

McKinsey Global Institute



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India's urban awakening: Building inclusive cities, sustaining economic growth

1. Urbanization is critical to India's development

2. India's current approach will lead to urban decay

As a result of deep-seated economic reform in recent years, India has made significant strides, achieving strong rates of economic growth and raising incomes. But it is questionable whether India can sustain its economic momentum unless it acts decisively to manage its growing cities.

Even at today's urban scale, India is struggling. The infrastructure of its cities is looking decidedly tattered and access to basic services in urban areas continues to be poor. Superimpose a surge in demand for services from an expanding urban population and rising incomes, and India's aspiration for social cohesion and sustainable economic growth could reach a breaking point. The risk is that the quality of life in urban India will deteriorate, gridlock will hopelessly compromise productivity, and investors will decide that India's cities are too chaotic for their businesses to thrive.

We believe that today's *laissez-faire* attitude to managing India's cities will no longer do. India's current approach to urban development is insufficient for the mammoth task ahead and needs an immediate revamp. To mitigate the undoubted strains that will develop as cities expand, and to maximize the potential economic opportunity that well-managed cities can offer, India urgently needs a fresh, proactive approach to addressing the challenges of urbanization.

GOOD CITIES OFFER ROBUST ECONOMIC GROWTH AND A SUSTAINABLE QUALITY OF LIFE

Cities have existed throughout modern history in every part of the world. Some have been successful, others not. Cities that have prospered have always delivered a compelling proposition to citizens who choose to bring their talent and energy to the city's fabric, and to investors who opt to bring their capital and enterprise, thereby sustaining urban livelihoods and growth (Exhibit 2.1).

Those cities that offer an attractive proposition to business and people create a virtuous cycle that creates jobs, fosters talent, attracts capital, boosts productivity, and improves the quality of life for residents. Not all cities achieve this virtuous cycle—and lose out to other urban centers that offer a more attractive proposition to skilled people and business investors. Such cities simply cannot leverage the potential economic benefits that urbanization can confer and suffer not only a deteriorating quality of life but also, eventually, subpar economic growth.

Exhibit 2.1

Good cities deliver robust economic growth, as well as a sustainable quality of life

What good cities deliver

| | | |
|------------------------------------|---|--|
| Robust economic growth | Sustained productivity advantage | <ul style="list-style-type: none"> Cities have established a robust economic growth agenda and provide a favorable investor climate |
| | Robust job creation | <ul style="list-style-type: none"> Ensures creation of sufficient jobs and livelihoods |
| Sustainable quality of life | Scaled public infrastructure | <ul style="list-style-type: none"> Uninterrupted access to clean water supply for every resident 100 percent coverage, proper treatment of sewage and solid waste 45 minutes maximum intra city travel time for all citizens |
| | Reliable social services | <ul style="list-style-type: none"> Quality, affordable education and health care facilities for all Access to affordable housing for all sections of the society; no urban slums |
| | Good recreational and community infrastructure | <ul style="list-style-type: none"> Parks within 15 minutes of walking for every resident Open spaces throughout all cities Entertainment hubs and community spaces that celebrate diversity and foster innovation for all residents |
| | Sustainable environment | <ul style="list-style-type: none"> Preservation of natural resources and ensuring access to clean air, water, and land Matching national standards on climate change, emissions, and sustainability |

