DIRECTIONS IN DEVELOPMENT
Infrastructure

Thirty Years of World Bank Shelter Lending

What Have We Learned?

Editors
Robert M. Buckley and Jerry Kalarickal

THE WORLD BANK

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1 2 3 4 09 08 07 06

Cover photo: Billy Cobbett, Cities Alliance.

ISBN-10: 0-8213-6577-0
ISBN-13: 978-0-8213-6577-9
eISBN: 0-8213-6578-9
DOI: 10.1596/ 978-0-8213-6577-9

Library of Congress Cataloging-in-Publication Data

Thirty years of World Bank shelter lending : what have we learned? / edited by Robert M. Buckley, Jerry Kalarickal

p. cm. — (Directions in Development)
Includes bibliographical references and index.
ISBN-13: 978-0-8213-6577-9
ISBN-10: 0-8213-6577-0

1. Housing—Developing countries—Finance. 2. Economic assistance—Developing countries. 3. World Bank—Developing countries. I. Buckley, Robert M. II. Kalarickal, Jerry. III. Directions in development (Washington, D.C.)

HD7391.T45 2006
363.582—dc22

2006041752

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Foreword

Over the past 34 years, World Bank lending to support improvement in shelter conditions totaled more than $16 billion for 278 projects located in more than 90 countries. According to independent evaluations, these projects have performed well, with more than 83 percent achieving satisfactory outcomes. This study reviews the lessons learned from this vast experience against a backdrop of changing perspectives on shelter policy and development lending. It is the third such review of the World Bank's support for shelter lending, coming 13 years after the last review, *Housing Policy: Enabling Markets to Work*, and 26 years after the first review, *Shelter*. Like those earlier studies, this review focuses on how the Bank can improve its delivery of such assistance in order to improve housing conditions in developing countries. Also similar to those earlier studies, this review reflects more general thinking about how the Bank can most effectively contribute to the overall development agenda.

The Bank began to provide assistance for the shelter needs of the poor in the 1970s, as the overall emphasis of the Bank moved beyond financing basic infrastructure and toward directly targeting assistance to the poor. The first shelter lending review in 1980 presented the case that the public sector alone could not expect to fully address a nation's housing needs. The review detailed the Bank's support for increasing the involvement of local communities and—somewhat more controversial at the time—its opposition to policies aimed at the destruction of the slums where the poor lived. Not surprisingly, therefore, most Bank shelter lending undertaken at that time was to support sites-and-services schemes and slum upgrading.

The second review focused on the constraints on housing markets, which often prevented Bank-supported projects from moving beyond being enclaves that were not broadly replicated even when they were successful. The study came on the heels of the fall of the former Soviet Union, at a time when President Gorbachev's advisers were warning that the housing sector was the most inefficient of all sectors in the old centrally-planned, command regime. The conclusion was that housing and land markets were too long-lived, spatially-fixed, and heterogeneous to work well without relying on private participants to express how they wanted to fulfill their shelter and related commuting needs, particularly in the world's megacities. The early 1990s was also a time when the Washington Consensus governed international policy advice and private sector international capital flows were emerging as powerful channels of influence. The second housing review presented a specific list of dos and don'ts for housing policy and called for a withdrawal of the state from many aspects of housing policy.

This review comes at a time of considerably less certitude about broad policy prescriptions. For example, as was said in a review of a recent Bank study, *Economic Growth in the 1990s: Learning from a Decade of Reform,* "...no one really believes in the Washington Consensus anymore. The question is...what will replace it" (Rodrik forthcoming). What seems to be replacing it is a movement away from mechanical prescriptions of what to do and what not to do, with a focus on the binding constraints on development. This shift in thinking certainly colors the perspective in this review.

More specifically, this review details the progress made on developing housing finance, improvements in the way housing subsidies are targeted, and the increase in support for efforts to improve the overall housing policy environment. It also details the increased private sector involvement in current Bank support to the sector and raises the question of whether the increase in policy-based lending was related to the reduction in lending for basic slum improvement programs. Finally, it emphasizes that, in many ways and in many places, malfunctioning urban land markets are undoubtedly an important part of the binding constraints on achieving not only improved shelter conditions, but also equitable economic growth.

Certainly, there are no clear and simple answers to improving the shelter conditions of the millions of people who live in slums and too often in ramshackle and unhealthy accommodations. Nevertheless, in the next few years, as the world reaches the point where for the first time the majority of its population lives in cities—mainly cities in developing countries—it is essential that progress on fulfilling the shelter needs of the poor be enhanced and that lessons learned be more broadly disseminated.

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Acknowledgments

This book was prepared by a team directed by Robert Buckley. Jerry Kalarickal is the principal author of chapter 2 and contributed to all other chapters and to the overall structure of the report, as did Robert Buckley, Ashna S. Mathema, and Kate Owens. Robin Rajack, Robert Buckley, David Le Blanc, and Roberto Chavez are the principal authors of chapters 3–6, respectively. In the Bank, helpful comments were received from Inger Andersen, Patricia Clark Annez, Jan Brzeski, Tom Buckley, David De Groot, Sateh Chafic El-Arnaout, Jaime Biderman, Tim Campbell, Loic Chiquier, Songsu Choi, Dean Cira, William Cobbett, Peter Ellis, Catherine Farvacque-Vitkovic, Mila Freire, Roy Gilbert, Sonia Hammam, Larry Hannah, Ellen Hamilton, Abhas Jha, Christine Kessides, Xavier Le Grande, Barjor Mehta, Deepali Tewari, Margret Thalwitz, Laura Vecvegare, and Yan Zhang. Solly Angel, Alain Bertaud, and Steve Malpezzi also provided helpful comments and discussions of various aspects of this work, and Bertrand Renaud prompted many of the ideas. The document was prepared with considerable patience by Oumi Himid and Francis Muraya under the overall supervision of Eleoterio Codato, Maryvonne Plessis-Fraissard, and Christine Kessides. Dana Vorisek oversaw the editing and production of the book with great skill.

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.

Abbreviations and Acronyms

CBO	Community-based organization
CGIAR	Consultative Group on International Agricultural Research
CGAP	Consultative Group to Assist the Poor
EU	European Union
GIS	Geographic information systems
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
KIP	Kampung Improvement Program (Indonesia)
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
NGO	Nongovernmental organization
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OED	Operations Evaluation Department (World Bank)
PDPL	Housing Sector Programmatic Development Policy Loan (Brazil)
SINAMOS	Sistema Nacional de Movilización Social (National System of Mobilization; Peru)
UNICEF	United Nations Children's Fund
WSS	Water supply and sanitation

All dollar amounts are in U.S. dollars unless otherwise indicated.

Section I
Introduction and Objectives

1
Introduction

Plan of the Book

The book is divided into three parts. In the first part, a brief introduction provides a background on Bank project evaluations and the policy instruments used to support shelter lending. It is followed by a chapter on Bank objectives and outcomes, as described in more detail in box 1.1. It also provides context for the rest of the study by reviewing the outcomes of various types of Bank-supported shelter projects. Section II focuses on policy instruments. It is subdivided into four chapters which correspond to the various policy instruments Bank projects have employed.

Each of the chapters in Section II considers a different policy instrument—land market policy, housing finance, housing subsidies, and direct low-income housing assistance projects, respectively. Box 1.2 describes these approaches more fully. Chapter 3 focuses on what we have learned about urban land markets and identifies some of the remaining weaknesses in our understanding of how these markets work. Its main message is that political economy constraints appear to be the key explanation for why many seemingly straightforward reforms are not implemented. It suggests that without better-functioning land markets, the wealth of the poor, as well as the effectiveness of many other shelter policies, will continue to be severely circumscribed. Chapter 4 describes how financial liberalization, if developed prudently, can significantly benefit both the housing conditions of the poor and the broader financial system. Chapter 5 documents that as market-oriented perspectives on housing policy have become more widely adopted, there is still no "silver bullet" for improving the efficacy of fiscal transfers for housing. Nevertheless, progress has been made, and many national housing subsidy programs are being restructured. The final chapter in section II, chapter 6, reviews the evolution of the Bank's efforts in directly affecting low-income housing through sites and services and slum upgrading projects. It traces the fits and starts that have characterized these efforts, highlighting some of the best practices as well as some of the more problematic experiences.

In section III, the final chapter brings the discussion together in a number of recommendations.

Box 1.1 Outcomes and Objectives

The World Bank's Operations Evaluation Department (OED) uses an objectives-based evaluation approach. This approach has three major advantages:

- It enhances accountability by focusing attention on the extent to which objectives agreed to by the Bank's Board of Executive Directors have been achieved;
- It promotes efficiency by relating the use of scarce resources to the accomplishment of specific outcomes; and
- It allows comparisons by applying a common metric across the wide array of sectors and countries for which the Bank provides financing.

OED evaluates development interventions by assessing how their results stack up against their own stated objectives. At the project level, this methodology focuses on outcomes, sustainability, and institutional development impact of Bank operations. In this study, we focus exclusively on the first of these measures, outcomes, which is the most frequently used measure.

Because we rely on OED evaluation measures to measure performance, an important aspect of this measurement is with respect to the objectives of the projects. In this connection, the Bank's earliest shelter prescriptive paper gave the following as the main objectives (World Bank 1975):

- The government should have a commitment to help the urban poor;
- The government should guarantee land tenure to project beneficiaries, either in slum improvement or sites and services projects;
- The government should improve pricing policies for housing and land and should reduce subsidies so that projects can recover their costs;
- The government should agree that projects should be integrated within a broader approach to urban planning and investment.

Source: OED Web site.

Box 1.2 The Changing Instruments and Policy Environment of World Bank Shelter Assistance

Perhaps the most positive change since the last review is that we have learned much about what constitutes appropriate policy. At the time of the last 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.[1] Since then, the evidence has become considerably clearer. Transition countries in Eastern Europe and, among others, China, India, and Mexico, have moved to a market-based system for housing delivery, showing that a market-oriented approach to housing policy is far more effective at improving the housing circumstances of the poor. Buckley and Kalarickal (2005) provide a more complete discussion of both the evolving policy environment and evidence of the efficacy of greater reliance on housing markets.

Land markets. Within the broad acceptance of the importance of the private sector in shelter provision, and the need for a delimited public sector to complement and enhance that role, there is little understanding or support for treating land as an important input in the provision of housing services. When extensive public land ownership is combined with the constraints commonly placed on land usage, land cannot serve its important role in the provision of affordable housing. When the input market for land is severely disrupted, as it is in cities such as Addis Ababa, Dhaka, and Mumbai (where the cost of housing is prohibitively high), market outcomes have become politically unacceptable.[2] In these cities, slums proliferate, demolitions and encroached infrastructure become the norm, and frequent, usually non-transparent, public interventions substitute for market processes. In such cities, it is not unusual for urban housing transactions to take place in a savage market environment, with ill-defined property rights that are illegally enforced often by gangsters.[3] 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.[4]

Finance. Chapter 5 deals another important and remarkable change in the policy environment in recent years: the speed with which market-based housing finance has spread to most of the world's population.[5] 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. While market-based housing finance is now available to most middle-income people, it is not available in most countries or for most poor people. These underserved families and countries represent an enormous audience for potential Bank assistance, where development of formal housing finance is in a nascent stage.

Although there is a great deal of productive institution building that can be realized in this area, it is also important to note that for most of the world's poor, development of housing finance will offer very little direct benefit. Moreover, many of the countries where formal housing finance is not available also do not have housing markets which would be hospitable to the development of finance.

For these families, mortgage finance remains a distant reality even if market-based finance is available. Often, when mortgage finance does become available, land market regulations are so restrictive that the finance simply feeds sharp house price increases rather than resulting in more housing (Shiller 2005). This problem has plagued many developed economies, and has come to be seen as an important macroeconomic risk for both developed and developing countries.[6] The World Bank and the international donor community have a large role to play in disseminating the lessons of how to develop sustainable housing finance, as well as in fostering housing microcredit institutions which could bring banking services and forms of consumer finance to millions of underserved poor people around the world.

