Section III
Summary

7
Conclusions and Recommendations

Has World Bank shelter lending contributed to creating "the chariots of fire" needed to rethink how to address the problems that arise when large numbers of poor people move to cities? Or, despite $16 billion in loans, do "dark satanic mills" characterize the cities of developing countries? Have cities in the developing world done something constructive about poverty, as Robert McNamara hoped, or as he feared might happen, has poverty done something destructive about cities?

The answer, in many ways, is it all depends. In many respects, the basic conclusion is positive. Bank lending for shelter has changed from providing relatively small loans to low-income countries to also providing large-scale, policy-related assistance to a variety of countries. For example, the first four shelter loans were for an average of $6 million. The most recently approved loan to Brazil was for $500 million, and it followed a recent $300 million loan to Mexico. Shelter loans have also had one of the most satisfactory outcomes of any sector in the Bank: more than 83 percent of shelter lending and almost 78 percent of shelter projects for the entire 34 years of lending have had satisfactory outcomes.[1] Shelter lending has also been a resilient, evolving sector. Demand for this sort of assistance increased in the 1990s, as did other types of infrastructure lending. Millions of poor families in thousands of cities have benefited from the assistance.

In addition, housing has also become a growing line of business for private sector development. After a slow start in the 1980s, 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 accounted for more than half of total urban lending over the entire period, and increased from less than 3 percent of infrastructure lending in the 1970s to about 8 percent. In short, Bank shelter assistance can no longer be described as lending to low-income enclaves. It has adopted the sector-wide integrative strategy articulated in the 1993 World Bank housing policy paper.

However, conclusions are by no means completely positive. In particular, while the nature of lending has evolved and has embraced the private sector, 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-1980s to the mid-1990s) and to support low-income countries (20 percent since the mid-1990s versus about 40 percent from the mid-1980s to the mid-1990s). 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 and Bank Shelter Assistance

Perhaps the most positive aspect of the changes in the last decade is that the Bank has learned much about the composition of the right policy environment. Most of all, as emphasized in the 1993 housing policy paper, that environment entails a strong reliance on an active private sector, well-targeted and transparent public resources, and a nimble, transparent regulatory environment. At the time of the 1993 analysis, the events following the breakup of the former Soviet Union were just beginning to demonstrate how poorly nonmarket approaches to the provision of shelter had performed. Since then, the evidence has become clearer (see Buckley and Kalarickal 2005). As shown in Buckley and Kalarickal (2005), not only have all the transition countries in Eastern Europe moved to market-based systems for housing delivery, and have reforms in China, India, Mexico and other countries have provided compelling evidence that a market-oriented approach to shelter policy is far more effective in improving housing circumstances. This result is, in many respects, not surprising. The poor have always had to solve their shelter problems with little public assistance. Now, however, public assistance is much less likely to be designed to presume that the state could possibly solve all the housing problems of the poor. An important part of efforts to improve the housing conditions of the poor involves improving the efficacy of the assistance provided. Fortunately, here too progress has been made. As market-oriented perspectives on housing policy have become more widely adopted, demands by borrowing countries to restructure national housing subsidy programs have increased. In the past few years, a number of the Bank's largest borrowers—Brazil, Ethiopia, India, the Islamic Republic of Iran, Mexico, Morocco, and Russia—have all engaged the Bank in discussions or projects on how to improve the targeting and effectiveness of these subsidies, some of which are described in box 7.1. There is clear agreement between these countries and the Bank that simple steps to improve the efficacy of subsidies can result in many-fold improvements in public expenditures. However, it is also clear that such reforms must be carefully crafted to specific country circumstances.

However, more than just the structure of public assistance must be crafted to individual country circumstances. The weakening of a paternalistic, controlling public sector presence in housing markets does not mean that there is a single simple formula to improve the conditions of poor. In most developing countries, there are a variety of circumstances that prevent the best assistance program from being implemented, and reform entails careful sequencing based on a long-term commitment and a credible sectoral dialogue.

