
Executive Summary

Almost 200 years ago, as England's Industrial Revolution started the process of urbanization that has since characterized development throughout the world, a poet worried about the "dark satanic mills" that were such a fundamental part of this revolution. Despite his misgivings, the same poet went on to argue that it was necessary for societies to arm themselves with "chariots of fire" and other weapons so that they could master this process (Blake 1995). In a somewhat more prosaic vein, World Bank president Robert McNamara launched the Bank's shelter assistance programs in 1973, saying, "If cities do not begin to deal more constructively with poverty, poverty may begin to deal more destructively with cities" (World Bank 1975). As the world's population is expected to become primarily urban in 2008, and with the population of cities in developing countries expected to increase by more than 1 billion by 2020, McNamara's and Blake's concerns appear to resonate even more today. This magnitude of urban growth is unprecedented and suggests that a significant increase in investment in shelter and related urban infrastructure will be needed to meet the needs of the world's growing population.

By reviewing the Bank's experience with shelter lending, this paper seeks to address the question of whether the World Bank has helped developing countries deal with the inevitable problems that arise with urbanization, particularly problems with the provision of shelter. It reviews the Bank's performance, with a focus on identifying lessons learned so that current demands can be more effectively addressed.

In contrast to earlier studies, however, this review focuses more on how the changing policy environment has affected the structure of Bank assistance, rather than on how Bank assistance has affected the policy environment. This perspective is taken for two reasons. First, in recent years, benevolent changes in the policy environment are helping to ensure that better shelter conditions are provided to the poor in rapidly growing cities. However, despite the generally improved environment, some serious and often long-standing obstacles are impeding and, in some

places, preventing progress. The emphasis on the policy environment allows us to give greater weight to these constraints. Second, World Bank shelter assistance is no longer an experimental program, as it was when the first review took place.¹ Shelter assistance is now a mature sector, with 278 loans (including International Finance Corporation [IFC] loans) made to more than 90 countries for a total of more than \$16 billion.² As a result, this review devotes considerably more attention to the outcomes of the Bank's shelter projects than did the earlier studies.

Findings

In many respects, the basic conclusion is positive. Bank lending for shelter has changed from providing relatively small loans to low-income countries to providing large-scale, policy-related assistance to a variety of countries. For example, the first four loans averaged \$6 million each. In contrast, a recently approved loan was for \$500 million, and such large loans are not unusual. The Bank's shelter sector also has been a very strong performer: more than 83 percent of lending and almost 78 percent of the projects for the entire 34 years since 1972 of shelter lending have had satisfactory outcomes, one of the highest satisfaction rates of any sector in the Bank. Shelter lending has also been a resilient, evolving sector; demand for this sort of assistance increased during the 1990s, while demand for other infrastructure lending decreased. Millions of poor families in thousands of cities have benefited from the assistance. In addition, housing has become a growing line of business for private sector development. In recent years, the IFC has undertaken 45 investments, and discussions are now taking place with the Multilateral Investment Guarantee Agency (MIGA) for supporting shelter investments. Shelter lending accounts for more than half of total urban lending since 1972 and increased from less than 3 percent of infrastructure lending in the 1970s to about 8 percent in recent years. In short, Bank shelter assistance is no longer described as lending to low-income enclaves as it once was. It has adopted the sector-wide integrative strategy recommended by the last Policy paper.

Conclusions about shelter lending are by no means completely positive, however. In particular, while the nature of the lending has evolved to embrace the private sector more fully, it has also moved away from the poverty orientation that was for many years the core focus. A much smaller share of lending now goes to support low-income housing (10 percent of total shelter lending since the mid-1990s, versus more than 90 percent from the mid-1970s to the mid-1980s) and a much smaller share now goes to low-income countries (20 percent, down from about 40 percent from the mid-1970s to the mid-1980s). If the Bank is to make a

meaningful contribution to the Millennium Development Goal of affecting the lives of 100 million slum dwellers, this trend will have to change.