Subsidies. While finance is an important part of improving the housing conditions of the poor in developed countries, in developing countries, which usually have very small housing finance systems, a potentially more important instrument is the use of subsidies. In recent years, a number of the Bank's largest borrowers have engaged the Bank in discussions and projects—either currently underway or under preparation—on how to improve the targeting and effectiveness of their public shelter assistance. There is clear agreement that improving the efficacy of subsidies can improve the effectiveness of public expenditures significantly, particularly if these subsidies are combined with effective community participation.[7] There is also, however, clear recognition of just how complex and politically weighted these sorts of reforms can be.

Source: Authors.

2
The Evolving Objectives and Outcomes of World Bank Shelter Assistance

The Bank's Evolving Shelter Objectives

The Bank's involvement in shelter was based on the idea that urbanization was one of the inexorable imperatives of development, and that the process involved enormous dislocation of urban residents. The poor, as they moved to cities, were thought to be adversely affected by this process. While experience has shown that urbanization is essential to achieve the sorts of specialization that lead to higher levels of development, it is also a disruptive, dislocating process (Chenery and Syrquin 1975). Following former World Bank President Robert McNamara's 1975 speech in Nairobi on urban poverty, considerable Bank resources were allocated to helping the poor deal with the costs of these dislocations, particularly with respect to living conditions and basic services such as water, sanitation, and shelter.

The 1980 Bank paper *Shelter* describes the ways that the Bank encouraged borrowing countries to adopt more modest approaches to housing, after earlier studies identified the shortcomings of country approaches. A paper by John Turner, Robert Fichter, and a number of associates (1972) argued that the public housing programs adopted by most countries missed the target group, were generally overdesigned, were excessively expensive, and perhaps most problematically, did not encourage the poor to use their own resources to improve their shelter situation. A 1993 World Bank paper echoed many arguments made in the Turner and Fitcher paper, and added one major additional concern about housing policy:

> "The housing sector cannot attain many of the stated norms without appropriate interventions by public authorities. However, intervention can be a two-edged sword. Appropriate housing policies can help achieve the goals of a well-functioning housing market. Inappropriate interventions stifle the sector, block supply and frustrate demand, reduce quality and choice, increase costs and damage the economy as a whole" (World Bank 1993, p. 18).

In other words, the interventions of the public sector, if not well-structured, may be more than just inefficient. Indeed, such interventions may well be worse than doing nothing. In other words, badly-designed policies could have such adverse effects on the way housing markets worked they hurt the larger numbers of the poor who did not receive assistance than the limited number of those who did receive assistance. This view received some currency in other multilateral institutions, as shown by Rojas' (1995) Inter-American Development Bank (IDB) study. Given this perspective, the 1993 World Bank review spent a great deal of time explaining how the housing market works so that an objective basis might be established for reconciling the interests of the different sector participants. As a result of the extensive discussion of the way the housing market operates, this book does not review the fundamentals of housing market functioning, nor does it review the nature and magnitude of the slum problem. Issues surrounding the measuring the size of slums are profound and are only beginning to be dealt with. Instead, this book discusses the Bank's experience with low-income housing interventions. Rather than make problematic estimates of the number of people who live in slums, the likely trends in these numbers, and the extraordinary costs of addressing these issues, as has been done by a number of studies, this study will focus on the fact that in most large cities in the developing world, highly congested, low-quality housing is pervasive and long-lasting. Strong equity and efficiency arguments can be made for public interventions to improve market outcomes in what is a ubiquitous problem that at the very least is getting worse in many cities. The following section reviews the Bank's experience in slum upgrading and places these projects in historical and country context.

Urbanization—More Idiosyncratic than We Thought…

In many ways and in many places, urbanization trends have not followed the logistic, positively-sloped pattern underlying the trends depicted in figure 2.1a (page 79), which describes the urbanization process as one in which countries urbanize as their income levels increase. Often, perhaps most notably in many Sub-Saharan African countries (see figure 2.1b, page 81), the opposite has taken place. That is, as the economies contracted, sometimes deeply and for many consecutive years, the share of the urban population appears to have increased. As described by Fay and Opal (2000), urbanization without growth characterized the 1990s in many Sub-Saharan African countries, creating a new type of housing demand in a much more urbanized, if poorer, world.[1] However, as Kessides (2005) argues, even in Sub-Saharan Africa, the economic growth that took place in the 1990s was located in urban centers, and the forces driving rapid urbanization will continue.

In other places, such as the already highly urbanized European transition countries, the positive relationship between income and the share of the population living in cities was maintained. In many of these countries, however, protracted recessions in the 1990s were accompanied by reductions in urban population (in other words, de-urbanization). Certainly, the urbanization process is more complex now than it was during the Bank's early efforts to address urban and shelter problems. This change in environment resulted in changes in approach beyond the concerns described by the 1993 review, which focused on the more traditional urbanization perspective. As the next section details, the Bank's approaches to shelter assistance have also changed, sometimes rather markedly. To review the Bank's experience, it is useful to begin at the beginning.

The Bank's Experience—The Beginnings

The Bank's experience in housing for the urban poor began with sites-and-services projects in the 1970s in Africa, Latin America, and Asia. The first housing sector review spoke of "the growing recognition of urban development and particularly the need for equitable development…" and recommended that "squatter upgrading and site-and- services continue to be the prime instruments for improving the housing conditions of the poor." At the time, many slums were located in city centers and served as temporary bases for poor migrant families, where they could secure a job before moving to what were essentially illegal settlements to build more permanent shelter (Turner and Fichter 1972). The early sites-and-services projects were designed to meet the demands of those poor people who had built up some savings and sought more formal housing solutions. In some cases, projects were targeted to specific groups, such as civil servants (in Malawi, for example), or for specific purposes, such as relocating slum dwellers from hazardous sites or private property (for example, in Peru).

Sites-and-services projects blossomed in the 1970s and early 1980s; between 1972 and 1987, as detailed in the chapter 3, they accounted for 49 percent of all housing-related loans. Relatively successful large-scale sites-and-services programs include those undertaken in Peru in the late 1970s and in Burkina Faso in the early 1980s. Over time, these projects have relied, to varying degrees, on participation of the community and individual beneficiaries through labor and various cost recovery mechanisms.

Diversification of the Shelter Portfolio

Although donor agencies other than the Bank also supported sites-and-services and slum upgrading projects, in many respects the timing was bad: many of these projects were being launched as the financial crises of the early 1980s unfolded. As is discussed in subsequent chapters, the absence of policies designed to deal with informal settlements frequently blocked the way for improvement, and the Bank began to move away from sites-and-services and slum upgrading and toward dealing with the policy issues. Sites-and-services and slum upgrading projects together made up only 15 percent of shelter lending in the 1987–2005 period, losing ground to policy-based loans, which viewed the project as a way of embodying accompanying policy changes in a specific investment.[2] An example of such lending is the Mexican project of 1992, which focused on reforming local housing market regulations to make housing finance more affordable.

The Bank's shelter portfolio continued to diversify away from urban upgrading as disaster-related projects involving slum upgrading or sites and services were successfully implemented in El Salvador and Mexico City in the 1980s. The share of disaster relief projects increased from 11 percent during the first 15 years shelter lending to 25 percent during the last 18 years. Disasters in Latin America, the Caribbean, and Asia indicate continued growth in demand for assistance in dealing with disasters of all types. The tsunami of 2004 brought these demands into stark relief as shelter projects were rapidly prepared in four of the most seriously affected countries.

The Bank began a fourth type of shelter project in 1982 in Zimbabwe with a project that gave central emphasis to the method of financing the investment. This type of lending expanded rapidly during the 1980s, perhaps most notably with a $250 million loan to the HDFC Company of India, which is now one of India's leading financial institutions and which has become the center piece of a largely private housing finance system. A central accomplishment of these loans was the marked improvement in loan recovery relative to earlier projects. Not surprisingly, in retrospect, such "good" loans have become an active line of IFC business; in recent years, IFC has made more than 45 such investments.

In sum, over time the Bank's sites-and-services and upgrading projects have been gradually displaced by housing finance and policy-oriented projects, which have experienced better outcome ratings (see the next section of chapter 2 for discussion of ratings). In many ways, there are good reasons for supporting these other approaches. However, it is not clear whether resources should be shifted away from urban upgrading. For instance, while progress by developing countries was made in the 1990s, as urbanization continued, the disparities within formal urban areas and their informal settlements has often remained, and in many places expanded. Indeed, as table 2.1 shows, despite significant progress over time, the lack of infrastructure connections remains widespread in developing regions.

Outcomes of the Bank's Shelter Portfolio

Since 1972, the Bank has supported 278 projects, which provided over $16 billion in housing-related assistance to over 90 countries.[3] The shape and size of these loans has varied considerably, but urban housing has continued to be major part of urban development loans provided by the Bank.

Table 2.1 Infrastructure Connections in Slums and Surrounding Overall Urban Areas, for All Developing Regions, 1998
percent

Water	Informal settlements	37.2
	Overall urban	75.8
Sewerage	Informal settlements	19.8
	Overall urban	64.0
Electricity	Informal settlements	59.1
	Overall urban	86.5
Telephone	Informal settlements	25.4
	Overall urban	52.1

Source: UN-HABITAT (2003b).

Broad Development Trends

First, similar to other Bank lending, the context within which housing-related lending has been provided has undergone a sea change in the past 30 years (see World Bank 2004b). Perhaps the most notable changes since the 1993 review are with respect to the level of urbanization and to the spatial dimension of poverty in the Bank's client countries. Urban population has doubled since 1975, to 3 billion in 2002. It is expected that urban population will further increase to 5 billion in 2030, and that the world will become primarily urban in 2008. Furthermore and more pertinently, most of this urban growth will be in developing countries. For example, in 1975, there were only four cities with a population of over 10 million, of which two were in developing countries. In 2003, this number had risen to 20, of which 16 were in developing countries. However, even with the emergence of large urban centers in the developing world, the bulk of urbanization in many countries is happening in nonmetropolitan urban centers.

Second, the Bank's client countries have become far more heterogeneous in terms of level of unbanization: Latin America is currently over three-quarters urban, while Sub-Saharan Africa and South Asia are just over a quarter urban. This diversity also extends to huge differences in per capita income and financial sector development among the Bank's client countries. For instance, average per capita income in South Asia and Sub-Saharan Africa is less than $500, while in Latin America it is over $3,500. Similarly, private transactions financed through financial intermediaries range from less than 5 percent of GDP in Sierra Leone to almost 60 percent in Malaysia (Beck, Demirguc-Kunt, and Levine 2000).

Third, the spatial distribution of poverty has changed dramatically. Though the majority of the world's poor continue to live in rural areas, poverty is rapidly becoming an urban phenomenon. Today, unlike in 1985, most of the poor in many of the Bank's biggest borrowers—including Brazil, Mexico, and Russia—already reside in cities. The scale of urban poverty has become deeper and more widespread, and it continues to expand. By some estimates, over fifty percent of the world's poor will be living in cities by 2035; in Latin America and in the Bank's Europe and Central Asia region this is already the case.[4] In such an environment, it is not surprising that urban slums are not being absorbed into the formal housing sector. In fact, as a result of the inexorable process of urbanization in many countries, slums are often becoming permanent housing settlements. Surveys in Brazil and India, for example, indicate that in many places slum dwellers are no longer temporary participants in a demographic transition process. Many of the 100,000 pavement dwellers in Mumbai, for instance, are second generation residents (SPARC 2002; Baker et al. 2004), as is the case in Rio's favelas (Perlman 2002).

Finally, in recent years, two changes in the approach to development assistance have taken place which have implications for shelter strategy. First, greater accountability for aid has been embodied in a series of quantitative development goals, the Millennium Development Goals (MDGs), which include a target of improving the lives of 100 million slum dwellers. Second, the structure of official development assistance (ODA) has changed in both composition and level.[5] In the more globalized world economy, ODA accounts for a smaller share of international credit flows, and within that lower overall level of assistance, support for infrastructure investments declined sharply in the 1990s, as shown in table 2.2. Bank shelter assistance, however, has not followed the overall trend in ODA or in infrastructure lending, and has actually increased in scale since the last review.

