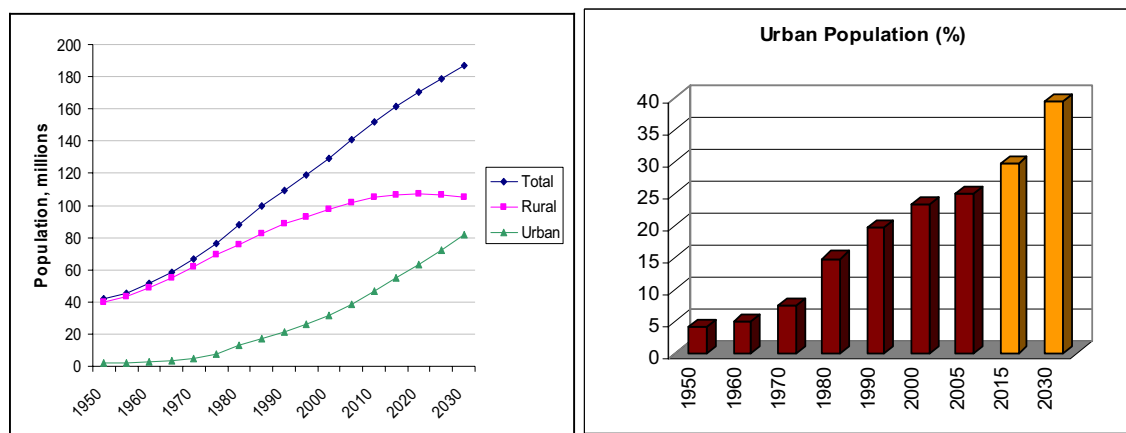


CHAPTER 5: URBAN DEVELOPMENT AND ECONOMIC GROWTH IN BANGLADESH

I. Urbanization and Urban Concentration in Bangladesh: A Process of Rapid Transformation

5.1 *Bangladesh, a predominantly rural country, is undergoing a transformation toward urbanization at a remarkable pace.* Its urban population has grown at a yearly average rate of 6 percent since independence, at a time when the national population growth was 2.2 percent. As a result, urban population has grown six-fold, compared with a 70 percent increase in rural population. As per recent UN data, about 35 million people, or approximately 25 percent of Bangladesh's population, currently live in urban areas, compared to only 8 percent at the time of independence: the number is projected to cross 80 million by the year 2030 (Figure 5.1).⁸¹ The share of urban activities in GDP increased from 26 percent in 1972-73 to over 42 percent by 1998-99,⁸² a period over which agriculture sector's share in GDP fell from 60 percent to 26 percent.

Figure 5.1: Urbanization in Bangladesh



Data Source: UN World Urbanization Prospects

5.2 *Urbanization has been more concentrated in the largest cities.* More than half the urban population lives in the four largest cities (see Table 5.1). Dhaka, the national capital, is the largest of these with 12 million residents:⁸³ an eightfold increase in its population since 1970. Its population is projected to reach a staggering 22 million by the year 2015 according to UN estimates.⁸⁴ This would make Dhaka, currently the world's 11th largest city, the 6th largest city in the world and 3rd largest in Asia by 2015. The next three largest cities – Chittagong, Khulna, and Rajshahi – are also growing rapidly, each having experienced at least a five-fold increase in population since 1970 (ten-fold increase the case of Rajshahi). At the other end of the size spectrum are about 300 smaller urban areas, which account for just 4 percent of the urban population.⁸⁵ Economic activity is just as concentrated in the largest metropolitan areas.

5.3 *Urbanization and concentration of it in the largest cities is a byproduct of economic development, a phenomenon hardly unique to Bangladesh.* Developed countries, almost by definition,

⁸¹ Urban growth in Bangladesh is considerably higher than its South Asian neighbors – urban populations in both India and Pakistan have grown at about 3 percent annually since the 1970. Similarly, urban population growth in Brazil has increased by 3.7 percent a year since 1970.

⁸² Center for Policy Dialogue (CPD) (2001).

⁸³ This is about one-third of the national urban population.

⁸⁴ Ahmed et al., mimeo, World Bank, 2006.

⁸⁵ Chowdhury (2004).

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have already made the transition to having a vast majority of their population living in cities. Similarly, as the emerging economies, including Bangladesh, have moved up the development ladder, the share of urban activities in GDP has increased and a rapid shift toward urbanization has resulted. Fast growing economies such as Korea and Malaysia, in fact, have doubled their urbanization rates to 65 and 80 percent, respectively, since 1970.

5.4 *The urbanization process has important implications for productivity and growth prospects of a country, and the associated opportunities and challenges require careful management.* Production typically benefits from being located in densely populated urban areas that provide a pool of skilled workers, a network of complementary firms that provide backward and forward linkages for supply chains, opportunities for knowledge flows, and a critical mass of consumers.⁸⁶ Presence of economies of scale and scope that arise in the early development stages generates increasing returns, with benefits for growth and productivity. At the same time, concentration of urbanization in a few large cities without concomitant improvements in their governance and infrastructure also carries associated costs in the form of congestion, pollution, and transport and services bottlenecks. After a point, the costs tend to dominate and decreasing returns set in, resulting in lower GDP growth, as shown by recent cross-country studies.⁸⁷ Accordingly, policies to manage this challenge need to first ensure strong governance of the larger cities to benefit from their dynamism and agglomeration economies, while also creating a level playing field for the smaller cities, to enable their emergence as viable urban alternatives. The latter focus is important to reduce concentration pressures on the larger cities and spread the agglomeration benefits more widely.

