physical infrastructure in new towns and cities, we propose a scheme for urban authorities appropriating most the increment in land value due to conversion from rural use to urban use, some thing similar to what China has done.
- For financing of social infrastructure including education and health, we propose property taxes of about 1% of property values to be collected in the new habitats, similar to what is done in the UK and US.

New approach to compensation to landowners

When land is converted from rural use to urban use, the landowners have done nothing for appreciation in land value due to conversion to urban use. They would be compensated on the basis of <u>present value of income stream from their land before conversion</u> and not on the basis of market value after conversion. Present value can be calculated with some robustness and will take speculation out of the game. Knowing which place will be converted into urban use will not pay.

Annual return on land can be put at 50% of GDP in agriculture per hectare with the other 50% going to workers on land.

The present value of the income stream

would be: 0.5* Ya * (1+r)/(r-n) where

r is the rate of discount and n the rate of growth of GDP per hectare in agriculture.

For 2009-10 this gave a value of land as Rs. 14 lakh per hectare. Allowing for generous compensation to landowners and other expenses the cost per hectare would be at most Rs.70 lakhs per hectare.

The value of land in urban areas with allowance for vertical growth of 15-20 storey will be at least Rs. 4 crores per hectare.

Thus by auctioning a small part (say 40%) of the land acquired the urban authorities could generate a surplus of about Rs. one crore per hectare acquired which would be more than sufficient to build infrastructure in the cities as per calculations in Isher Ahluwalia report.

Self-financing of slum development

- Most of the slums are single storey tenements.
- Replacing them by 15-20 storey buildings with 2-3 basements will generate enough surpluses to build the new houses for erstwhile slum dwellers with healthy surpluses left.
- For sale of these homes, authorities may allow cash payments without any questions about