The Changing Policy Environment

Perhaps the most positive aspect of the changes since the mid-1990s is that the Bank has learned much about the composition of the right policy environment. Most of all, as emphasized in the 1993 World Bank housing policy paper, that environment entails a strong reliance on an active private sector, well-targeted and transparent public resources, and a nimble and transparent regulatory environment. At the time of the 1993 analysis and the events following the breakup of the former Soviet Union were just beginning to demonstrate how poorly nonmarket approaches to the provision of shelter performed. As market-oriented perspectives on housing policy have become more widely adopted, demands by borrowing countries to restructure national housing subsidy programs have increased.

Another remarkable change in the policy environment in recent years is the speed at which market-based housing finance has spread throughout the world. Since about 2000, the world changed from one in which most of the world's population did not have access to mortgage finance to one in which most of the world's population now lives in countries with a market-based mortgage finance system with generally affordable terms. Only a few years ago, most citizens of most countries could not borrow to finance housing. The result was that housing was affordable only through a combination of subsidies and savings, or households were forced to get along with less, often far less, in the way of basic housing. While market-based housing finance is now available to most middle-income people in the world, it is still not available in most countries or for the poorest people. These underserved people in countries where formal housing finance is in a nascent stage represent an enormous potential audience for Bank assistance. Moreover, many countries in which formal housing finance is available do not have housing market conditions hospitable to the development of finance. In such countries, lack of secure title, restrictive zoning and occupancy regulations, and inability to enforce contracts prohibit the development of mortgage finance. The situation is often exacerbated by other forms of social exclusion, so that most of the world's poor do not even have access to basic banking services, much less mortgages. For these families, mortgage finance remains a distant reality even if market-based finance is more widely available.

Unfortunately, policy reforms and increasingly broad acceptance of the importance of the private sector role have not translated into policy

makers treating land as an important input into the provision of housing services. When the input market for land is disrupted so severely, as it is in many cities of the developing countries (in some cities, the cost of housing approaches that of cities such as New York), market outcomes become politically unacceptable. The immediate result is that nontransparent, public interventions continue to substitute for market processes. The ultimate result is that slums proliferate, and demolitions and encroached infrastructure are the norm. In such places, it is not unusual for urban housing transactions to take place in a savage market, with ill-defined property rights often illegally enforced by gangsters. Hence, in many ways, and in many places, urban land markets remain the most pervasive binding constraint on the provision of shelter for the urban poor.

Finally, progress has also been made on the role of greater community involvement in Bank projects. While enthusiasm for such projects has soared, our understanding of the role of nongovernmental organizations (NGOs) remain very basic. Recognizing that NGOs, like markets, can be important in housing policy does not mean that they provide the missing link in effective housing policy. Such local organizations cannot hope to replace the systemic policies needed to ensure that many basic services, such as electricity and water, are provided to people in massive, teeming cities. As effective as they often are, local community groups are not able to provide the professionalism needed to build and maintain power and water companies, nor should they be expected to do so. Nevertheless, in many places, these groups are showing how participation in housing improvement programs can improve not only their immediate housing conditions, but also lead to the realization that the poor can take more control of their lives. Thus, for many of the urban poor, improving housing conditions is a means to improving their integration into society.

Two of the three levers through which policy makers have traditionally affected housing markets and the housing circumstances of the poor, subsidies and finance, have evolved rapidly in the world's more decentralized, democratic, and market-oriented economies. There has also been an increase in the international community's acceptance of the effectiveness of community-based participatory efforts. Finally, all of these efforts are now supported by a formal donor action group established in 1999—the Cities Alliance. This global partnership is working to focus donors' efforts in much the same way that earlier multilaterals did for areas such as agriculture research and microenterprise finance. These changes have the potential to be enormously more productive now that many of the larger debates about what works, and perhaps more importantly, what does not work, in shelter policy have

largely been settled. These improvements, however, have come none too soon given the demographic imperative faced by most developing countries and the serious constraints that remain in the other important policy lever, the land market. In other words, the world's unprecedented growth in urban population will require greatly improved shelter and land policy if the situation is not to deteriorate.

Recommendations

A major underlying theme of shelter policy should be to recognize that, while shelter provision is important for improving the livelihoods of the poor, it is also an important sector in its own right. Improving shelter conditions has undeniably desirable welfare effects. But when housing and land account for such a significant share of investment, wealth, and (in functioning systems) finance, improvement of shelter conditions can also be a key feature of the investment climate. It follows that when managed effectively, shelter policy can be an important source of financial stability and economic resiliency, as well as a major component of the social development agenda. Perhaps equally importantly, when shelter policy is not managed effectively, the housing sector can contribute to financial instability and increased inequality.