5.5 In this context, two aspects of the urbanization process in Bangladesh seem quite relevant. First, *from a production perspective, how can the net benefits from urban concentration be maximized?* Second, *from a consumption perspective, how can cities overcome administrative and fiscal constraints to provide services that are valued by households and firms?* The two issues are necessarily intertwined. The first involves national level policies such as expenditure on inter-regional transport network and decentralization that shape the patterns of urban concentration and have a bearing on demand for urban services. The delivery of city services, itself along with improvement of other aspects of urban city management (such as revenue mobilization), works to reduce the costs of urban concentration and hence improve the net benefits of urban concentration. Additionally, improvement of urban services in the smaller cities has the spillover effect of alleviating pressures on the largest cities. To address these issues, it seems important to examine more closely the costs and benefits of urban concentration in Bangladesh, including the factors driving it, and also the structure of urban management (including division of responsibilities at the national and local levels) that guides the extent to which individual cities can innovate. The rest of this chapter is organized along such lines.

II. Urban Concentration in Bangladesh: Extent, Causes, Benefits, and Costs

Urban Concentration in Bangladesh

5.6 *As already noted above, the process of urbanization in Bangladesh has been rapid and uneven: it has been much more concentrated in the largest cities, especially Dhaka (Table 5.1).* The four largest cities – Dhaka, Chittagong, Khulna, and Rajshahi – account for over 60 percent of the urban population, up from 48 percent in 1970. One-third of the urban population resides in Dhaka alone. Dhaka, Chittagong, and Rajshahi have each outpaced national urban growth. The urban concentration trends, not surprisingly, largely mirror the concentration of economic opportunities in these cities. Most major industrial activities and auxiliary businesses services are concentrated in the largest cities. Dhaka alone

⁸⁶ World Development Report, World Bank, 1999-2000.

⁸⁷ For example, Henderson (2003).

accounts for 80 percent of the garments industry—the mainstay of manufacturing in Bangladesh.⁸⁸ In Dhaka and Chittagong, about one-tenth of the labor force is engaged in the garments industry, which is over seven times the national average (**Annex Table 5.1**). If this is linked to availability of complementary businesses services, then the data bear that out as well. The representation of business services, particularly finance and real estate in employment is considerably higher in the four largest cities relative to the rest of the country. At the same time, and not surprisingly, the share of population in the largest cities engaged in primary activities is significantly lower than in the rest of the country.

Table 5.1: Population growth of the largest agglomerations

	City Population Rank (2000)	Population (2000)	Population (1990)	Population (1980)	Population (1970)	Annual Growth (1970-2000)
Dhaka	1	12300	6619	3248	1474	7.1%
Chittagong	2	3581	2265	1333	693	5.5%
Khulna	3	1426	972	622	310	5.1%
Rajshahi	4	1016	517	238	105	7.6%
Mymensingh	5	328	189	108	N.A.	-
Comilla	6	307	135	126	86	4.2%

Note 1: Population in thousands;

Note 2: Data are for agglomerations;

Data Source: Global Cities Database <http://www.econ.brown.edu/faculty/henderson/worldcities.html>

5.7 The degree of urban concentration in Bangladesh appears to be higher than in many of its comparators. A straightforward measure of urban concentration is *primacy*, or the share of the largest city in the total urban population in the country. In Bangladesh, Dhaka’s primacy rate is about 32 percent, which is significantly higher than in neighboring South Asia countries (See **Table 5.2**) and is also high relative to countries with similar land areas – for example, primacy is 21 percent for Bulgaria and 23 percent in Korea. However, Dhaka’s primacy seems in line with countries such as Honduras when these were at similar levels of economic development.

Table 5.2: Urban concentration in comparator counties (%)

South Asia Region		Per capita Incomes		Land area		Historic Incomes	
Country	Primacy	Country	Primacy	Country	Primacy	Country	Primacy
India	5.72	Cameroon	22.48	Bulgaria	20.84	Colombia (1975)	20.16
Pakistan	21.94	Mongolia	56.27	Guatemala	20.09	Honduras (1985)	35.48
		Senegal	43.53	Korea	23.28	Armenia (1995)	50.85
		Kyrgyz Republic	45.50	Honduras	27.25	Turkey (1975)	21.63

Data Source: WDI Tables, SIMA

Causes of Urban Concentration: Market Access, Agglomeration Economies, and Policy Biases

5.8 Analyses for other large developing countries have identified the following factors as being key to firms’ location choices across sub-national regions:⁸⁹ (i) the quality and cost of complementary utility services, including electricity, water and telecommunication; (ii) market access, or the geographical reach, given existing transport infrastructure; (iii) agglomeration economies as measured by the presence of firms in own industry and of firms in related industries; (iv) labor and other regulations; and (v) access to serviced land. Due to data limitations, for the case of Bangladesh we restrict ourselves to assessing the

⁸⁸ *Dhaka Urban Poverty: Land and Housing Issues*. Draft paper, World Bank, 2005.