Box 7.1 "Magnum" Shelter Loans in Mexico and Brazil

Theory and practice show housing to be a synthetic sector in which effective programs and policy require action in institutional strengthening, credit, subsidies, property rights, basic services, and land development. In the past, the Bank and other development institutions have focused on only one or two of these topics. But in recent years, the Bank has attempted to engage clients with more ambitious projects that are more appropriate for the multisectoral nature of the housing sector. In Mexico and Brazil, for example, the Bank is undertaking what might be termed "magnum" loans that address a comprehensive housing agenda, including questions about sequencing and better overall integration of all the major housing policy topics.

Mexico. Affordable housing in cities represents one of the crucial challenges in urban development at Mexico's current state of demographic and socioeconomic development. Though population growth has slowed dramatically, new household creation and demand for housing and basic services have accelerated—doubling the number of new households—due to the baby boom of the 1970s and 1980s. Low- and moderate-income families, in particular, often lack access to formal sector. Furthermore, housing continues to be critical to the economy at large. Housing and urban investment account for 10 percent of GDP and the construction sector generates 9 percent of all employment. In response to this increased demand, the Mexican government has undertaken a comprehensive reform agenda. This reform agenda allowed the Bank to support a lending project that aims to address the various pieces of the puzzle rather than addressing interrelated sectors on a piecemeal basis.

Specifically, the Bank has agreed to undertake the three-phased Housing Sectoral Adjustment Loan (HUSAL), along with the Housing and Urban Technical Assistance Loan Project (HUTAL). These loans aim to address the broader policy and institutional framework while improving the functioning of the sector for the poor. The projects aim to assist the government of Mexico to: (a) develop a sound national policy and institutional framework for housing and urban development; (b) design and put in place a unified federal housing subsidy system; (c) strengthen the housing credit and savings system and move these systems downmarket; (d) strengthen urban real property registries and rights; (e) coordinate physical and social investments to systematically upgrade poor neighborhoods; (f) increase supply of urban land and market access to urban land by the poor; and (g) better prevent and manage the impacts of natural disasters.

Brazil. In the past decade, Brazil has laid the institutional foundations for responsible macroeconomic management. Economic growth has recovered in over the past few years. However, the housing deficit of an estimated at 7.1 million units affects primarily low-income households and continues to be a problem. A large share of housing is unauthorized and informal settlements are growing four times faster than average urban growth. At the same time, the housing sector is crucial to the health of the broader economy because housing investment represents 3 percent of GDP and the construction industry employs 5 percent of the labor force. The government of Brazil has initiated a low-income housing strategy aimed at improving the living conditions of the poor, strengthening access by the poor to assets, notably housing and serviced or serviceable land, and expanding construction in the formal housing market.

As in Mexico, the Bank is undertaking a set of loans to promote sustainable and equitable growth in Brazil. One of these loans, the Housing Sector Programmatic Development Policy Loan (PDPL), focuses on housing sector reform in the broad agenda of economic growth and poverty alleviation. Furthermore, a technical assistance loan will support implementation, monitoring, and evaluation of the government reform program supported by the PDPL. Specifically, the proposed operation supports the government in its efforts to: (a) develop a sound national policy and institutional framework for housing and urban development; (b) strengthen the housing credit and savings systems and provide incentives for the housing finance market to expand as well as move downmarket; (c) design and implement a unified federal housing subsidy system to address the affordability of housing solutions to the poor; and (d) reduce the cost of formal urban land development by strengthening land legislation and regulations and real property registries.

Source: Authors.

Another remarkable change in the policy environment in recent years is the speed that market-based housing finance has spread throughout the world. Since about 2000, the world has 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. This represents an enormous change because only a few years ago, most citizens of Ireland, Portugal, and Spain, not to mention China, India, Mexico, and Poland, 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 housing, often far less. While market-based housing finance is now available to most middle-income people in the world, it is not available to the poorest people in most countries. These underserved groups, particularly in countries where the development of formal housing finance is in nascent stages, represent an enormous potential audience for Bank assistance.

For most of the world's poor, development of housing finance offers very little direct benefit. Moreover, many countries where formal housing finance is not available also do not have housing market conditions hospitable to the development of finance. Issues such as lack of title, restrictive zoning and occupancy regulations, large-scale employment in the informal sector, and inability to enforce contracts make mortgage finance infeasible in these countries. 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 other banking services, much less mortgages. For these families, mortgage finance remains a distant reality even if market-based finance is increasingly available to other subgroups of the population.