Sectoral Perspective

Partly in response to the changing environment described above and partly in response to lessons from research and previous project experience, the Bank's shelter portfolio has evolved over the last thirty years. First, as noted earlier, the Bank's urban shelter lending has shifted away from sites-and-services and slum upgrading projects to broader housing policy and housing finance loans. Second, the regional focus of the loans has shifted away from Sub-Saharan Africa to the transitional economies of Europe and Central Asia and the Middle East and North Africa. The middle-income countries of Latin America continue to be prominent borrowers, and many countries in South Asia, after experiencing a hiatus in the 1990s, are undertaking Bank-funded shelter and land sector projects. Finally, the Bank's housing portfolio not only continues to grow but has experienced much-improved performance during the 1990s, making it one of the strongest-performing sectors in the World Bank.[6]

Table 2.2 Amount and Rate of Satisfactory Outcomes of World Bank Loans to Various Sectors[1]

		1972–81	1982–91	1992–2004
Infrastructure	Amount (2001 US$, millions)	68,656.13	83,985.42	59,804.80
	Satisfactory rate[2]	79	71	83
Water supply and sanitation	Amount (2001 US$, millions)	7,634.00	9,644.23	9,443.46
	Satisfactory rate[2]	66	57	71
Urban development	Amount (2001 US$, millions)	4,399.46	10,922.39	9,943.32
	Satisfactory rate[2]	78	78	88
Urban development without housing	Amount (2001 US$, millions)	2,132.37	4,973.19	5,089.47
	Satisfactory rate[2]	71	73	88
Shelter[3]	Amount (2001 US$, millions)	2,301.50	6,006.17	6,893.29
	Satisfactory rate[2]	84	82	83

Source: World Bank loan data.

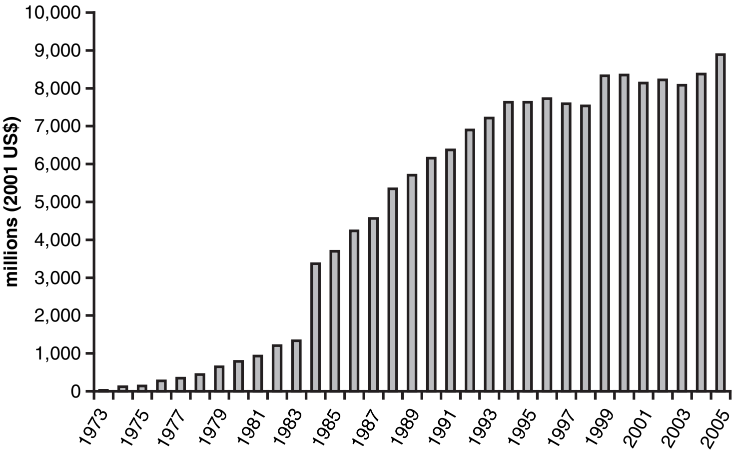
1. Figures include active and closed loans as of June 2004. The amounts are commitment amounts, not disbursed amounts. Infrastructure includes energy and mining, global information/communications technology, and transport. However, satisfactory rates apply only to closed loans.
2. Satisfactory rate is by amount (not as a percentage of number of loans), in dollar-adjusted terms, in percent.
3. IFC loans are excluded from the shelter loans.

Shelter Projects

The Big picture. The $14.3 billion disbursed in shelter lending since 1972 is spread over 278 projects with an average size of almost $50 million (in 2001 dollars).[7] Each year an average $422 million was disbursed, although there was a wide variation in the annual disbursements: from approximately $28 million in 1972 to over $1.1 billion in 1999 (see figure A.1 in the appendix). On average, the Bank sponsored almost eight projects per year, but again, there was wide annual variation; in some years, only 2 projects were started, while other years as many as 14 projects were started. In figure 2.2 we see the evolution of the portfolio of housing loans from what might be termed a banking perspective. That is, the figure shows the size of the outstanding portfolio on a year-to-year basis. It essentially subtracts loan repayments from new loans and then adds this figure to the remaining amount of loans outstanding. As the figure shows, the portfolio peaked at $8.3 billion in 2000 and again at $8.8 million in fiscal year 2005.

Figure 2.3 carries this analysis a step further by looking at the volume of shelter lending relative to Bank lending for infrastructure, water and sanitation (WSS), and nonshelter urban lending by splitting the 30 years

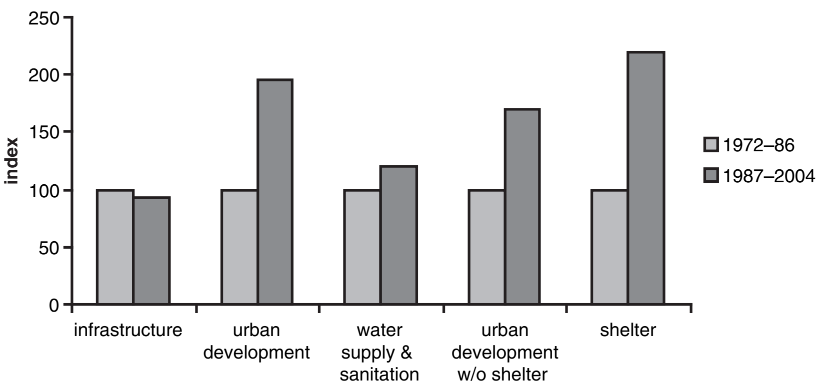
Figure 2.2 World Bank Shelter Lending Portfolio



Source: World Bank loan data.
Note: See the appendix of this book for the methodology used to calculate these figures.

of lending into two periods.[8] It shows that both shelter and other urban lending countered the broader tide of sharply contracting support for infrastructure. Rather than declining slightly as overall infrastructure lending did, or growing slightly as WSS did, both urban and shelter lending increased dramatically.

Figure 2.3 Growth in World Bank Lending for Various Infrastructure Components



Source: World Bank loan data.
Note: Figures for 1987–2004 include only closed loans. Infrastructure includes energy and mining, global information/communications technology, and transport, leaving out water supply and sanitation and urban development. The first period is normalized to a base of 100. All figures are in 2001 U.S. dollars. All amounts are based on commitments.

Table 2.2 provides an alternative perspective by breaking up this period into three periods: 1970s, 1980s, and 1992–2004 (the final period is the time since the last review).[9] This table captures the sharp decline in infrastructure spending from the 1980s to the 1990s. Here we see that urban development, water supply and sanitation, and shelter experienced declines, though the drop in shelter lending was less dramatic than the drop in other sectors. To some extent this is not a surprise because housing loans, as discussed earlier in this chapter, moved from infrastructure projects such as slum upgrading and sites and services into more policy-oriented and housing finance loans. In other words, shelter lending shifted from the "bricks and mortar" of traditional infrastructure projects to policy- and institution-building loans.

Table 2.2 also shows the trend in the performance of the loans between 1972 and 2004. The reduction in lending in the 1990s coincided with an improvement in overall loan performance, as it did for the Bank generally. The housing sector continued to be one of the strongest performers, with 83 percent of lending having a satisfactory outcome.

Trends in shelter lending. As discussed earlier, the Bank's earliest shelter projects were usually designed to help develop sites and services in low-income countries.[10] As documented in the first Bank housing policy review in 1980, in most developing countries, public housing agencies produced expensive and heavily subsidized housing that could only meet a fraction demand. Housing agencies also regularly demolished squatter settlements. The overarching idea of housing assistance at the time was that rather than attempting to replace the informal sector, or seeing the sector as a "problem," public assistance could be used so that the strengths of the informal sector could be built upon. Over time the types and locations of shelter assistance have changed, beginning with the shift to upgrading of existing slums rather than developing entirely new sites in the early 1970s. This change was recommended by the Bank's first paper on the topic, *Housing* (1975).[11]

The second change was to move from projects focused on one city to national programs, as occurred in the Tanzania project in 1978. Nationwide orientation then became a common feature of subsequent sites-and-services projects. A third type of shelter project, policy-based loans, started in 1980 and became increasingly important through the decade. This type of project viewed the project itself as a way of embodying accompanying policy changes in a specific investment and, as documented by the World Bank, policy-based lending became an increasingly popular Bank instrument (World Bank 2004b).[12] An example of such lending is the Mexican project of 1992, which focused on reforming local housing market regulations to make housing finance more affordable.

A fourth type of shelter project was begun in 1982 in Zimbabwe, when a project was designed which gave central emphasis to the method of financing the investments. The project was financed through privately-owned building societies which carefully monitored loan recovery. Private sector involvement contributed to a significant improvement in loan recovery relative to earlier projects. As noted earlier, housing finance projects have become a significant portion of both Bank and IFC shelter assistance.

Finally, in the late 1980s and early 1990s, following earthquakes in Mexico and the Islamic Republic of Iran, shelter assistance for countries hit by disasters became more than just an occasional Bank project. Besides lending assistance, the Bank is now developing a program that attempts to reduce housing vulnerabilities before disasters occur, as demonstrated by a 1999 project in Turkey.

In sum, when the last low-income shelter strategy was written in 1993, over two-thirds of the 98 Bank shelter projects and almost 50 percent of all urban projects were largely for sites-and-services projects or slum upgrading. A few years before that review, two new types of loans—for housing finance and to encourage policy change—were introduced. Finally, though the Bank has carried out occasional disaster relief projects since 1972, disaster relief became a regular component of the shelter loans in 1986, and now accounts for approximately 25 percent of annual shelter assistance.

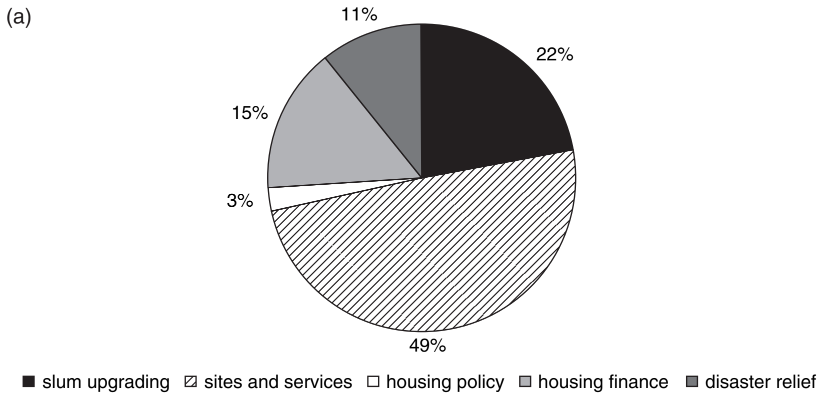
This story is portrayed in figures 2.4a and 2.4b. From 1972–86, sites-and-services projects and slum upgrading projects made up more than 70 percent of total shelter lending. However, this changed dramatically in the 1980s. From 1987–2005, such lending fell to only 15 percent of the shelter loans. On the other hand, housing policy loans increased from 3 percent to 11 percent of total shelter lending, while housing finance loans increased from 15 percent to 49 percent.

In other words, a major shift in project structure occurred over the last decade and a half. The increase in housing policy and housing finance loans signaled a dramatic shift from limited project-based loans to loans that addressed the whole sector, whether in terms of creating an "enabling" environment or in terms of creating the institutional framework for a sustainable housing finance sector (World Bank 1993).

Table 2.3 provides a decade-by-decade breakdown of the portfolio and captures the improvement in project performance in the 1990s. In the first decade, (1972–81) housing projects did reasonably well, with an average satisfactory rating of 85 percent. The second period (1982–91) showed deterioration in loan performance, with sharp decline in outcome ratings for loans involving slum upgrading and sites and services. This deterioration may in part have contributed to the shift to the more successful finance and policy loans.