⁸⁹ Lall, Venables, and Redding (2005).

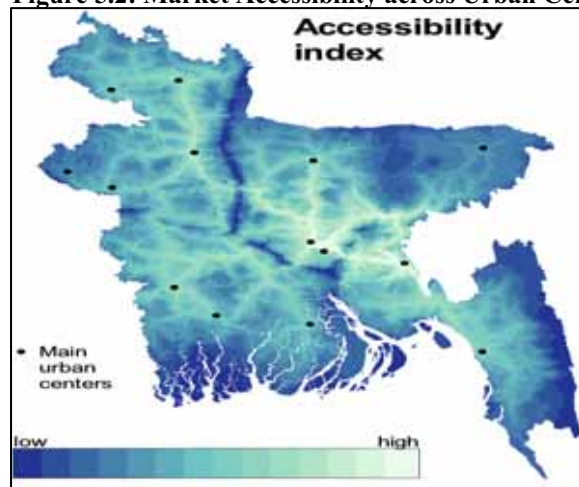
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role of market access and agglomeration economies, in addition to that of major policy biases toward the largest cities.

The Role of Market Access

5.9 **Regional variation in market access, the distance from and the size and density of market centers in the vicinity of the firm, is an important factor leading to urban concentration.**⁹⁰ Firms are attracted to areas with better market access, which leads to concentration of production in these areas.⁹¹ In the case of Brazil, India, and Indonesia studies have found market access to be the most important factor in determining where firms locate.⁹² Market access and urban concentration appear to be closely linked also in Bangladesh. **Figure 5.2** shows market access – which is a combined function of road network and its quality, travel speeds, and population density – to be the highest around the Dhaka metropolitan area. As one moves out of the corridors that link Dhaka to other major urban centers, market access drops off quite rapidly. This does not, however, establish in any way that market access *causes* urban concentration in Bangladesh. It may well be that urban concentration, arising from other factors, is leading to higher market access. A more reasonable reading would be that market access and urban concentration reinforce each other in Bangladesh.

Figure 5.2: Market Accessibility across Urban Centers



Source: Deichmann 2003

The Role of Agglomeration Economies

5.10 **Agglomeration economies are another major reason why industrial and commercial activities tend to cluster.** The benefits of agglomeration economies take two forms. Firms benefit from co-locating with other firms in the same industry: a phenomenon also known as *localization economies*. Firms also benefit from presence of complementary activities or *urbanization economies*.⁹³ Firms that produce intermediate goods will tend to locate close to producers of the final good (a forward linkage).

⁹⁰ The classic gravity model is commonly used in the analysis of trade between regions and countries (Evennet and Keller (2002)). It states that the interaction between two places is proportional to the size of the two places as measured by population, employment or some other index of social or economic activity, and inversely proportional to some measure of separation such as distance.

⁹¹ Davis and Weinstein (2003) show that good market access has a magnified effect on location decisions because firms will locate in the larger market and export (bearing transport costs) to the smaller ones, rather than vice versa.

⁹² Deichmann et. al, 2005; DaMata et. al. 2005; Lall and Mengistae (2005).

⁹³ World Development Report, World Bank, 1999-2000.

Downstream firms, similarly, will gain from locating close to their suppliers (a backward linkage). These linkages can also serve as a channel for information transfers. Firms that are linked through stable buyer-supplier chains often exchange ideas on how to improve the quality of their products or on how to save production costs.

5.11 ***Do agglomeration economies explain urban concentration in Bangladesh?*** It is highly likely that the concentration of garment activities in Dhaka and Chittagong generate *localization economies*, a draw for newcomers in the sector. To test whether the largest cities in Bangladesh also provide more opportunities for *urbanization economies*, we calculate a population-weighted specialization index, with the expectation that lower the value of the index for a given city, the less specialized is the city and greater is the presence of *urbanization economies* in that location. The index is calculated at the district level, using data from the 2003 Labor Force Survey.

5.12 We first group the districts into three size categories. The first category consists of the Dhaka metropolitan area with a population of more than 5 million. The second consists of the cities of Chittagong, Rajshahi and Khulna metropolitan areas, which have populations more than 500,000 but less than 5 million. The third category consists of all the other districts.⁹⁴ The index is measured as follows:

$$SP_i = \sum_{j=1}^k (s_{ij} - E_j)^2$$

where E_j is the share of industry j in national employment, s_{ij} is the share of industry j in total employment of agglomeration i , and the sum is over k industries locally. The index measures for each industry how much the local production share differs from the national share. If all industries mimic the national share the index has a value zero and the city is perfectly diverse. A highly specialized city would have an index approaching two.