Often, when mortgage finance does become available, land market regulations are so restrictive that additional finance simply fuels housing demand in supply-constrained markets, thereby feeding sharp price increases in housing rather than increases in housing supply. This problem has plagued many developed countries and has come to be seen as an important macroeconomic risk for both developed and developing countries. The Bank and the international donor community have a large role to play in disseminating the lessons of prudentially responsible housing finance, as well as in fostering housing microcredit institutions which would help bring banking services to the millions of underserved poor people around the world.

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 in the provision of housing services. When extensive public land ownership is combined with the sorts of constraints commonly placed on land usage, land cannot serve its important role in the provision of affordable housing. And when the input market for land is disrupted so severely, as it is in many cities in Africa and Latin America, as well as in places like Dhaka and Mumbai, 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.

Of course, identifying problems with land markets as a constraint on the provision of shelter is by no means a new perspective, nor is it a simple one. Urban land markets have been dysfunctional in many places not because some simple reforms have been overlooked, or because the need for reform is misunderstood, but usually for reasons of political economy—that is, some parties benefit greatly from the current situation and they are able to resist reforms and policy changes. Hence, because of the host of political constraints on the development of effective urban land markets, land market policy, in most cases, continues to be the most pervasive constraint on the provision of shelter for the poor. While recognizing the political economy dimension of the problem does not solve the problem, at least it makes it no longer credible to argue that the pervasive public sector controls and regulations are designed to help the 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) remains very basic. Recognizing that NGOs, like markets, can be important does not mean that they provide the missing link in effective housing policy. Such local organizations cannot hope to replace the systemic sorts of policies needed to assure 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 substitute for the professionalism needed to build and maintain power and water companies; nor should they be expected to do so. Nevertheless, an optimistic message has emerged from the difficult environments in which many NGOs operate. It is that in many places, these groups are showing how participation in housing improvement programs can improve not only their immediate housing conditions, but also contribute to the creation of, in the words of a recent study, the "capacity to aspire" (Appadurai 2004). That is, the same group efforts that lead to improvements in sanitation and living conditions can 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 also 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 a change 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 1997, the Cities Alliance. This global partnership, which is housed in the World Bank, can help focus donors' efforts in much the same way that earlier established multilaterals such as CGIAR and CGAP did for agricultural 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

It is important to show how the shelter sector is linked to economic growth as well as poverty alleviation. A major underlying theme of shelter policy should be to recognize, as did the last housing policy paper in 1993, that while shelter provision is important for improving the livelihood 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, it 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 in quality.

It is perhaps not surprising that a significant part of the growing demand for Bank assistance in the shelter sector stems from the concerns of middle-income urbanized countries seeking to revise their fiscal and financial approaches to the sector. As these countries liberalize their financial systems and deregulate their real estate markets, more flexible institutions that can read and react to market conditions will be needed. What is perhaps surprising is the similarly important role shelter assistance has played in lower-income countries such as China, Ghana, and India. Clearly, a broad sectoral perspective should govern the Bank's engagement in the sector. In appropriate macroeconomic circumstances, this breadth of vision should not impede opportunistic engagement with borrowing countries that are seeking assistance.

Response 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.

Efforts to 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 on the poor. As noted earlier, large fiscally-oriented loans have been approved or are in process in Brazil, the Islamic Republic of Iran, Mexico, Morocco, and Russia. But even more important than the realization that there can be significant payoffs to improving the structure of subsidies is the realization that this sort of reform is almost never a straightforward, simple process. Indeed, given the institutional complexity and variety in the types of housing subsidies provided within a single country, it is often one of the most misunderstood of fiscal transfers. Like the reform of many long-term public financing plans in developed countries, for example, social security reform in the United States is not the sort of reform that can be done without first establishing a credible reform process, one which clearly defines the scale of the implicit and explicit resources involved and the political economy and historical concerns that constrain reform.