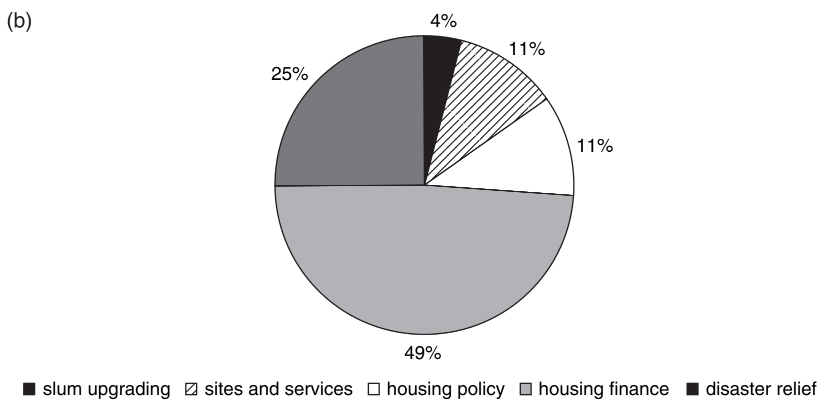
Table 2.3 also shows that over the 34 years of lending, 83 percent of the amount lent had satisfactory outcomes, a rating that is considerably higher than the Bank's overall performance over this period. The table also underlines the following trends, as identified earlier:

Figure 2.4a Composition of World Bank Shelter Lending, 1972–86



Source: World Bank loan data.
Note: Total loans for 1972–86 were $4.4 billion (2001 US$).

Figure 2.4b Composition of World Bank Shelter Lending, 1987–2005



Source: World Bank loan data.
Note: Total loans for 1987–2005 were $10.3 billion (2001 US$).

- A dramatic decrease in lending for sites-and-services and slum upgrading projects, despite improved performance since the last review;
- A greater than tenfold increase in the volume of policy-based lending occurred over the last decade, from $95 million in the 1980s to over $1 billion in the 1990s; and

- Lending for disaster relief experienced a steady rise in volume, rising from $121 million in the 1970s to over $2 billion in the 1990s.

While beyond the scope of this analysis, perhaps a word of caution should be applied to Bank ratings of disaster relief projects. For almost $3 billion in what are necessarily hastily implemented emergency projects to have experienced a 97 percent satisfactory outcome suggests that at the very least, these findings should be subjected to more detailed analysis.

Table 2.3 World Bank Shelter Loans by Type and Performance

	Project type	*Amount (2001 US$, millions)*[2]	*Satistactory rate (by amount, dollar adjusted; in percent)*	*Satisfactory rate (by number of projects; in percent)*
1972–81	Slum upgrading	827.00	88	88
	Sites and services	1,136.49	83	86
	Housing policy	30.60	100	100
	Housing finance	36.74	100	100
	Disaster relief	121.49	72	75
	Subtotal	2,152.32	85	84
1982–91	Slum upgrading	234.80	31	65
	Sites and services	1,620.56	69	64
	Housing policy	95.31	98	80
	Housing finance	2,745.24	91	76
	Disaster relief	716.01	97	93
	Subtotal	5,411.92	82	72
1992–2005	Slum upgrading	338.38	64	57
	Sites and services	505.83	86	60
	Housing policy	1,057.49	36	60
	Housing finance	2,711.93	86	86
	Disaster relief	2,173.31	97	95
	Subtotal	6,792.30	84	80[1]
1972–2005	Total	14,356.55	83	77

Source: World Bank loan data.

Note: The loan amounts include open and closed loans, as well as IFC loans. For closed loans, only actual disbursals are counted. For open loans, commitments are counted, since final disbursements are not available. The satisfactory ratings are based only on disbursed amounts for closed loans. See the appendix of this book for details on how the dataset was constructed.

1. Two more projects—not included in the above calculations—are in the process of finalizing their implementation completion reports with satisfactory ratings. Including these projects would improve the satisfactory rating for projects to 81 percent.

Table 2.4 provides a breakdown of shelter lending by region and highlights the following trends:

- Lending in Sub-Saharan Africa dropped rather sharply, from approximately \$500 million in the 1980s to approximately \$80 million in the 1990s;
- Lending volume North Africa and the Middle East climbed steadily over time, to \$100 million per year, as the number of loans to the region also increased;
- In the reforming socialist economies, an essentially new line of business arose in the 1990s, going from no lending during the 1980s to almost \$900 million in the past decade; and
- After over 30 years of lending, nearly a billion dollars (or more) of loans has been made to each region (Latin America, with over \$4 billion, has received the most of any region) and more than 90 countries have received shelter loans.

Discussion

The first question that arises from a review of these trends is what prompted this shift in design and regional focus of housing loans. Chapter 1 suggested that evolution in the design of shelter loans might be explained by the Bank's focus on major historical events, in addition to research findings and experience. To be slightly more speculative, we suggest that the 1970s focus on slum upgrading and sites-and-services projects was driven by an attempt to address the needs of the poor directly. This meant that the Bank focused on projects with limited reach but resulted in discernible improvements in the shelter conditions for those affected by these projects.

In the 1980s, many of the Bank's borrowers and much of the world's financial system became embroiled in a debt crisis. Many Latin America countries experienced runaway inflation and financial instability. It became apparent during this time that the Bank needed to address broader sectoral concerns if it was to address poverty on a sufficiently large scale. The Bank's interest in housing finance grew because it had become increasingly apparent that it was not just the asset being financed that was important, but also how effectively funds were being mobilized to support the demand for these assets. In a sense, the shift recognized that in virtually all developing countries, not only were the assets of affordable dimensions inadequate—that is, there was not enough low-cost housing—but also that there was no system of finance to support the funding of these investments.

Finally, in the 1990s, with the fall of the Soviet Union and the adoption of market-oriented economic policy in China and India, the central planning approach to policy was largely discarded. Most countries began to rely on a public policy approach that augmented and complemented market processes rather than substituting for them. This was accompanied by a growing

Table 2.4 Regional Breakdown of World Bank Shelter Loans by Type and Decade

Approval decade	*Region (2001 US$, millions)*	*Slum upgrading (2001 US$, millions)*	*Sites and services (2001 US$, millions)*	*Housing policy (2001 US$, millions)*	*Housing finance (2001 US$, millions)*	*Disaster relief (2001, US$, millions)*	*Total (2001 US$, millions*	*Lending to region as % of total lending*
1972–81	Sub-Saharan Africa	172.77	305.26	11.03	9.76	0.00	498.82	23.18
	East Asia and Pacific	412.11	277.80	10.79	10.00	0.00	710.70	33.02
	Europe and Central Asia	0.00	0.00	2.93	0.00	0.00	2.93	0.14
	Latin America and the Caribbean	107.22	431.95	0.00	0.88	121.49	661.53	30.74
	Middle East and North Africa	31.23	41.14	0.00	3.74	0.00	76.11	3.54
	South Asia	103.68	80.34	5.85	12.35	0.00	202.22	9.40
1972–81 subtotal		827.00	1,136.49	30.60	36.74	121.49	2,152.32	
1982–91	Sub-Saharan Africa	55.42	231.85	12.55	82.12	27.50	409.44	7.57
	East Asia and Pacific	2.84	434.43	2.22	800.73	35.90	1,276.14	23.58
	Europe and Central Asia	0.00	0.00	0.00	0.00	0.00	0.00	0.00

	Latin America and the Caribbean	101.81	645.27	1.63	1,076.04	450.18	2,274.92	42.04
	Middle East and North Africa	35.10	90.11	23.09	322.68	182.49	653.47	12.07
	South Asia	39.63	218.90	55.81	463.67	19.94	797.95	14.74
1982–91 subtotal		234.80	1620.56	95.31	2,745.24	716.01	5,411.92	
1992–2005	Sub-Saharan Africa	42.42	16.32	2.57	17.04	2.92	81.26	1.20
	East Asia and Pacific	40.78	35.80	36.12	439.05	33.92	585.66	8.62
	Europe and Central Asia	10.61	16.46	311.34	235.20	305.37	878.98	12.94
	Latin America and the Caribbean	128.97	0.00	656.73	1,584.89	397.34	2,773.29	40.83
	Middle East and North Africa	94.42	358.26	48.37	290.43	549.82	1,341.31	19.75
	South Asia	21.18	79.00	2.37	145.32	883.95	1,131.81	16.66
1992–2005 subtotal		338.38	505.83	1,057.49	2,711.93	2,173.31	6,792.30	
Total		1,400.19	3,262.88	1,183.40	5,493.90	3,010.82	14,356.55	

Source: World Bank loan data.

Note: Loan amounts include open and closed loans, as well as IFC loans. For closed loans, only actual disbursals are counted. For open loans, commitments are counted, since final disbursements are not available. See the appendix of this book for details about how the dataset was constructed.

consensus in empirical research on the importance of correcting policy distortions. For example, OED's 2004 *Annual Review of Development Effectiveness* indicates that countries that improved their policy environment grew twice as rapidly as those that did not. The importance of this kind of view to shelter lending was synthesized in the 1993 Housing Policy Paper, "Enabling Markets to Work" (World Bank 1993), which showed that land use regulations, such as rights of way, set backs, and the amount of land provided for community facilities, could cumulatively increase costs markedly, making housing affordable only for high-income groups. Ultimately, the 1992 study suggested that projects that did not consider the broader policy dimensions could become enclaves that were not replicable.

For the Bank, these emerging lessons resulted in a new emphasis on policy and institutions as fundamental aspects of project support. While these emphases had always been an important aspect of Bank shelter projects (see box 1.1 in the previous chapter), they received more attention in the 1990s. Unfortunately, however, as projects moved away from pure infrastructure, the emphasis on slum improvement and sites and services declined. The volume of such lending fell to less than half the level of the previous two decades.

Some of the regional trends in housing loans that we have identified can also be at least partially explained by considering the interaction of history and the peculiarities of client countries. For example, the continuing importance of Latin America in the shelter portfolio should not be surprising given that it is the most urbanized region among the Bank's borrowers. The increasing importance of the Middle East and North Africa in shelter lending may well owe to the fact that this region, along with Sub-Saharan Africa, experienced the most rapid urbanization in the world during the 1970s and 1980s. But this explanation, in turn, raises the question of why one region increased and the other declined. Finally, after the collapse of the Soviet Union, Eastern Europe and Central Asia became prominent Bank client as countries in the region transitioned to market-oriented economies. In many ways, then, the regional trends we have observed are mostly what should have been expected given the peculiarities of urbanization in these regions.

The only exception is the sharp fall in shelter lending to Sub-Saharan Africa, which is particularly troubling since Sub-Saharan Africa is the most rapidly urbanizing region in the world and has been for the past 30 years. At this point, we can only speculate about the fall in shelter lending in Sub-Saharan Africa. First, and most obviously, the decline is what the borrowers wanted. In recent years, decentralization has became increasingly important in the region, and rather than continuing with shelter assistance, shelter support was in effect replaced by greater emphasis on municipal assistance.[13] Second, there was a secular decrease in all urban development loans to Sub-Saharan Africa even though urban development loans in the 1980s performed quite well, and in fact better than many other infrastructure sectors.

Box 2.1 Development Effectiveness and Urban Lending in Sub-Saharan Africa: A Thought Experiment

Suppose that in 1986, the Bank and Sub-Saharan Africa policy makers used outcome ratings over the previous 15 years as general predictor of the likely development effectiveness of Bank-supported assistance. These policy makers would have been confronted with satisfactory outcome ratings of 87 percent for shelter, 84.3 percent for urban, and 60 percent for all lending in the 1972–86 period. Shelter made up 2 percent of all lending in this period. From 1987–2004, shelter lending fell to 0.5 percent of all lending. If the policy makers had used ratings information to guide them and shifted 1.5 percent of the resources provided to nonurban lending to shelter loans (to maintain a 2 percent shelter lending portfolio), based on past performances they would have expected overall outcomes to have improved from 60 percent to 65 percent. However, they obviously, and no doubt correctly, did not use this sort of allocation, and overall outcomes were 0.5 percent less satisfactory at 64.5 percent. If they had shifted 9.5 percent of the resources provided to nonurban lending to shelter loans (for a 10 percent shelter lending portfolio), based on past performances they would have expected overall outcomes to have improved to increase from 60 percent to 67 percent.

Source: Authors.