5.13 ***Estimates of the specialization index suggest a more significant presence of urbanization economies in the largest cities.*** As seen in **Table 5.3**, relative to the smaller cities (size less than 500,000), the index has a lower value for the four largest cities in Bangladesh, suggesting diversified economic structures in these cities. This, together with the concentration of the major economic activities such as garments production and organized business services in these cities, reflects scope for both aspects of agglomeration – *localization economies* and *urbanization economies* – in the largest cities. A somewhat surprising finding, however, is that Dhaka is more specialized than the next three cities on both specialization measures.⁹⁵ On the other hand, the small and medium size cities appear to be more specialized, consistent with empirical evidence for other countries which similarly find smaller urban centers to be specializing in production activities such as food and beverages, textiles, shoes, or pulp and paper products, among others.⁹⁶ Therefore, while there is scope for *localization economies* for the smaller cities in Bangladesh, the scope for *urbanization economies* is much more limited compared with the

⁹⁴ Rural parts of the district have been excluded.

⁹⁵ Much of Dhaka's excessive specialization comes from the fact that it diverges from the national share of agriculture employment (11 percent vs. 60 percent nationally) giving it a high overall index, and its share of garments employment is twice the national share, thereby giving it a high value in the manufacturing index.

⁹⁶ Henderson et. al 2001.

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larger metropolitans. This appears to be another likely reason behind the uneven pace of different-sized cities in Bangladesh.

Table 5.3: Specialization Index

City Size	Manufacturing	Overall
5 million + (Dhaka)	0.19	0.28
500,000- 5 million (Chittagong, Khulna, Rajshahi)	0.07	0.2
less than 500,000	0.4	0.5

Data Source: Labor Force Survey, 2003

The Role of Policy Biases

5.14 **Policy bias and resulting favoritism also aid urban concentration.** In a centralized governance structure, as in Bangladesh, the national government tends to favor one or two cities, typically the national capital (Bangkok, Dhaka, Mexico City, Jakarta, or Seoul) or certain financial/commercial capitals (Sao Paulo), over others. Such favoritism often involves disproportionate allocation of public expenditures toward the favored cities. These cities also receive disproportionately high levels of public services, while hinterland cities are restricted in their ability and autonomy to deliver public service.⁹⁷ Favoritism can also involve the national government choosing not to invest sufficiently in interregional transport and telecommunications, so hinterland cities are less competitive locations.⁹⁸ Both forms of policy bias are visible in Bangladesh. Policy bias can also take the form of restrictions in capital markets, export/import markets, and licensing of production rights, all favoring firms that locate in the national capital, although there is no direct evidence of this in Bangladesh. An additional problem in Bangladesh is the inefficient functioning of the national land development markets which, together with lack of fiscal decentralization, prevents land developers and local governments from actively developing alternate urban locations and spreading development across the urban hierarchy.

Negative Externalities Arising from Excessive Urban Concentration

5.15 **While market access, agglomeration economies, and policy biases influence location decisions of firms towards large cities, excessive urban concentration in the absence of concomitant improvements in urban management and infrastructure carries associated economic costs.** Such costs are becoming fairly evident in the major urban areas of Bangladesh, especially Dhaka. Real estate in Dhaka has gotten out of reach for most, rapidly worsening traffic congestions have increased commute times substantially, Dhaka's infrastructure is being stretched to the limit, and citizen ratings of most urban services border on complete dissatisfaction.

5.16 **The cost of real estate in Dhaka has reached astonishing levels. Residential land values in prime locations of Dhaka are higher compared to those found in developed countries.**⁹⁹ For example, the Bangladesh Institute of Planners estimates that land in Dhanmondi, among the more expensive areas in Dhaka, is Tk 3,500/ft² or roughly US\$50. Similarly, land in Gulshan is priced at Tk 3,194 /ft² and Baridhara at Tk 3,000 /ft². Even in peripheral areas of Dhaka, such as Uttara, Pallabi, and Shyamali, land

⁹⁷ However, it is quite likely that there are increasing returns in the provision of many public goods. For instance, if a country is to build 100 miles of paved roads, it may be efficient to build most of it joined together in a dense network rather than scattered around. In this case an, 'favoring' large cities in public expenditure and provision may be an efficient allocation of resources.

⁹⁸ Recent literature confirms the importance of inter-regional discrepancies in influencing urban concentration. Henderson (2003) finds that investment in national roads and highway systems significantly reduces national urban primacy. Gallup, Sacks, and Mellinger (1999) and Rosen and Resnick (1980) find similar results for investments in waterways and railways.

⁹⁹ Seraj and Afrin (2003)

costs over Tk 1,500/ft² (over US\$20). Consider in comparison the land prices (in) in the cities of the United States (whose per capita income in purchasing power prices is about 20 times higher): US\$13/ft² in Boston; US\$14/ft² in Chicago; US\$30/ft² in Los Angeles; US\$11/ft² in Miami; US\$32/ft² in New York; US\$26/ft² in San Diego; and US\$64/ft² in San Francisco.¹⁰⁰ The situation is not that much different in other metropolitans in Bangladesh. Land prices in Khulna have been estimated to be similar to those in Dhaka, and are about 15 percent lower in Chittagong.¹⁰¹ The least expensive middle class housing in the country is estimated at about Tk 700,000, which is more than 10 times the median income.