Respond to the Increased Demand for Assistance

In response to the increase in the demand for shelter assistance, the Bank should increase its emphasis on two areas, as detailed below.

Improve the provision of housing subsidies. For the Bank, the form of shelter assistance most in demand in recent years has been that directed toward improving the financing and targeting of housing subsidies. These sorts of reforms offer the prospect of greatly improving the effectiveness of government expenditures for the poor. Large, fiscally-oriented loans have been approved or are in process of being approved in Brazil, the Islamic Republic of Iran, Mexico, Morocco, and Russia. This sort of work is in its initial stages. In many cases, the links between subsidies and finance will be quite strong, emphasizing the potential importance of Bank assistance in coordinating efforts.

Cautiously expand the reach of housing finance. The rapid expansion of market-based housing finance across a variety of country situations is very promising. Moving to such widespread availability of credit in such a short time period, however, is also a cause for concern. Rapid growth in credit almost always raises prudential concerns, and the experience of the

deregulation of housing finance systems in developed economies suggests that housing finance is no exception to this rule. In addition, as housing prices increase globally, it is important to lay the groundwork for the development of effective finance.

Improve the Bank's Approach to the Shelter Sector

Because housing is a good with so many different aspects—it provides basic shelter and wealth, it is affected by urban planning and finance, and it is affected by demographic trends—it is difficult to keep sectoral strategies and priorities clear. Nevertheless, improvements can be realized in a number of areas.

Reinvigorate and retarget bank support for low-income housing. Despite the strong performance of Bank shelter lending in terms of volume of lending and outcomes, questions remain as to how this support can sustain the original focus on slum upgrading and poverty alleviation. In particular, how can these poverty-oriented efforts be integrated into the important role played by the broader policy environment? There is no reason that policy loans should be mutually exclusive of investment lending for slum upgrading. In short, there is no apparent reason for the Bank's almost desertion of lending for slum upgrading or sites-and-service projects. Therefore, to be consistent with its support for the Millennium Development Goals, the Bank should make an effort to reinvigorate these activities, particularly in Sub-Saharan Africa.

Become more responsive to borrowers and other donors. Certainly one of the constraints on developing assistance to slum dwellers is the long gestation period involved with preparing a project. Not surprisingly, given this long time period, many potential projects are never realized. Ways that could short circuit this lengthy gestation period, perhaps working in concert with other donors, should be developed.

Improve understanding of urban land markets and slum conditions. Despite frequent claims that the number of people living in slums is increasing, we do not have a full grasp of the numbers. Nevertheless, we know that for a variety of reasons, urban land markets often work very badly, making housing and land market outcomes so expensive that they prompt continual government interruptions in the functioning of land markets. We also know that these intrusions often have spillover effects on all shelter-related submarkets, prompting further regulations. In short, we know that there is a vicious cycle that often compounds the problems. Finally, we know that in most large cities with significant slum populations, it is almost certainly the case that land market failings are the single most important constraint on

development effectiveness. Further efforts to identify and clarify these constraints should be developed. Observers such as Hernando de Soto are almost certainly correct: Improving land use and the clarity of property rights, formally or informally, can confer enormous benefits on many poor families.

1. The 1983 review of Bank urban lending of the previous decade, *Learning by Doing*, makes clear just how experimental the Bank's urban lending had been and how the Bank had moved to hire new types of staff and undertake new types of projects which were more community participation oriented. It notes that by 1983, the number of urban sector staff had increased over the previous decade from 10 to 61. As of 2005, there are now 115 staff mapped to the urban sector. In addition, a recent study by the same author of *Learning by Doing*, Michael Cohen (2001), shows that Bank urban projects have supported more than 10,000 communities throughout the world.

2. This figure is based on commitments to housing components of projects at the time of approval. This was done to make comparisons with other sectors. If actual disbursements for closed loans and commitments of active loans are counted, total lending over the last 34 years is \$14.3 billion.