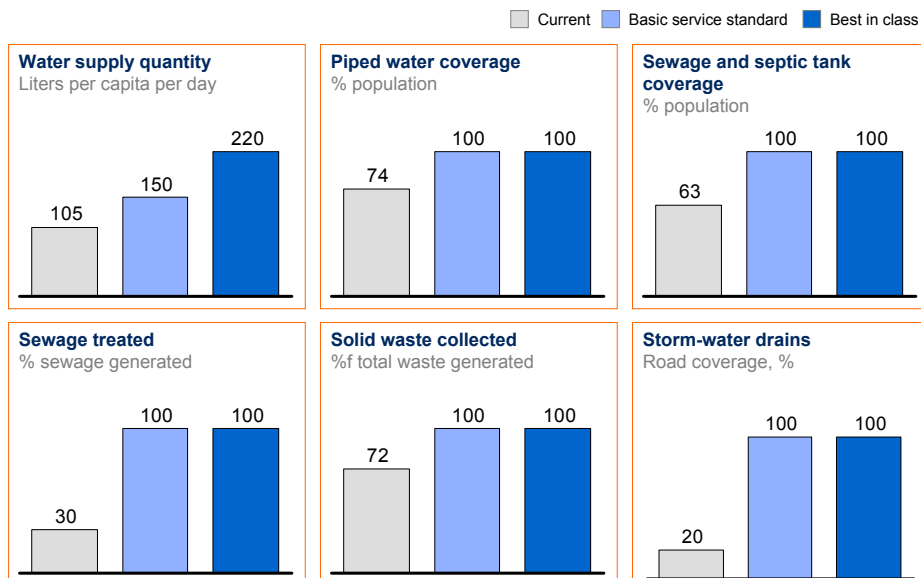
SOURCE: McKinsey Global Institute analysis

INDIAN CITIES ARE ALREADY STRUGGLING TO PROVIDE A BASIC QUALITY OF LIFE

Urban India has attracted investment on the back of strong growth but is failing its citizens. Across all major quality-of-life indicators, India’s cities fall well short of not only the levels of service to which international cities aspire but even a “basic” standard of living for their residents (these basic standards have been defined using a combination of Indian and international benchmarks). While this is true across every service, we are choosing to highlight the poor quality of physical infrastructure as a particular example of the crisis affecting Indian cities (Exhibits 2.2 and 2.3).

Exhibit 2.2

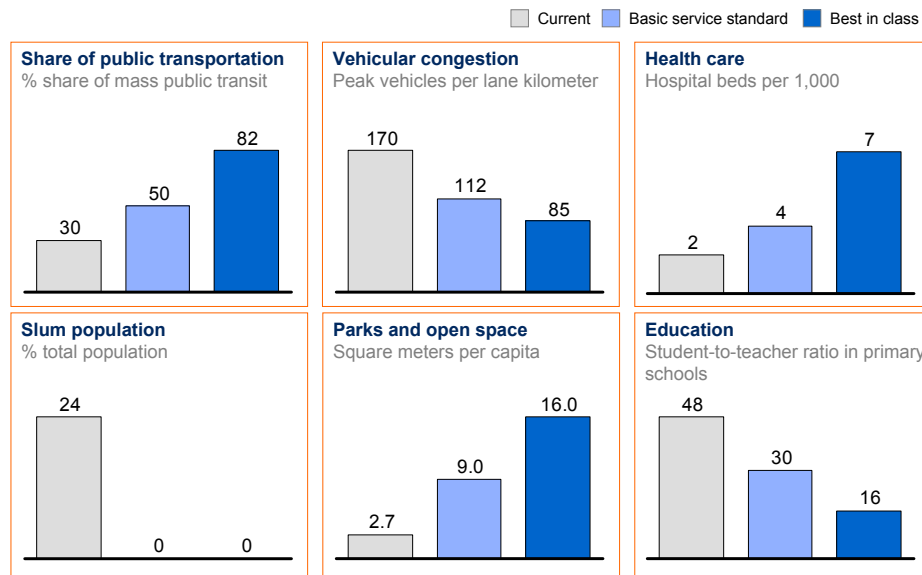
The current performance of India’s cities is poor (1/2)



SOURCE: United Nations; press search; City Development Plans; The Energy and Resources Institute; Planning Commission; Census 2001; Central Pollution Control Board; McKinsey Global Institute analysis

Exhibit 2.3

The current performance of India's cities is poor (2/2)



SOURCE: United Nations; press search; City Development Plans; The Energy and Resources Institute; Planning Commission; Census 2001; McKinsey Global Institute analysis; *Study on Traffic and Transportation Policies and Strategies in Urban areas in India*, Wilbur Smith, 2008