5.17 Dhaka's high land prices stem from the topographical features that limit its supply of land as well as from poor land management. Dhaka is located in a flood plain and surrounded by rivers which periodically flood the lowlands around the city. This creates scarcity of developable land, reflected in the city's high population density of about 20,000 persons per square kilometer, going up to 100,000 persons in some parts.¹⁰² The land constraint imposed by the natural features is exacerbated by poor land management by the Rajdhani Unnayan Kartripakkha (RAJUK), the regional planning and development agency. Since its formation in 1959, RAJUK has developed serviced parcels sufficient only for 16,000 housing units, or less than 400 units per year. At the same time, the area within its jurisdiction has added more than 6 million people—roughly 1 million households.¹⁰³ Thus, the one public agency responsible for housing infrastructure, and with the means to assemble parcels, has been able to meet one 1-2 percent of demand for serviced land.

5.18 Infrastructure and service bottlenecks in the major urban areas have become just as acute. In a 2002 consumer satisfaction survey (Table 5.4),¹⁰⁴ less than 20 percent of households in each of the four metropolitan areas expressed satisfaction with almost any urban major service. Police, land registration, public transport, electricity, and especially judiciary were rated very poorly. In Chittagong, only 5 percent of the respondents were satisfied with the quality of education and 4 percent with the quality of health care.

Table 5.4: Satisfaction with Services (% of surveyed households)

Services	Dhaka	Chittagong	Khulna	Rajshahi
Police	2	0	1	2
Land Registration	2	1	10	4
Transport	7	3	19	6
Electricity Services	8	2	12	2
Judiciary	8	1	2	5
Health Care	11	4	18	9
Garbage Disposal	15	10	12	10
Sewerage/Sanitation	17	16	11	16
Education	21	5	28	12
Drinking Water	27	9	11	8

Source: Proshikha (2002)

¹⁰⁰ Glaeser and Gyorko (2003)

¹⁰¹ *Housing Finance Reforms in Bangladesh*, South Asia Finance and Private Sector, World Bank, 2004.

¹⁰² Islam (2004).

¹⁰³ *Housing Finance Reforms in Bangladesh*, South Asia Finance and Private Sector, World Bank, 2004.

¹⁰⁴ The survey was conducted in 2002 by Proshikha (a Bangladeshi NGO) and the Public Affairs Center (Bangalore, India). Six satisfaction-related response options were provided to the households ranging from strongly satisfied to strongly dissatisfied. These were aggregated into three groups: (i) "satisfaction", which represented the share of respondents strongly satisfied and moderately satisfied with any particular service; (ii) "dissatisfaction", which represented the share of respondents strongly dissatisfied and moderately dissatisfied with any particular service; and (iii) "ambivalent", which represented the share of respondents marginally satisfied and marginally dissatisfied.

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5.19 *Firm surveys, too, reflect deep dissatisfaction on the part of business owners and executives with infrastructure and access to land in the main cities.*¹⁰⁵ Firms in Dhaka and Chittagong were equally unhappy with the quality of electricity supply, reporting power interruptions of about 250 days per year. Forty percent of firms interviewed in Dhaka reported access to land as a severe constraint to business expansion.

5.20 *Until recently, Dhaka ranked among the world's most polluted cities*, with emissions from vehicles with two-stroke engines (baby taxis, tempos, motor-cycles) and trucks and buses being the main contributors to air pollution. However, with the phasing out of two-stroke engines on December 31, 2002, air quality has improved quite dramatically. PM2.5 concentration in Dhaka declined from 250 micrograms/m³ prior to the phase-out to 150 micrograms/m³ on Jan 2, 2003.¹⁰⁶ However, the overall welfare effects of this policy is not clear as the phase out baby taxis are likely to be used in other cities and increase emission levels in those places.

Growth Implications of 'Excessive' Urban Concentration

5.21 *The relationship between urban concentration and growth appears to have an inverse-U shape, for given levels of income and urban governance and infrastructure.* As noted, concentration of resources in early stages of development is useful and improves efficiency as economies of scale and scope help get the most out of scarce resources. At the same time, the economic costs – congestion, overburdening of infrastructure etc. – also begin to rise with increasing urban concentration, more so in absence of good urban management. In fact, recent research suggests that there is an optimal range of urban concentration relative to the quality of the country's urban governance and infrastructure.¹⁰⁷ As show by Henderson (2003), for example, deviations from this optimal point lead to productivity and growth losses.

5.22 *Primacy of Dhaka is considerably higher than the "optimal" primacy level suggested by Henderson's cross-country estimations.* At Bangladesh's income level and urbanization scale, Henderson's estimates suggest an 'optimal' primacy rate of around 21 percent for Dhaka, whereas it is about 32 percent, or more than two standard deviations higher than the optimal. This implies a loss of at least two percentage points in annual GDP growth. This likely overstates the case, but does make the point that excessive concentration of economic activity in one city, Dhaka, relative to its level of governance and infrastructure, could have serious growth costs for the nation as a whole.

III. Urban Management Structure and Financing and Delivery of Local Amenities

5.23 In the previous section, we considered the benefits from agglomeration economies and the costs associated with excessive urban concentration. To be sure, the extent of the negative externalities is related to the quality of the city management. If cities suffer from bad management and inadequate resources, then that will only add to the bottlenecks in infrastructure and service provision, resulting in diminishing returns from urbanization setting in sooner. On the flip side, better management of cities can help contain the costs of increasing concentration, prolonging the period of net benefits from urbanization. The quality of urban management in smaller cities also matters – the higher is the quality, the lower will be the concentration pressures on the major cities. What is the structure and state of urban management in Bangladesh?