New approaches to lending will often be required, approaches that recognize that all problems will not be addressed by a single project, but rather by longer-term engagements. Long-term programs are in initial stages, as are studies on how to improve housing subsidy and measurement. They should be closely monitored and further developed jointly by the countries involved, the Bank, and other donor counterparts. In many cases, the links between subsidies and finance will be quite strong in emphasizing once more the potential importance of cross-Bank coordination of efforts.

The reach of housing finance should be cautiously expanded. 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. As described in box 7.2, care must be taken so that this lending expands soundly. In addition, as housing prices increase globally, it is important to lay the groundwork for the development of effective finance.

Box 7.2 Housing and Macroeconomic Risks

The Economist (2005) reports that never before have real house prices increased so fast, for so long, in so many countries. It also suggests that one of the key determinants of this trend is that historically low interest rates have encouraged more borrowing. At the same time, the IMF (2003) reports that all major banking crises since World War II have coincided with housing price busts. In addition, the contingent liability realized by the U.S. government following the U.S. savings and loan crisis was more than $150 billion, the largest ever such crisis experienced in the United States. Finally, the U.K. government has described housing market concerns as one of the key risks that must be addressed for integration into the EU. Against such a background, it is quite clear there must be a public role in monitoring and assuring soundness and effectiveness of housing and housing finance systems.

Source: Authors.

Many countries are in need of additional housing and land market reforms in order to enable their real estate markets to effectively make use of expanded financial services. This process may be slow, but in the meantime, efforts should focus on how activities similar to the Grameen Bank's successful microfinance housing lending could be expanded to improve access to housing finance by the poor. In addition, the Bank has had great success with housing finance assistance in a number of low-income countries, including Ghana and India. Perhaps these successes could be implemented in other low-income countries, perhaps in concert with the efforts of IFC.

Improving 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? One of the main criticisms of the early loans is that they supported enclaves that they could not be scaled up. The chief alternative was to give greater emphasis to the policy issues that constrained the sector. These policy-oriented loans are now a dominant form of lending in the sector, whereas in the early days of Bank support almost all lending went to support slum upgrading or sites and services. Certainly, the policy-based loans are appropriate. However, there is no reason that they 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. In terms of satisfactory outcomes, these loans outperformed other loans to the same countries, and it is a rare case, perhaps in Jordan and Tunisia, where one can conclude slums have been decisively addressed. Therefore, to be consistent with its support for the MDGs, the Bank should make an effort to reinvigorate this activity. While a number of steps would help improve Bank efforts, it is important to recognize that:

- We cannot begin to understand all the issues involved. For example, we do not know how political economy constraints on land markets or ineffective utility companies affect the ability to scale up the efforts of even the best NGOs; and
- Ultimately, we do not know the efficacy of direct assistance versus broader-based policy initiatives.

Nevertheless, on the other hand, we do know that:

- Successful innovations are occurring with considerable frequency in slums throughout the world;
- The situation of the urban poor in many cities is deteriorating; and
- Bank assistance has markedly shifted away from providing shelter support to slum dwellers, particularly in low-income countries.

In sum, despite a strong performance over the years, the Bank does not appear to be well-positioned to provide shelter assistance to the poor, particularly in Sub-Saharan Africa, and this must change.

Become more responsive to borrowers and to other donors. Certainly one of the constraints to providing assistance to slum dwellers is the long gestation period involved with preparing a project. Counterparts for such loans are often mayors or ministers of local government, as well as local NGOs or community-based organizations (CBOs). The existing funding for such support, as was the case in the early Bank shelter projects, is often provided in unsustainable ways that are not consistent with the sorts of approaches that have been supported by the Bank. The result is that it often takes more than a year for a country's finance ministry to determine if there is any interest in Bank assistance. Then, if interest is expressed, it often takes another year or more to prepare a project for appraisal. Not surprisingly, given this long time period, many potential projects are never realized. Ways which could shorten 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 their functioning. 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 which often compounds the problem. And 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. For example, while the implementation issues are complex, the basic point made by observers such as Hernando de Soto is almost certainly correct: improving land use and the clarity of property rights, formally or informally, can confer enormous benefits on many poor families. Accordingly, such efforts should be an increasingly important feature of urban shelter policy.