Life for the average city dweller in India is tough. Across India, urban citizens have access to only 105 liters per day of potable, piped water supply, as compared to a minimum basic requirement of 150. Only 63 percent of population has access to sewerage and septic tank facilities, and only 30 percent of sewage generated actually gets treated. This is true even for large cities—Mumbai, for example, treats only 30–40 percent of its sewage today. Another key urban pressure point is affordable housing. Nearly 80 million people live in slums across the country. Transportation, too, has deteriorated over the years. Lack of investment in public transportation has resulted in a significant decline in share of public transportation, from nearly 40 percent in 1994 to 30 percent today. Private transportation infrastructure is equally dismal. Peak private vehicular density has already touched 170 vehicles per lane kilometer—50 percent higher than the basic requirement.

ON CURRENT POLICIES, INDIAN CITIES WILL FACE WORSENING DECAY AND GRIDLOCK

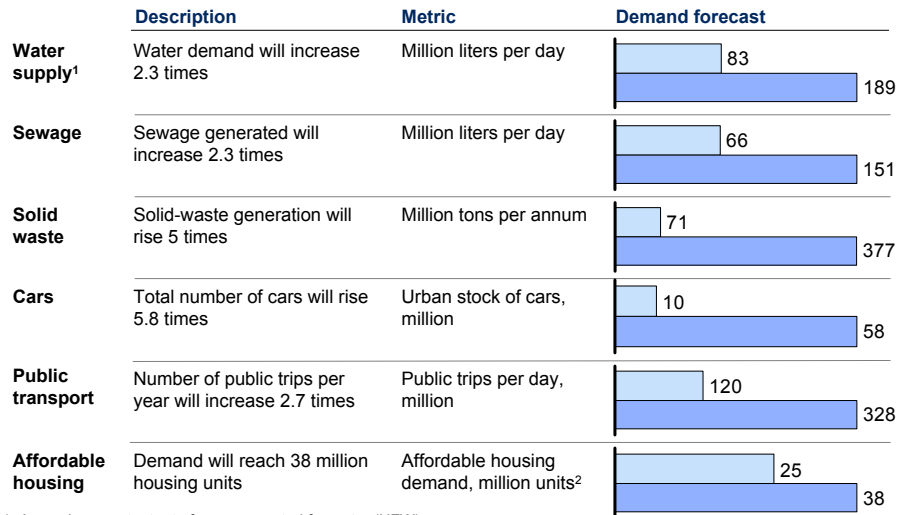
As the urban population and its incomes increase in India, demand for every key service will increase many times (Exhibit 2.4). This will be true in cities of every size and type across the country (Exhibit 2.5).

And if India continues to invest in urban infrastructure at its current rate—very low by international comparison—in 20 years' time the urban infrastructure will fall woefully short of what is necessary to sustain prosperous cities (Exhibit 2.6). On current trends, India is likely to invest \$300 billion in urban infrastructure over the next 20 years, a twofold increase in per capita spending of \$17 today. Even with such a large investment program, capacity building in urban India will not come anywhere close to meeting the surging demand for services. For example, peak vehicular densities will likely reach as high as 610 vehicles per lane kilometer. At such densities, an average journey may take up to five hours in peak morning traffic—similar to the acute congestion that disfigures some Latin American cities. Similarly, the per capita water supply could drop from 105 liters today to 65 in 2030.