¹⁰⁵ The Bangladesh Enterprise Institute and the World Bank carried out the investment climate survey, covering 1001 firms in Dhaka and Chittagong.

¹⁰⁶ Details on air quality issues are at <http://www.cleairnet.org/caiasia>

¹⁰⁷ For example Wheaton and Shishido (1981), and Henderson (2003).

5.24 ***Out of the 522 urban areas identified by the 1991 Census Commission, only 295 urban centers have urban local governments.*** The six largest cities have a city corporation status, while 289 other urban centers have *Pourashava* or Municipality status. *Pourashavas* are further classified into four categories based on their own source revenue potential. These are Special Category *Pourashavas* (only 2 in number), Category I *Pourashavas* (61), Category II *Pourashavas* (46), and Category III *Pourashavas* (190). In centers with no local government, urban infrastructure and services are provided by the field administration of the central government through its line ministries.¹⁰⁸

5.25 ***City governments in Bangladesh do not have much autonomy to develop economic development programs or design and provide most public services.*** There is considerable vertical imbalance where most ‘urban’ functions are the responsibility of the central government. This includes all utility services, housing and land development, secondary and higher education, and economic development planning. Several national ministries are responsible for the management of the ‘urban sector’. The Ministry of Local Government, Rural Development and Cooperatives (MLGRDC) and the Ministry of Housing and Works (MOHW) share the responsibilities of developing and providing urban services and infrastructure through the Local Government Engineering Department (LGED) and the Department of Public Health Engineering (DPHE) respectively. Urban development authorities such as RAJUK are part of the MOHW. Local autonomy is further stifled by the fact that local governments have little or no choice on the staffing, nor do they have control over the wages for their employees. Further, key personnel at the local levels are central government employees with limited accountability to residents.

5.26 ***City corporations and Pourashavas are responsible for delivering a set of generic public services, which leaves little scope for competition among them to attract investment and labor.*** Table 5.5 summarizes various responsibilities of local governments and other service providers along with their main revenue sources.¹⁰⁹ It also seems that by creating many small *Pourashavas*, the government has not carefully considered scale economies in service provision or the implications of limited fiscal and administrative capacity at the local levels, creating dependence on fiscal transfers from the center.¹¹⁰

5.27 ***City governments are unable to ensure satisfactory delivery even of the small subset of responsibilities entrusted them, due to their weak fiscal and administrative capacity. Importantly, they do not have buoyant tax handles, which limits their own-source revenues.*** The main own-source revenue for *Pourashavas* is the property tax and associated fees for water, lighting and conservancy that are imposed on the same base, collectively called the holdings tax. The base of the property tax is the ‘annual value’ (or rent) of buildings and lands, as is common in many other countries.¹¹¹ Rebates on the

¹⁰⁸ Chowdhury (2004).

¹⁰⁹ There are only small differences between the responsibilities of a City corporation and a *Pourashava*. However, in case of Dhaka and Chittagong city corporations, water supply and sewerage, planning and development responsibilities have been given to special development authorities (RAJUK for Dhaka, CDA for Chittagong, and WASA for both Dhaka and Chittagong). Water supply is a local government responsibility for the *Pourashavas*.

¹¹⁰ Asaduzzamar (1996), Chowdhury (2004), and *Bangladesh Municipal Finance Management Sector Study*, Infrastructure Operations Division, South Asian Region World Bank, 1998.

¹¹¹ The tax on land and buildings is imposed at a maximum rate of 7% of the tax base (the annual value); and government regulations also set the maximum rates for the other parts of the holdings tax, at 3% for the lighting rate, 7% for the conservancy rate, and 10% for the water rate, giving a maximum combined tax rate of 27%. This overall rate of taxation is similar to, if slightly higher than, other countries with an annual value system of property taxation *Bangladesh Municipal Finance Management Sector Study*, World Bank, 1998.

annual taxable value are offered to owner occupied properties to deduct mortgage costs as well as for maintenance expenditures.¹¹²

Table 5.5: Providers responsible for delivering urban services

Name of Agencies	Main Services	Sources of Finance
City Corporations	Sanitation, solid waste disposal, road building and maintenance, street lighting, traffic signaling, parks, playground, poverty alleviation, slum improvement	Property taxes, conservancy, lighting and water rates, fees, fines, rental income, government grants, donor funds.
Pourashava	Sanitation, solid waste disposal, Road building and maintenance, Street lighting, traffic signaling, parks, playground, poverty alleviation, slum improvement, Planning, etc	Property taxes, conservancy, lighting and water rates, fees, fines, rental income, government grants and donor funds.
Water and Sewerage Authority (WASA) in Dhaka and Chittagong	Drinking water supply and sewerage	Water tariffs, loans, grants from govt. and donors
Development Authorities: RAJUK, CDA, KDA, RDA	Planning and development of physical infrastructure	From sale of lands and government grants
Department of Environment	Environment Control	Government budget
Specialized authorities: PWD, NHA, DPHE & LGED	Civil works, Housing, physical Development	Government budget and donor's grant and aid