To some extent, then, the trends we have observed are consistent with what appears to be a well-thought-out Bank approach. In other areas, however, they appear to be the result of either increasing demands on the nonshelter dimension of urban lending or a more general sense that development effectiveness required a shift in loan composition.[14] But has the pendulum swung too far? Is there a need to refocus on slum upgrading and sites-and-services projects now that new and better tools of community participation and microfinance, which have developed apace in recent years, can provide the opportunity to improve the outcomes of such project-based loans? This is a question to which we will return in chapters 3–5. Before turning to the various instruments through which the Bank can affect shelter policy, first consider the following lessons learned.

What Worked…

At the broadest level, shelter lending worked: it evolved with changing circumstances, engaged the private sector, was resiliently demanded, and perhaps most basically, performed at a very high level. Indeed, except perhaps in Russia, shelter lending outperformed other Bank loans, even in countries in which performance was relatively weak.

…And What Did Not Work

At the broadest statistical level, the reduction in lending for urban upgrading, particularly in Sub-Saharan Africa, seems to be the result of strategic choice. However, the reduction does not appear to be warranted from a development effectiveness standpoint, particularly when the MDGs are placing renewed interest in slum alleviation. At the same time, it should be pointed out that the measures developed thus far to track performance of this MDG are themselves deeply flawed.

Section II
Policy Instruments

3
Land Market Issues: The Mystery of Capitalism Revisited

Policy Instruments

Chapters 3–5 each consider one of the policy instruments used to affect shelter provision—land policy, finance, and subsidies. In each case we review the changing policy environment, the Bank's experience, and then try to distill lessons about what has worked and not worked. However, before turning to land market policies, we present yet another instrument through which the Bank can and has provided assistance—that is, through technology (box 3.1).

Box 3.1 Satellite Images, Maps, and GIS

Remote sensing or satellite images, maps derived from these, and GIS (geographic information systems) have been used in a number of Bank operations. Satellite images were used in Angola to produce the first updated maps available to local authorities in Lobito Benguela since 1975. The level of resolution was very low at the time, but combining the images with "windshield surveys" allowed the team to estimate, with reasonable accuracy, the number of people without access to water and the distances required for rehabilitation and development of water systems to the low-income periphery of the port city of Lobito. A how-to manual on simple computer imaging and mapping was issued based on this experience (Pazner, Thies, and Chavez 1993). At present, the Kabul Development Plan is using Ikonos satellite imagery at 1 meter resolution for 2002 and 2004 to facilitate spatial data gathering and processing.[1] Maps created by combining satellite imagery with topographical data will divide the city into homogenous neighborhoods, or planning zones, following the administrative boundaries of districts and gozars, and provide the background for thematic maps. These include existing land use (dwelling typology and socioeconomic data); population density and population movement; land value and available government-owned land; existing and planned infrastructure coverage, including community and social facilities, particularly schools and health clinics; and, based on all of the above, a basic priority needs assessment. The project will strengthen the city government's planning capacity and help it to formulate a spatial strategy concerning the densification of existing neighborhoods and the expansion of the city in new areas. The strategy will be made concrete in land use and housing regulations, a zoning map, land use and land subdivision regulations, and investment plans.

Source: Authors.

Urban Land Policy: Is Titling the Answer?

The 1993 World Bank shelter paper *Housing: Enabling Markets to Work* stressed the importance of appropriate land market regulation and large-scale urban property rights development, including land tenure regularization in informal settlements. The approach was in some ways similar to that of the earlier Bank study *Shelter*, although the earlier paper seemed to be of two minds on the topic. On one hand, it suggested that land costs were likely to be a very small part of shelter costs. However, it simultaneously argued that the development of security of tenure is a prerequisite for land to be delivered at the scale needed. Thus, while the early Bank view was that institutional issues relating to land supply in urban areas was important, it also held that these costs were not likely to be substantial.

In the years since *Housing: Enabling Markets to Work*, international interest in urban land management has increased substantially. For example, building on a 1992 policy paper on land market issues, the Urban Management Program produced several other publications in the mid-1990s.[2] These papers were followed by the launch of the Global Campaign for Secure Tenure by UN-HABITAT, and the establishment of the Millennium Development Goals in 2000, which pinpointed tenure security improvements for slum dwellers as a target. Also in 2000, Hernando de Soto published the controversial bestseller *The Mystery of Capital*, which placed urban property rights issues back into the development community spotlight and led to renewed interest in land titling programs. This was followed by a World Bank Policy Research Report on land policies in 2003 (Deininger 2003).[3] Finally, in the last two years, *The Economist* has published a regular international housing price index, and the European Central Bank and the Bank for International Settlements have undertaken studies of land prices out of concern for the effects the EU may have on housing and land costs.[4]

This growing body of research and policy interest has provided an unambiguous answer to the question of whether land prices play an important role in the cost of housing. In particular, a significant body of empirical work on both developed and developing countries indicates that land market policies not only drive much of the increases observed in housing prices, but they also account for a large fraction of total housing costs (Buckley and Kalarickal 2005). What is still disputed, however, is whether titles matter as much as claimed by de Soto.[5]

To answer this question, it is useful to begin with recent analyses of de Soto's arguments. He contends that secure property rights to land explain why capitalism has been such a productive economic system in the West. And more importantly, he emphasizes the corollary of this argument, i.e., that the absence of titles explains the failure of capitalism to take hold in much of the developing world. De Soto makes an interesting, even compelling, case that property rights as embodied in titles are an essential mechanism for converting assets to usable wealth. Titles, de Soto argues, "capture and organize all the relevant information required to conceptualize the potential value of an asset and so allows us to control it" (de Soto 2000, p. 47). He estimates that if developing countries could provide secure property rights to residential property, they would be able to effectively "unlock" $9.3 trillion of what he calls "dead capital."

While there are good reasons to agree that improving property rights should be an essential part of reform, there are also a range of practical problems that potentially reduce the seemingly large gains. Among these problems are:

- Titling is often a costly process. It is not just a matter of formalizing informal arrangements that already exist. Very often, contradictory claims of ownership succeed the announcements of titling programs. As Woodruff (2001) shows, the costs of adjudicating these claims may abrogate the gains from titling.
- Much of the land on which informal houses are built is obtained through illegal squatting on private property, and compensation is not paid to existing owners. Therefore, any titling program will have to consider providing amnesty for those who benefited from invasions. Whether such a process will result in greater respect for property rights is open to question.
- As Lee-Smith's (1997) analysis of property contracts in Kenya shows, this sort of contract's value depends in large part on existing and often unwritten contracts, such as the degree of access women have to property. The broader web of societal contracts and constraints, as well as a wide variety of political economy issues, may well reduce the value given to property titles in isolation.
- A title is less valuable if it cannot be used as collateral. Such a result occurs whenever there is no effective formal financial system, as is the case in many developing countries. Moreover, even if a formal financial sector is functioning, very often many of those who live in informal housing

are self-employed or work in the informal sector, so that it is difficult for them to show proof of income—a necessary condition to obtain credit from formal financial institutions. The result is that in most developing countries, the collateral value of property title remains low.

- The articles in Payne (2002) argue persuasively that in most developing countries, what may be termed the anthropological perspective on tenure —that is, a continuum of tenure categories with different levels of security of tenure—applies. Across this spectrum, some may value titles much more strongly than others. Once again, no simple policy reform will change this situation.

These implementation problems with unlocking the wealth locked in urban land holdings do not mean that de Soto's basic point is in question, nor do they mean that housing policy should not include reforms to improve tenure and the legal framework for individual ownership. Undoubtedly, in many cases, formal titles are a necessary condition to developing a fully functional housing market, particularly a housing finance system, but they are not a sufficient condition to unlock the trillions of dollars that are said to be locked up in dead assets. Moreover, simpler approaches to alleviating

Box 3.2 Street Addressing in Maputo, Mozambique

"Adressage," or street addressing, was introduced in Mozambique by the French Cooperation, in connection with the first World Bank urban rehabilitation project. In three years it covered most of the metropolitan area and was not only a self-sustaining operation but a profit center for the participating municipalities. The benefits it brought to municipal management and to the utilities worked as advertised. One unforeseen use of the system, which provided names or numbers to streets and numbered all properties, came during a cholera epidemic. When patients arrived in hospitals and clinics throughout the city, the government assumed there were multiple outbreaks. Someone proposed asking the patients their address, rather than assuming that they lived near the facility they were in. Indeed, people had not gone to the nearest facility, but rather where they knew somebody who could help them, even if it was across town. When the addresses were compiled, it became clear there was a single source of contamination, a slum near the city center. The area was drained and the threat of the disease controlled thanks in part to the addressing system. Street addressing has taken root in over twenty countries in Africa and in Cambodia, mostly in francophone areas.[7]

Source: Farvacque-Vitkovic et al. (2005).

tenure insecurity are often available and, depending on the existing constraints, there are a variety of tenure instruments that can be employed to convey property rights or freedoms.[6] In addition, because many of these instruments do not require prior physical planning, infrastructure servicing, and surveying of the settlements, they are often an advantageous strategy from the perspective of widespread coverage at reduced costs. Box 3.2 discusses one of the simplest ways some of these gains can be realized.

In short, while capitalism may well be mysterious, it is so in subtle ways. The poor are not impoverished because a simple housing market improvement has been ignored or simply misunderstood. If it is not just titles that constrain housing and land markets in developing countries, what is it? The accumulating evidence is that the constraints placed, sometimes inadvertently, on urban land markets by policy makers have deleterious spillover effects on the workings of the urban economy. In other words, de Soto's major point—that urban land markets are an enormous constraint on development—is right, even if the situation is much more complex than he suggests.

In what follows, we present snapshots of how these constraints on urban land markets prevent them from working in a number of cities. The objectives are first, to provide a sense of the cascading effect that land market policies can have on cities, the poor, and the effectiveness of shelter assistance in such places; and second, to suggest just how complex and idiosyncratic these interventions can be. In effect, like de Soto, we examine the constraints on buying, selling, and improving urban property that derive from urban land policy distortions.

Unresponsive Public Holders of Urban Land Often Make It Impossible to Buy Property

Public sector land use in many cities of the developing world is often not responsive to demand. Under various ministries—defense, railroads, agriculture, urban development, industry, housing, etc.—the public sector often holds a significant share of a city's accessible land in ways that are indifferent and unresponsive to demand. The result is that the limited amount of available land is much more expensive.

Results observed in Dhaka, Bangladesh are perhaps extreme in this regard, but not unusual. As the World Bank (2004c) shows, policies in Dhaka have resulted in land prices similar to those observed in New York City. Certainly, the city's rapid population growth feeds these prices. But more than just demographic pressure is involved. Almost certainly, the land holding patterns of many public bodies dictate these prices. For example, as shown in maps 3.1 (page 83) and 3.2 (page 85), large amounts of public land in the central Dhaka remain undeveloped. Government-owned lands as well as other locations are occupied by government-related activities with no or very little available for construction (this is the case of the Tejgaon airport, the military cantonment, and land tracks left for future construction of public buildings). Such activities may characterize as much as 20 percent of the land in the inner city area. Other centrally-located areas, such as the areas containing public housing, are developed at very low densities in relation to land prices. Rarely do building densities correspond to underlying land costs. This is the case of the university area, located in the heart of the city, and other residential areas for civil servants and government workers. In more price-responsive economies, these properties would be redeveloped and put to different uses, so that the same land supply could be used to provide much more housing.

A consequence of this scarcity of formal serviced land has been the development of the city almost entirely by the informal sector. As shown by the maps, most of the new urbanization since the mid-1980s has occurred without any heed to planning regulations and without any planning enforcement. The yellow areas in the maps correspond to land that has been developed in this way—that is, illegally. The dominance of informal delivery systems over the formal system indicates that formal market solutions are available to few residents of the city. The majority of residents must rely, in one way or another, on those who have gained control over the land. Formal finance and direct connection to utility providers are not available; instead, they done informally in the breach.