Exhibit 2.4

The massive scale of India's urbanization will create a huge surge in demand

2007 basic service demand
2030 basic service demand



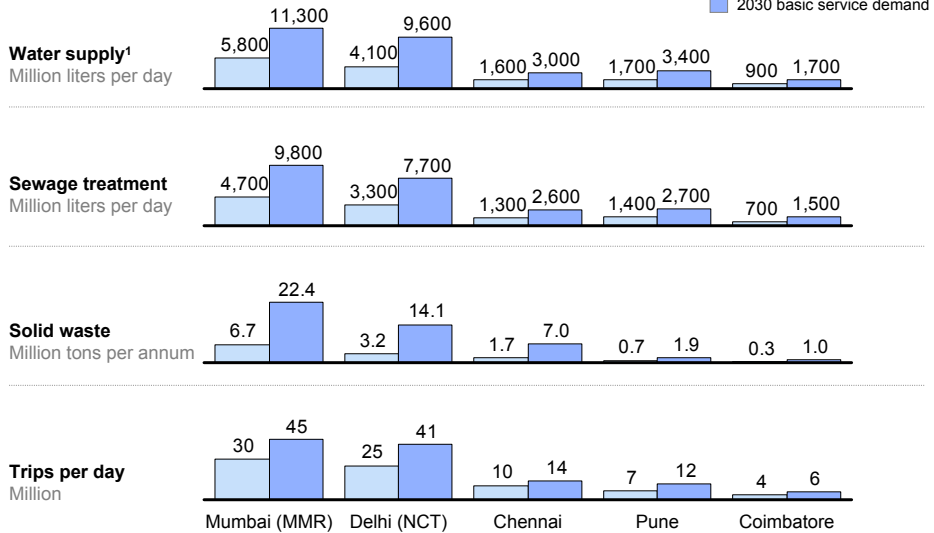
1 Assuming constant rate for unaccounted for water (UFW).
2 Net of existing supply.

SOURCE: United Nations; Handbook of benchmarks, Ministry of Urban Development; W. Smith, *Transportation Policies and Strategies in Urban India*; National Council for Applied Economic Research; press search; McKinsey Global Institute analysis

Exhibit 2.5

All cities will see surging demand for services

2007 basic service demand
2030 basic service demand

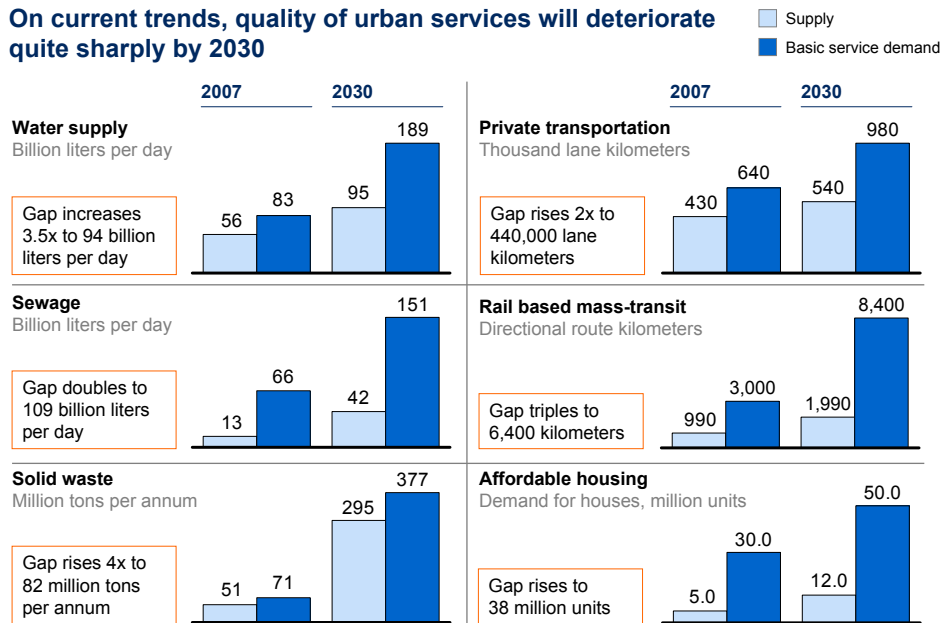


1 Assuming constant rate for unaccounted for water (UFW).

SOURCE: United Nations; Handbook of benchmarks, Ministry of Urban Development; W. Smith, *Transportation Policies and Strategies in Urban India*; National Council for Applied Economic Research; press search; McKinsey Global Institute analysis