Source: Chowdhury (2004) based on different sources

5.28 Weak administrative capacity and strong political interests limit the extent to which local governments can tap an expanding tax base and enforce compliance with taxes. In principle, property tax collection should be sufficient to finance delivery of services expected of local government. This, however, is not the case. While the tax base is scheduled for revaluation every five years, the reassessments are seldom performed in practice. The administration of the stagnant tax bases is also fraught with problems. The rate of tax collection across *Pourashavas* is low – between 2000 and 2002, only 29 percent of smaller *Pourashavas* collected more than 50 percent of their estimated holding tax. Further, only 25-30 percent collected more than 50 percent in arrears.¹¹³ Moreover, in many local governments, the assessed base and taxable values are recorded by hand, which increases the potential for rent seeking and limits the potential for regular updates.¹¹⁴ Growth in revenues from the property tax is further limited when local politicians make promises of not raising tax rates (as was done in the 1990s). Finally, the linkage between taxes and the receipt of public services is extremely weak, which lowers tax payer confidence and willingness to pay property taxes.

5.29 In the absence of strong own source revenues, most local governments (especially Pourashavas) rely on central government transfers. These transfers often account for 50 percent of local government revenues. However, such grants, in turn, depend on the central government's own fiscal wellbeing; thus their reliability as source of municipal revenues is limited. There has also been a steady decline in grant allocation per *Pourashava* over time. With additional *Pourashavas* being created on a regular basis, total government grants per *Pourashava* fell by more than half between 1996 and 2002 (Table 5.6). This has adversely affected the ability of municipalities, especially the smaller ones, to provide services to their citizens.

¹¹² Maintenance rebates are offered regardless of whether the resident or the landlord has incurred these expenditures.

¹¹³ Similar problems of low collection rates and incomplete assessments of the property tax are seen in Indian cities.

¹¹⁴ *Bangladesh Municipal Finance Management Sector Study*, World Bank, 1998.

Table 5.6: Reductions in central government transfers

Government grants to Pourashavas 1996-2002			
FY Year	Total Municipal Govt. Grants (million)	No. of Pourashava	Average Govt. Grants for Pourashavas (million)
1996	1200	133	9.02
1997	1050	160	6.56
1998	1150	181	6.35
1999	1250	213	5.87
2000	1300	226	5.75
2001	1300	252	5.16
2002	1200	276	4.35

Source: Ministry of Local Government, GoB, Dhaka; Chowdhury (2004)

5.30 The transfers from the central government to urban local governments are mainly in the form of: (a) specific transfers for investment expenditures identified in the Annual Development Plan (ADP); (b) block grants to finance local expenditures; and (c) revenue budget transfers to finance recurrent expenditures, mainly salary subventions for municipal employees (City Corporations are not given salary subvention grants). Grants to local governments in support of the ADP are declining. In the year 1997/1998, City corporations and *Pourashavas* received 0.82 and 0.86 percent of total ADP grants respectively, and these figures fell to 0.63 and 0.74 percent by 2001/2002. Two important issues in the context of ADP allocations are not clear. First, the mechanism and criteria by which ADP block grants are allocated across different types of local governments are not defined. Second, the rationale for centralized administration of the bulk of ADP block grants is unclear. Further, even when ADP grants are locally administered, they are pre-committed to specific sectors, which constrains innovation at the local level.

IV. Policy Options To Improve the Contribution of Cities to Economic Growth: Improving Management of Cities and Removing Policy Distortions

5.31 *The urban management challenge is twofold. First, to improve access to and quality of basic services and infrastructure in Dhaka and other major metropolitans. Second, to improve the prospects for the smaller cities to emerge as viable urban alternatives.* Cutting across both challenges is the need to devolve key services to city governments, together with clear delineation of duties and accountability chains between the federal and city governments, among the various agencies involved with urban management functions, and between the service providers and the citizens. This has to be carefully sequenced with improvements in city governments' ability to perform, particularly by enhancing their own revenue sources and building their technical and administrative capacity. To improve own revenues, local governments first need to step up collection from existing tax bases, for which training of the appraisers and computerization of billing would be useful. However, these efforts can succeed only if the link between local taxes and quality of public services is strengthened.

5.32 *A multi-pronged holistic approach is necessary to effectively tackle urban management problems of the severity and scope seen in Dhaka.*¹¹⁵ *Strengthening the city's governance structure is the foremost priority*, and would involve addressing the mentioned issues of decentralization, capacity and resource constraints, and fragmentation of responsibilities and accountabilities among the various agencies. Some specific recommendations follow:

¹¹⁵ Ahmed et al., mimeo, World Bank, 2006.