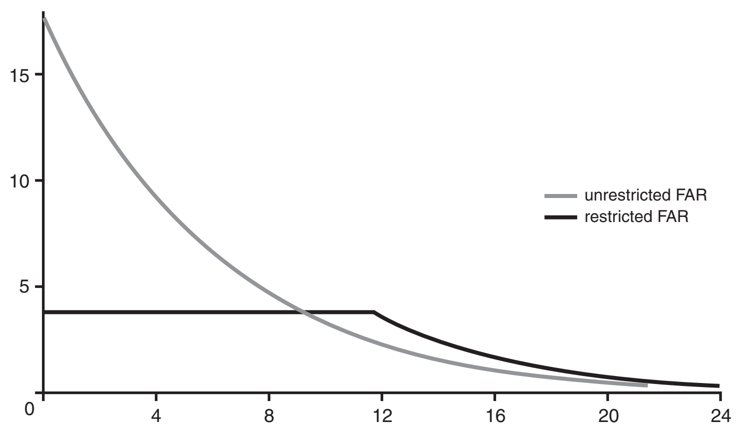
In short, because of these policies, few people are able to formally buy or even legally rent shelter in Bangladesh's largest cities. Informal trades take place but the sorts of trades that would put the land to alternative uses cannot readily be undertaken. To see why, it is useful to trace through one more example of how nonmarket solutions work in another city. We use is Mumbai as an example to explain why inappropriate regulation restricts not only the purchase but also the redevelopment of land.

Inappropriate Regulations Often Restrict the Ability to Sell Urban Property

Since the early 1990s, Mumbai, India's largest city, has lost more than 300,000 manufacturing jobs. The textile mills that were the source of the city's wealth in the late 19th century and beginning of the 20th century have been closed, and the petrochemical industry migrated to the neighboring state of Gujarat, and the port declined in importance and shipping volume. These sorts of shocks are always difficult for a city and its poorer citizens to bear, but in Mumbai the decidedly nonmarket land regulations had particularly deleterious effects on the low-wage workers who lost their jobs. In effect, urban land use regulations designed to help these families made them, as we will explain, house rich and cash poor. Ultimately, the

Box 3.3 Freezing Mumbai's Housing Stock

Tracing the way in which Mumbai's urban land use controls affect poor households requires some elaboration of the broader set of housing and land market regulations. The first regulation to consider is the city's restriction on building heights. Mumbai, like many Indian cities, imposes severe restrictions on how tall buildings can be, limiting them to less than one-tenth of the height that is permissible in many other Asian cities. The figure below shows that the inability to build upwards means that the city expands horizontally (the darker line in the figure). It also means, as shown by Bertaud and Brueckner (2005), that housing costs in the constrained area increase sometimes markedly.



Source: Bertaud and Brueckner (2005).

Note: FAR means floor area ratio, a measure of the amount of floor are that can be developed in a given land area.

Bertaud and Brueckner estimate that the restrictions in Bangalore increase costs by 3 to 6 percent of the median family's income. Bertaud, Buckley, and Owens (2003) apply this same framework to Mumbai's much more topographically constricted land mass and its more restrictive limitations on building heights and find that the restrictions bid up housing costs for lower income families by as much as 15 to 20 percent of income. However, as long as the people living in the city—even if they are renters—do not have to pay these prices, the policy has no direct effect on them. This is exactly what policy makers aimed to achieve to protect the tenants from high costs. They imposed binding rent controls on the city, so that the higher costs would not be borne by the tenants. The law thus transferred the rights of the property to the tenants.

However, the law also made it illegal for tenants to sell these rights. Over the more than 50 years that rent control applied, tenants often did sell these rights, but they did so illegally. This form of sale meant that developers who, in a market free from severe limitations on building height, could not redevelop the properties. It also meant that while the low-wage workers were able to use their properties, even if the rent-constrained landlord would not maintain them, they could not exchange them for anything near the true use value for the underlying land. Other similarly situated families could purchase or rent the low-level housing on these properties, but because the sales were illegal and height restrictions were in place, it was impossible to economize on the high cost of land by building taller buildings. Many of these impoverished workers then kept their properties and became part of the city's growing army of informal workers—in short, they became house rich but income poor.

Source: Authors.

policies drove workers into informal sector jobs and the city's fixed capital stock was prevented from adjusting to the evolving demands of the city's talented labor force. Cumulatively, as shown in box 3.3, regulatory policies made these workers much less able to adjust to the changed economic environment.

The story of Mumbai is just one example of nonmarket interventions in a land market that few can afford. Undoubtedly, there are infinite ways that land market restrictions can feed into other aspects of the urban economy, but consider two: finance and subsidies.

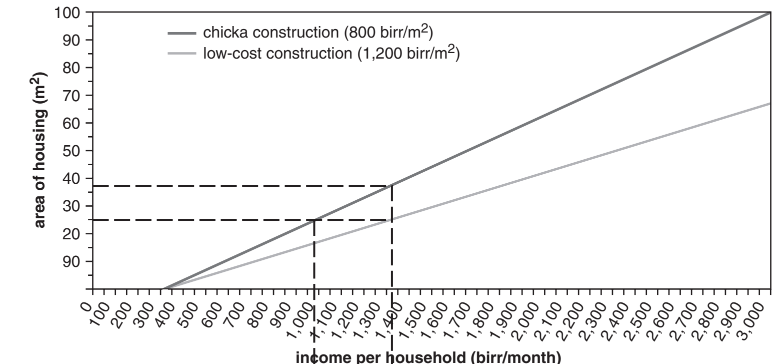
- When land is expensive, organizations like Grameen Bank, one of the world's most successful lenders for microenterprise finance, are unable to make loans in cities like Dhaka, even though such loans account for the bank's largest single asset. Land prices in the city are simply too prohibitive for the bank to provide finance.
- When land prices are many times what they would be in the absence of regulatory controls, it follows the number of people who can be served with subsidy assistance is much smaller.

Hence, urban land market constraints of this sort can have important, adverse spillover effects on a city's economy, as well as decrease the effectiveness of other instruments that can help address these problems.

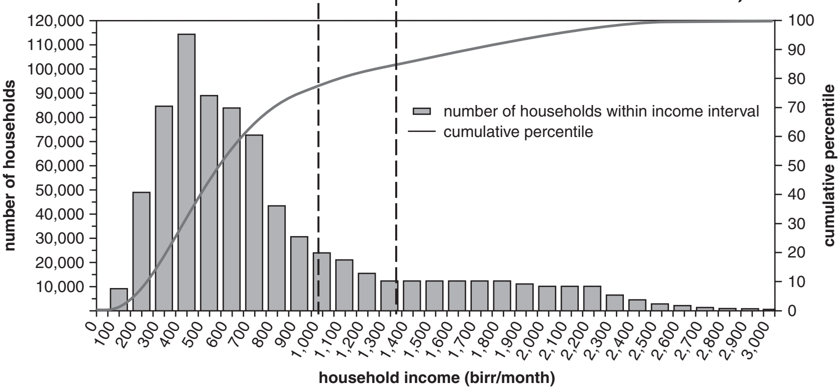
Box 3.4 Standards and Affordability: An Example from Addis Ababa

The figures below show (a) the relationship between construction costs for different types of construction and household income in Addis Ababa; and (b) the distribution of houeholds over the income range. Together, they show how standards in the formal market put housing in the formal (chicka) sector beyond the reach of the majority of people. The top figure shows that a formal house of 25 square meters on a mandated minimum 75 square meter plot in a suburban area would be affordable to

Area of Housing Affordable for Various Income and Construction Types on a Plot of 75m^2 in a Suburban Zone



Distribution of Household Income in Addis Ababa, 2002



households with a monthly income above 1,400 birr. However, an informal construction of 25 square meters built on the same plot is affordable to households with an income of 1,000 birr.

The lower figure shows how many additional households can afford housing with the lower construction standards. Similarly, land development schemes would reach a larger number of households if they tolerated the sharing of minimum plots by several households and allowed more affordable construction standards. This regulation, as a result, makes all the households between the two dotted lines in the lower figure unable to afford the minimum sized unit. They become illegal property even with titles.

Once these low-income households have a tradable title for land, there are good reasons to think that most of them would progressively improve their houses, and that they may eventually build adjacent structures in the long run.

Regulations Often Make Even Titled Property Development Illegal

Regulation, zoning, and minimum standards are key policy levers for affecting the operation of urban land markets and particularly access to shelter and land by the poor. There is ample evidence that when formal land development parameters (such as minimum plot sizes, setbacks, and infrastructure servicing standards) are not benchmarked against what the local population can afford to pay, most households (not just poor households) are excluded from access to formal land ownership. See box 3.4 for a study of such conditions in Addis Ababa. Thus, inappropriate regulation often renders dwelling construction and improvements illegal, regardless of whether the underlying plot is titled. The result is that even titled owners have reduced incentives to rehabilitate their ultimately illegal units. More realistic and appropriate regulation and standards are needed to address this constraint, particularly standards that would allow for incremental improvement. Payne and Majale (2004) discuss a methodology for computing the effects of such regulations.

Without downward revisions in standards, all of de Soto's constraints on land use are realized: it is very difficult to buy property, it is similarly difficult to sell property to someone who would put the land to a different use, and it is unattractive to invest in property once title has been acquired because the standards are so high that the property does not satisfy legal codes. To make things worse, many of these places also have poor enforcement of contracts, incomplete or absent land registry systems, and ineffective conflict resolution mechanisms. In such places, it is an exaggeration to say that a land market even exists.

Some Difficult Questions

The evidence presented in this chapter addresses only in part some of the difficult policy questions which clearly need further empirical enquiry. These questions include:

- How can adequate, suitably-located land be developed within the financial reach of the majority of the urban population?
- How can the tenure security of informal settlers be safeguarded without losing the public sector's ability to provide high value infrastructure services and redevelopment options in prime urban locations?
- Can development standards and zoning be made less restrictive without compromising environmental, public health, and disaster preparedness?

Some tentative answers about what has been learned in relation to these and other crucial issues are presented in the concluding section, but clearly, there are no universally applicable answers.

Lessons Learned

What Has Worked...

There are, as detailed in the text, a variety of methods to improve shelter conditions. However, in most places, formal titling does not seem to be the most important first step to take in many places.[8] The attempt to provide more flexible ways to assure slum dwellers that they will not have their shelter demolished is an extremely important step forward and should be a prerequisite for the development of policy. However, in densely populated megacities where the value of land put to different uses is likely to be high, formal titles are likely to be considerably more valuable.

Less conventional interventions such as land readjustment and land swaps have not been adequately explored as instruments of intervention in land markets. In land readjustment schemes, multiple owners of land pool their plots to facilitate the development or rationalization of infrastructure and public spaces. Readjustment schemes have been widely practiced in Germany, Japan, the Republic of Korea, Nepal, Singapore, and elsewhere, and offer considerable potential for pursuing the dual objectives of enhancing tenure security and land use efficiency.

While the experience with land acquisition has at best been mixed, the new ability of the Bank to lend for this purpose (since April 2004) is a significant development that has the potential to enhance the governance of this process and to facilitate interventions on more strategically located land in future projects.[9]

...And What Has Not Worked

The cross-cutting nature of urban land issues makes integrated institutional approaches crucial to the success of interventions. But such arrangements are not easily forged; in fact, their absence has undermined the success of several Bank projects.[10] Project experience indicates that the process becomes easily derailed when appropriately integrated approaches are not adopted. The Morocco Land Development Project, for example, highlighted the need for such an integrated institutional arrangement. The advantages of integrated operations between land registration and land administration have also been seen in several cadastre-related projects in Europe and Central Asia, Latin America and the Caribbean, and elsewhere. In a broader context, however, institutional arrangements for urban land administration need to be conceived in the context of what are often new, unconventional, and therefore less familiar roles for the state. Participation of the private sector in the land development process is also necessary. Examples of where such roles come into play are land readjustment, joint venture approaches to sites-and-services projects, and the upgrading of informal settlements on private land.