Exhibit 2.6

On current trends, quality of urban services will deteriorate quite sharply by 2030



SOURCE: United Nations; Handbook of benchmarks, Ministry of Urban Development; W. Smith, *Transportation Policies and Strategies in Urban India*; National Council for Applied Economic Research; McKinsey Global Institute analysis

We have seen the strains that arise from such unplanned urbanization elsewhere. For example, in many Latin American countries, rapid urbanization without a corresponding stepping up of infrastructure construction has led to a steep deterioration in quality of life. Until recently, the metropolitan city of São Paulo, Brazil, with a population of 19 million, had only 38 miles of public rail transportation, which resulted in traffic queues at peak hours that could stretch out for more than 120 miles. More than 60 percent of citizens who moved into the city since the 1980s lived in slums (*favelas*). Brazil may also have not fully leveraged the economic opportunity of urbanization, unable to generate sufficient jobs to match the movement of people into cities. Unlike in many other countries, the transition to a mostly urban population (e.g., from 50 to 80 percent) was accompanied in Brazil by only a twofold increase in per capita income, compared to double that in other countries.

This is a stark warning for India. If India continues with its current unplanned urbanization path, it will result in a sharp deterioration in the quality of life in its cities, putting even today's rates of economic growth at risk.

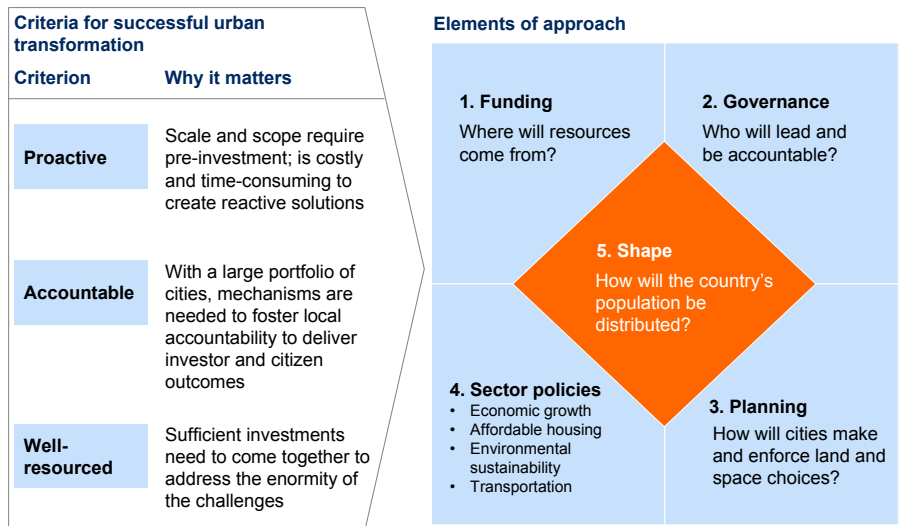
INDIA NEEDS A NEW APPROACH ACROSS FIVE ELEMENTS

Many countries have faced the challenges that urban India is grappling with today, albeit not on the same scale, and emerged as successes. So what can India learn from the successes and mistakes of others? Our analysis finds that, although countries naturally make different choices, there is a broad consistency in the basic approach employed by countries with thriving cities. Our study shows that five dimensions are important: funding, governance, planning, sectoral policies, and shape (Exhibit 2.7).

India scores poorly on all five of these aspects of the urbanization challenge (Exhibit 2.8).