- ***Strengthen the role of the Dhaka City Corporation (DCC) in urban management and improve inter agency coordination between the DCC and various development authorities in charge of infrastructure development and service provision.*** The DCC does not manage the use of public land nor does it have power over public utility companies that are operating within its jurisdiction. There are more than 16 government/autonomous organizations directly involved with urban development in Dhaka, with another 30 other organizations having indirect roles.¹¹⁶ Many of these are line ministries of the central government who have very little accountability to the elected local government.
- ***Improve DCC's own-source revenues.*** Dhaka's property tax base has not been reassessed for over 10 years. Furthermore, data from the Bangladesh Bureau of Statistics show that in 2001 the DCC collected holding tax from only 180,000 households out of the 1.1 million holdings in its jurisdiction. It is critical to address fundamental issues of updating property tax rolls, computerizing billing and collection systems, and strengthening enforcement.
- ***DCC has recently tried to initiate self-assessment of the holding tax to reduce administrative costs, which should be promoted.*** The self-assessment system not only reduces the costs of administration and reporting, it also reduces opportunities for informal agreements arrangements between homeowners and appraisers. According to municipal finance experts and local government officials, self-assessment system could increase property tax revenues by 40 percent.¹¹⁷ However, implementation of the self-assessment program has been stalled following a High Court stay order in response to petitioners who argued that the program did not have provisions of appeal in case of dispute over assessment. Civil society organizations have also opposed the self-assessment system in absence of a guaranteed link to public service standards.

5.33 ***In addition to improving governance of Dhaka, it is also important to consider options for enhancing the potential for other cities as viable investment destinations.*** As in the case of Dhaka, the emphasis should be on improving the governance structure of these cities – a multifaceted agenda involving development of their administrative capacity, strengthening of their own-revenues, and greater autonomy over local matters such as utility services, crime prevention etc.

5.34 ***A carefully thought-out national urban development strategy is needed for more balanced urban development across the country.*** This would seek to remove policy biases – such as those in public expenditure allocations and public investments in transport networks – that work against the emergence of smaller cities, and to create incentive structures and competitive pressures among cities such that (public and private) investment and labor movement are guided by objective measures of urban management. Investments in inter-regional transport and communications are likely to make the smaller cities more attractive to private economic activity and reduce excessive concentration in the largest cities.¹¹⁸ To be really effective, concomitant improvements in local infrastructure and service provision

¹¹⁶ Center for Policy Dialogue (CPD) (2001).

¹¹⁷ Chowdhury (2004).

¹¹⁸ While infrastructure links may enhance productivity and, in combination with complementary investments, attract firms to smaller cities in the hinterland, these investments can also have unintended consequences. In particular, inter-regional transport networks provide firms in the larger cities easier access to lagging-region markets, in competition with local producers. Higher transport costs for these large-city producers are often more than made up for by their inherent advantages such as economies of scale, better know-how and lower unit cost of production. This could result in a flow of resources and opportunities out of the lagging region.

within the smaller cities would also be important,¹¹⁹ which, in turn, will require better governance of these cities and large public investments by the local governments.¹²⁰

5.35 ***The recently initiated Municipal Development Funds (MDF) appears to be a useful way to address the large investment needs of the local governments.*** The MDF, a government-owned company, was established in 1998 with initial funding of US\$70 million from the World Bank to provide financial support to *Pourashavas* for infrastructure development and service provision – including, water supply, roads, drainage, sanitation, solid waste disposal, street lighting, development of office complexes and community centers. The fund explicitly requires *Pourashavas* to improve performance on many counts before they become eligible to apply for its resources. In particular, holding tax collection rates need to cross 50 percent of estimated revenues; the municipality’s accounting system should be converted to a double-entry system; office management and accounts should be computerized; and local stakeholders should be involved in choice of projects. Currently, around 100 municipalities have applied for MDF. An important implementation issue relates to development of the *Pourashavas’ capacity* to enable them to qualify for the MDF. Otherwise, the less developed *Pourashavas* with weaker capacity risk being left behind.

5.36 ***Finally, land and housing market reforms also need to be addressed to accommodate new and existing demand.*** RAJUK’s limited capacity as a land servicing agency needs to be enhanced – its mandate needs to be updated and performance improved. At present physical constraints in land availability are worsened by widespread public ownership of land, poor land record maintenance, costly registration procedures, and unclear property rights. These issues will need to be addressed to improve the ability of cities to accommodate growth.

5.37 In sum, Bangladesh would need to unleash the enormous economic potential of its major urban centers to ensure sustained high growth rates. While special attention is warranted toward Dhaka, which would remain an important engine of growth, a more enabling environment is needed other urban centers to emerge as viable alternatives to Dhaka. This will require long-term collaborative efforts of central and local governments, development agencies, international donors, the private sector, and local communities. The main strategic issues that can help start-off the process include:

- Building on agglomeration economies in large metro areas by improving management of ‘urban’ functions and promoting inter-agency coordination among service providers;
- Reducing vertical imbalances (in responsibilities and revenue generation) *and* building local capacity.
- Improving local fiscal capacity *and* linking improvements to service delivery (the MDFs appear to be a useful idea).
- Improving attractiveness of alternate locations through regional transport improvements.
- Reducing growth constraints from land supply and infrastructure bottlenecks.

¹¹⁹ Paul Krugman (1991).

¹²⁰ Recent empirical evidence on Brazil (DaMata et. al (2005)) shows that along with national policies such as regional transport networks and education quality, local matters such as land use, zoning, and crime reduction, too, are important for a city’s growth.