Redressing imbalances of powers of implementing agencies can also be important. For instance, in the Third Structural Adjustment Credit to Georgia, the land ownership reform component performed at a highly satisfactory level; land registration was completed for 3,000 enterprises. A key element of this success was the amendment of a law governing the administration and disposition of state-owned nonagricultural land.[11]

4
Housing Finance: The Genie Is Out of the Bottle

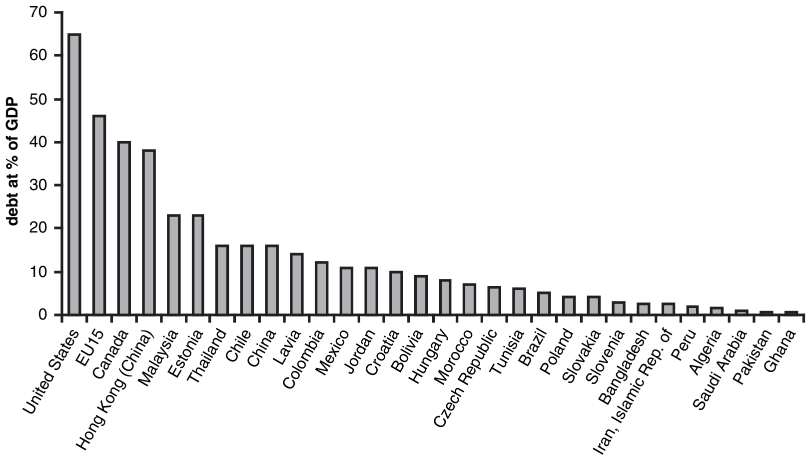
World Bank involvement in housing finance first arose when it became apparent that the housing being produced by the public sector was unaffordable and that there was no financing available to support individual investment in housing. Outside of public production, in almost all developing countries cash or sales of other assets were used to finance almost all private housing purchases.[1] Renaud (1984) documented how the interest rates charged by specialized, usually public, lenders were unsustainable and often hindered the entry of private financial institutions. Such a finding required that emphasis be given to the constraints on the ability of lenders to compete for the financial resources to onlend.

The Growth of Housing Finance

In some ways, the notion that market-oriented, competitive financial systems could generate more resources appears now to be an almost foregone conclusion. However, it is useful to consider just how much conditions have changed over time. In the 1980s, as noted by Abiad and Mody (2005), most European financial systems operated under extensive controls: directed credits, limits on the terms for loans, and often, public ownership of the financial institutions. These systems were also segmented, subsidized, and limited in scope. The United States, too, was in the midst of a savings and loan crisis. In the mid-1980s, financial systems in developed countries were tightly controlled, directed, and not nearly as liberalized as they are today.

In recent years, market-based housing finance has come to account for an increasingly significant share of financial sector activity in many countries. While it has for many years played an important role in countries such as Denmark, the United States (which has more than $6 trillion in mortgage assets outstanding), and the United Kingdom, access to finance is now expanding elsewhere. In Western European countries, housing finance is increasing at more than 8 percent per year, more than double the rate of growth of GDP for the past decade (Suarez and Vasallo 2004). As suggested by figure 4.1, for developed countries, which represent the four columns on the left side of the figure, housing finance is now an important part of the financial system. It is also becoming increasingly important in many

Figure 4.1 Depth of Residential Mortgage Markets



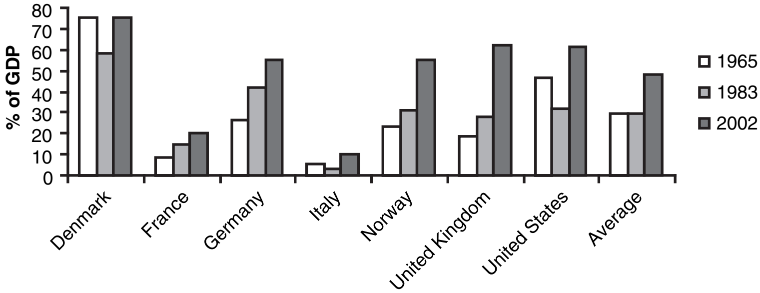
Source: Chiquier (2005).

developing countries. All of the developing countries listed now have mortgage debt in excess of 10 percent of GDP; a few years ago most of these systems did not exist. The obvious question is: why has this growth started and is it likely to expand?[2]

The answer to this question, according to both Calomiris (2003) and Rajan and Zingales (2000), is simple: until financial systems were liberalized in the mid-1980s, they were stagnant. In their view, for many years after World War II, the financial systems of Organisation for Economic Co-operation and Development (OECD) countries were, as noted above, highly regulated and noncompetitive. Indeed, the Rajan and Zingales study argues that the systems not only did not develop, but that they were less developed in 1980 than they were in 1913. This was a result of these financial systems being dependent upon a broader policy environment that strictly limited competition for financial resources. For housing finance, this sort of approach implied that noncompetitive, closed systems were the norm (see Boleat 1985; Diamond and Lea 1995). The result was that housing finance was available to a limited number of people, who usually received government assistance of some kind.

In the mid-1980s, all this began to change. Systems began to be deregulated, adapt, and grow, as shown in figure 4.2.[3] The figure shows that in every country except Italy, mortgage debt outstanding in the last year of observation far exceeded outstanding debt 20 years earlier. In contrast, during the earlier, path-dependent period, there was little overall growth, with some systems increasing and the others declining.[4] Indeed, the more the details of the growth and dynamics of housing finance are considered, the more striking are the differences since deregulation began. (See, for example, the European

Figure 4.2 Size of Housing Finance System in High-Income Countries



Source: The 1965 data is from Goldsmith (1985). The data for France and Germany in the first period is from 1960 and for Italy is from 1963. The 1983 data is from Dubel, Lea, and Welter (1997). The 2002 data for European countries is from the European Mortgage Federation and for the United States is from the Federal Reserve.

Mortgage Federation's Web site.) In short, for housing finance in developing countries, further deregulation and expansion seem almost inevitable. The genie is out of the bottle, and if prudently managed, can be expected to confer enormous benefits. Competitive affordable housing finance is growing rapidly in both developed and developing economies.

To understand how rapid this growth is likely to be, consider the recent experience of Western Europe as a benchmark. By this standard, it is very likely that housing finance in Europe's transition countries could grow very rapidly for a substantial period of time. The conclusion seems reasonable because, as noted in box 1.2 in chapter 1, almost all the transition countries, as well as China, India, and Mexico, are in the process of liberalizing their financial systems as much of Western Europe did more than a decade ago. High rates of growth therefore seem likely. However, other stimulating factors also come into play.

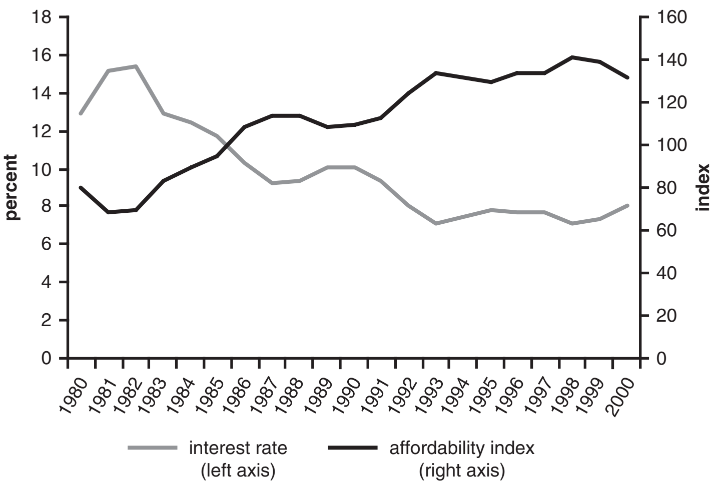
In the past, controls on financial systems and corresponding levels of credit allocation were much more pronounced in developing countries than in developed market countries. Indeed, until 1990, India prohibited its commercial banks from supplying any mortgage credit, even though most families owned homes. Similarly, in China, which prohibited such homeownership, such finance could not even be demanded. Clearly, in these two enormous economies, housing finance was beginning from a much lower base. But the experience of China and India among developing countries is not unusual. For instance, in the transition countries, rule of law and enforceable contracts have only recently been reembraced, and a considerable amount of residential property—perhaps as much as $1 trillion dollars worth—has changed from public to private hands (World Bank 2001). In addition, respectable, even rapid, rates of economic growth have been achieved in reforming economies, and high rates of inflation have largely been tamed.[5]

In such a context, growth rates for mortgage credit of 20 percent per year for a decade or more would not be surprising; India and China have both regularly exceeded those rates over the past three years, in the latter case to some international concern. These trends in housing finance have contributed to the high economic growth rates observed in a number of EU countries, particularly Ireland, Portugal, and Spain, which have recently liberalized their financial systems. They also contribute to the sort of fixed capital stock restructuring that is necessary in many transition countries.[6]

In sum, experience in developed and developing countries is quite optimistic on the likely growth trajectory for housing finance. Besides the systemic changes that are conducive to such growth, there is also a more basic reason for growth—financial costs have fallen, making homeownership much more affordable. When greater access to credit is combined with the world's currently favorable interest rates, housing becomes significantly more affordable, as depicted in figure 4.3. When the costs implied by borrowing behave as described in figure 4.3, more housing demand can be accommodated.

A recent IDB Financial Sector Study (2004) of Latin America suggests two important constraints on the prospects for housing finance growth: (a) in countries with inegalitarian distribution of income, affordability for the poor is difficult; and (b) higher macroeconomic volatility requires higher interest rates to compensate for the risks involved. These constraints are particularly binding for Latin America, which as a region has highly unequal

Figure 4.3 Homeownership Affordability under Different Interest Rates



Source: National Association of Realtors.

Note: The composite affordability index is the ratio of median family income to qualifying inccome. Values over 100 indicate that the typical (median) family has more than sufficient income tto purchase the median-priced home.

income distribution and high macroeconomic volatility.[7] The World Bank is involved in various projects in Brazil and Mexico that attempt to ameliorate these problems, and over the years the Bank has lent Mexico more than $1.5 billion for such purposes.

The Public Role in Housing Finance[8]

The likelihood of rapid growth in housing finance in many developing countries raises two questions. First, what is the appropriate public role in the emerging housing sector? Second, how can the Bank best support and help define this role? These questions gain importance in light of the problems that periodically have arisen in the financial systems of developed countries, particularly those in Western Europe, as they deregulated their housing finance systems.[9]

In addition to recognizing the important public role in assuring prudent expansion, it is important to recognize that in virtually all market economies, the public role in housing finance is pervasive. Every country that has a substantial housing finance system also has an extensive, often complex and nontransparent, public role. The opposite is also the case: countries with less mortgage credit generally have followed policies that prevent mortgage market development. For example, figure 4.2 shows that Italy's housing finance system is only slightly larger than those of many of the developing countries described in figure 4.1. A number of studies have shown the important role that policy played in this result (for example, Suarez and Vassallo 2004). Thus, a country's policy environment can be expected to play a significant role not only in managing growth but in determining how rapidly mortgage finance develops.

It is also important to note the historical role of government in the development of housing finance. In many cases, the current public role in housing finance in OECD countries is the result of government financial innovations following an economic shock or in response to an expectation of a sharp increase in housing demand. For example, what is generally described as a bond-based system of mortgage finance, the sort observed in Denmark, Germany, and the United States, was developed by government action in response to a perceived shortage in the supply of funds.[10]

Not only have government innovations in housing finance been frequent, they have also occurred because the sorts of innovations undertaken by the private sector were, as Miller (1986) describes, hardly the "life blood" of the financial system. Indeed, many government financial innovations in housing finance were designed to offset or reallocate some of the risks or moral hazard problems that arose due to private sector innovations in the sector. In other words, rather than relying on the private sector to spontaneously innovate and effectively show the way, many public innovations were designed to do exactly the opposite, that is, control private actions or stimulate them within well-defined parameters. Snowden (1995), for example, reviews the problems that arose with private sector development of mortgage securitization in the United States in the 19th century as an example of the sort of moral hazard that can arise in strictly private innovations. Miller (1986) documents how many of the financial innovations that took place in the United States in the early 1980s were designed largely to circumvent taxes or regulations.