Exhibit 2.7

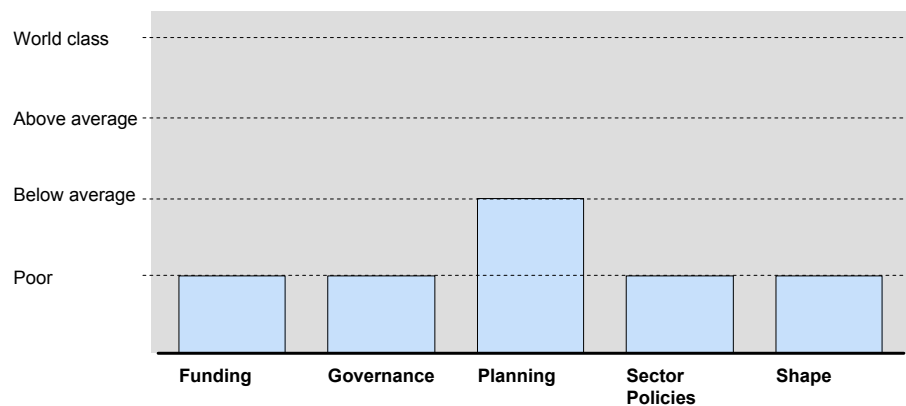
To manage urbanization, countries around the world have used a common approach consisting of five elements



SOURCE: McKinsey Global Institute analysis

Exhibit 2.8

India scores poorly on four, and below average on one, of these five elements to date



SOURCE: McKinsey Global Institute analysis

- **Funding.** Sufficient resources for investment to build services for citizens, preferably anticipating demand rather than playing constant catch-up as we see in India, are the bedrock of successful cities. In countries around the world governments have devised mechanisms to ensure cities have reliable access to four sources of funds: land monetization; property taxes and user charges; debt and private participation; and a formula based grant system from the government. With some exceptions, India has barely leveraged these sources of funding, resulting in significant underinvestment (one-eighth of what is necessary) in its cities. In addition, central and state governments do not follow a systematic formula in their approach to provide funds to cities.
- **Governance.** Choices that cities make on leadership and management are a second vital component. The most successful governance is a devolved model that empowers local leaders but holds them accountable. India has not devolved power to the local level, leaving states to run cities from a distance and with weak accountability. India is the only G20 country that has not adopted a system in which empowered mayors run cities, and where dedicated expert agencies deliver services. Moreover, Indian cities have a large shortage of administrative and technical talent.
- **Planning.** Effective and systematic urban planning has been part of the fabric of successful cities for decades. Planning is important to allow cities to make informed trade-offs on their use of scarce resources such as land. Cities around the world use micro-plans to ensure effective use of every aspect of the city's urban space. Usually a metropolitan master plan sets out the overall strategy for the economy, mass transit, and affordable housing which is then applied in detail at the local level. Indian urban plans, on the other hand, exist on paper but have little impact on the ground. The choices India's cities make on land use and other aspects of planning are ad hoc. Exemptions are so systemic that there is a very weak relationship between what plans prescribe and the decisions that unfold at the local level. A significant shortage of world-class urban planners exacerbates the poor quality of India's urban planning.
- **Sectoral policies in job creation, public transportation, affordable housing, and climate-change mitigation.** Great cities invest effort in designing policies for the most important sectors that influence the city's economy and quality of life. Take affordable housing as an example. In general, cities plan for affordability and work to create policies to match affordability with income levels to ensure wide access to housing. India does not plan for affordable housing systematically and has built fewer than 200,000 units a year, in comparison to the minimum that India needs: 2 million annually. While models exist, India has not found a large-scale, economically viable model that can be executed nationally. As a result, 17 million households live in slums, a number that could double by 2030.
- **Shape.** Most countries in the world have had the luxury of urbanizing organically through history and have ended up with different portfolios and distributions of cities. China is exceptional in that it proactively shaped a concentrated pattern of urban expansion in the beginning, with the development of its dynamic coastal cities. India can proactively shape the overall portfolio of cities in a way that optimizes their economic contribution, investment and land requirements, and the objective of regional equity. India has not made any active attempt to do this. MGI sees no evidence that central and state governments in India are addressing the issue of how best to shape its portfolio of cities to maximize their potential to drive growth.



The need for a new approach to managing India's urbanization is urgent and critical. If it adopts a new approach, India could turn its urban expansion into a compelling opportunity to attract investment and drive social transformation. The next chapter offers a detailed discussion of what India needs to do on the five elements of effective urban management and development.