More generally, a theoretical case can be made for an active public role. For instance, in a recent review of both financial innovations and the study of these innovations, White and Frame (2004) attribute low rates of financial innovation to an information externality. They claim that underlying financial innovations do not allow innovators to be able to appropriate all the returns from successful innovations. That is, in the financial sector, innovations that work are quickly and cheaply copied by competitors. The result is that there is less investment in innovating. Similarly, in considering the sorts of financial systems emerging countries should establish, Stiglitz (1993) says that because of the range of information problems that "there is no presumption in favor of unfettered markets" (p. 15).

In sum, both history and theory suggest that the public sector will have an important role to play in housing finance. Unfettered private sector development is unlikely to result in optimal systems, and the regulatory structure and public sector involvement will remain important. This public role must also remain inclusive, particularly in countries where access to credit by the poor, such as Bangladesh and Bolivia, has historically been constrained by dysfunctional financial systems. In these places, private sector initiatives of the sort developed by Grameen Bank and Bancosol can be expected to be important aspects of the beginnings of housing finance. In the case of Grameen, one of the world's most effective microfinance lenders, housing loans are already its largest single asset. Extending the remarkable pro-poor achievements of the microfinance innovation to urban shelter lending is something the Bank should help to foster.

Institutional Arrangements

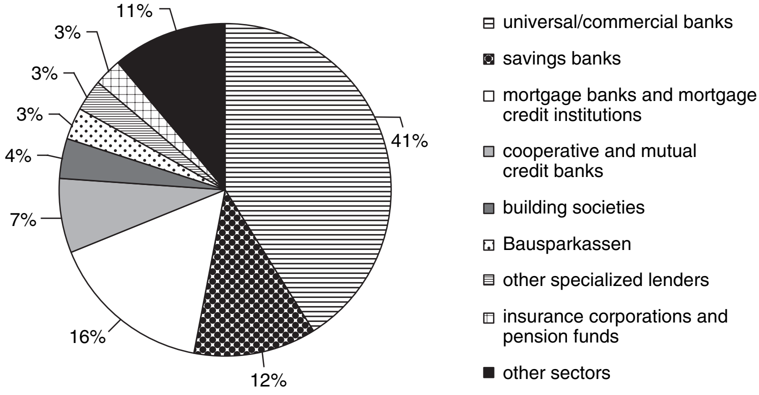
What sort of new institutional arrangements can reasonably be developed by the public sector? Can policy makers in these countries jump start the development of their housing finance systems? Can they, for instance, encourage the development of the securitization of mortgages or the establishment of a secondary mortgage market to accelerate the development of housing finance?[11] Or should the attention of policy makers be more modestly focused on establishing the legal underpinnings and infrastructure of simple, enforceable, and prudent mortgage contracts?

The forthcoming *Housing Finance in Emerging Economies* (2006) provides a richer perspective on these questions. Here we briefly review some of the dimensions of what can be inferred from the institutional arrangements that characterize developed economies. A basic question in this regard is how are housing finance institutions in developed countries funded today?

The funding structure depicted in figure 4.4 suggests that in 1998, roughly 15 years after financial liberalization had begun in Western Europe, bond finance accounted for only 20 percent of total mortgage funding. Most of that finance was accounted for by the more than 100-year-old mortgage bond systems of Denmark and Germany. Thus, in most of Europe, deposit-based lending remains the unambiguously preferred funding method. Consequently, because bond markets in developing countries are considerably less developed than in developing countries, the main sorts of mortgage lenders will initially be bank-like institutions that monitor the assets they originate. This has certainly been the case in most, but not all, of developing countries with rapidly growing housing finance systems.

Deposit-based finance, of course, is not the entire story. Depositories raise money in deposit markets. Such markets often require branches and tellers and other costly ways of raising money. Raising money in stock or bond markets will often generate scale economies and be considerably less expensive. Certainly, technological improvements and the sorts of cost saving innovations in underwriting practices now being realized in the United States suggest that in the long run, depositories will be under increased competitive pressures from bond based methods of finance. Similarly, the long-term successes of both the Danish and German systems of bond finance, not to mention the largely bond-based U.S. system, suggest that over time, origination and investment functions can be separated to allow for the advantages of specialization and economies of scale, which lower transaction costs. Such systems can also provide an effective way to

Figure 4.4 EU Mortgage Loans: Market Share, 2001



Source: European Mortgage Foundation.

address the need for matching the maturities of long-term mortgages with similar long term liabilities, and will undoubtedly have a large role to play in many systems. Thus, perhaps the main point is that there is no single "best approach." Flexibility will be required, as will attention to the broader effects that the institutional arrangements can have on the macroeconomy.

A Institutional Structures and Macroeconomic Risks

As macroeconomic problems that have arisen in restructuring housing finance systems have made clear, institutional structures can have broad consequences. For instance, an institutional structure that relies on short-term liabilities, such as deposits, may also, for regulatory reasons, require that the assets it funds also be short term in order to control the lender's exposure to interest rate risk. Hence, a bank-oriented system may affect resource allocation by forcing variable rate mortgages on borrowers, as appears to be the case today in the United Kingdom according to Miles (2004). This requirement can also carry undesirable side effects. For instance, if borrowers are not in a better position to accept the accompanying interest rate risk, there will be a smaller mortgage market and a less efficient allocation of capital.

Problems can also arise when lenders and borrowers engage in transactions that unwittingly put borrowers at risk in ways which after the fact are deemed to be socially or politically nonoptimal. Under such circumstances, the government, as suggested by observers such as Laidler (1976), may adopt macro policies that are protective of borrowers by being more inflationary.[12] The optimal structure, then, will do the best job of balancing the broader costs and risks involved in housing finance. It should also provide a range of choices to borrowers among mortgage instruments which are consistent with well-managed macroeconomic policy. This is not an easy task, but again, as pointed out by the IDB (2004) it can be a very important one, particularly in smaller, more risk-prone economies.

To sum up, when legal and regulatory structures are weak and monitoring costs are high, the system that initially emerges in most developing countries is likely to be considerably less specialized than the U.S. or European systems. Other changes will often be prerequisites. For instance, until people become more comfortable with the "financial rules of the game," and until improvements in information technology are more widespread, the legal consequences and risks of various actions are better known, and the economic returns to investments better understood, the transition to a more liberalized housing finance system is likely to begin with basic transactions in secondary markets and securitization. More emphasis should be given to allowing market incentives to shape the institutional forms used and the speed of liberalization. At the same time, policy makers would do well to be cautious. When, for instance, unfettered adjustable rate mortgages are widely available, repayment problems can arise, and these risks will be compounded by macroeconomic financial instability.

Lessons Learned

What Works…

The liberalization of financial systems in recent years has been a strong stimulus to the development of market-based housing finance and will no doubt contribute to a continued expansion of the Bank's role in this sector. Both history and theory suggest the need for a strong public role in this development. Transactions with people who are often undertaking the largest expenditure of their life with sophisticated financial institutions will always require a strong, if unobtrusive public role. Finally, we have learned that uncollateralized lending, as shown by the Housing Development and Finance Corporation experience in India and the Grameen Bank in Bangladesh, can be an effective starting point.

...And What Does Not Work

Perhaps the clearest lesson of the past 20 years is that housing finance does not work in unstable or inflationary environments. Of the housing finance projects rated unsatisfactory, almost 30 percent took place in inflationary environments. Nor can housing finance be expected to be productive in a highly regulated or distorted housing market. In such an environment, greater access to finance is likely to contribute to asset price bubbles rather than expansion of the housing stock. Finally, housing finance tolerant of high levels of delinquency and default inevitably leads to failure. Rarely, if ever, has a public institution returned to sustainable lending from a prior position of having tolerated high levels of delinquency.

5
Housing Subsidies: The Political Economy of Reform in an Nth Best Situation

Every country uses housing subsidies, which take a wide variety of forms to address either the supply or the demand side of the market. In fact, due to the range of ways subsidies are provided, it is often a serious challenge to measure their scale and incidence.[1] This limitation has significant implications for the implementation of reforms to improve the effectiveness of subsidy expenditures. And as a result of some of the practical difficulties involved in designing housing subsidies in developing countries, there are often basic constraints on the sorts of policy options available. These difficulties can make what we know to be the most effective options for delivering assistance in a developed country context not viable. As a result, subsidy improvement is often practiced in a second- or even the third-best world, which is often characterized by thorny questions about the political economy of reform.

Before we discuss why housing subsidies are complex to administer and evaluate, we offer the caveat that there is considerable debate on whether housing subsidies should be offered by any country. There is considerable discussion within the World Bank on how targeted income support and family benefits achieve welfare enhancements, including housing. Huge subsidy programs exist in many large developing countries, and completely doing away with them is often not politically feasible. In these circumstances, housing subsidies are the second (or nth best, as in the chapter title) best option, and there is much room for improvement of the design of these subsidies.

Housing Subsidies Are Complex Even in Well-Functioning Housing Markets

The Level of Subsidies

Expenditure on housing subsidies varies a great deal across countries as well as across time within countries, as discussed in table 5.1.

This variability in expenditure suggests that the allocation of substantial public resources to the housing sector is either a political choice or a choice deeply affected by country-specific circumstances. Patterns of expenditure are idiosyncratic and therefore recommendations about whether subsidies are too low or too high are very difficult to make based on comparative evidence.

Table 5.1 shows official figures regarding housing subsidies as a portion of GDP for a sample of developed and developing countries. Three points stand out from the table. First, housing subsidies often represent a non-negligible portion of GDP, particularly in developing countries. In Algeria and the Islamic Republic of Iran, for example, housing subsidies amount to the equivalent of 4–6 percent of the GDP, making the magnitude of expenditure comparable to expenditure on education or health. Second, high levels of housing subsidies are rarely achieved in developed countries. Third, expenditures on housing subsidies vary a great deal across countries, by a factor of almost 15. Of course, a variety of country circumstances can affect the amount allocated to housing assistance, including differences in demographic circumstances, level of income, and even the country's climate (World Bank 1980). Additionally, the level of subsidies within a particular country can vary significantly, as illustrated by the case of the Nordic countries, particularly Sweden, in the past decade (Lujanen 2004).

Table 5.1 Housing Subsidies as a Portion of GDP in Selected Countries

Country	*Year*	*Housing subsidies as a portion of GDP (%)*
Algeria	2002	5.00–6.00
Chile	1998	1.25
Colombia	1998	0.46
Denmark	2003	2.11
Finland	2003	1.05
France	2001	1.74
Iran, Islamic Rep. of	2002	4.00–6.00
Mexico	2001	0.50
Morocco	2002	2.90
Norway	2002	1.45
South Africa	1998	0.38
Sweden	2002	1.14
United States	2001	1.54

Source: For United States, HUD; for France, Ministère du Logement; for Denmark, Finland, Norway, and Sweden, Lujanen (2004); for Chile, Colombia, and South Africa, Gilbert (2004); for Algeria, Islamic Republic of Iran, and Morocco, Le Blanc (2005); for Mexico, World Bank (2002).

Subsidy Delivery Mechanisms

Subsidy delivery mechanisms are perhaps more variable than the amount of resources allocated to housing subsidies. Table 5.2 gives a sense of just how complicated subsidy delivery can be: the columns give ten discrete qualities of subsidy programs, and the rows a list of programs currently operating in 12 Latin American countries. Combining the rows and columns indicates that there are over 1,000 program combinations possible in these 12 countries, making subsidy delivery approaches difficult to compare across countries.

Despite these analytical difficulties, specialized literature on the performance of housing subsidy programs has developed rapidly since the mid-1990s. In parallel, studies centered on the evaluation of subsidy programs have flourished in mainstream economic literature (see the references in Le Blanc 2005). As a consequence, understanding of the economic performance of housing subsidy programs, and subsidy programs in general, has increased tremendously. The core of the analysis of subsidy programs has revolved around the notions of efficiency and targeting, whereas more applied papers have emphasized issues such as transparency, administrative simplicity, incentives, and sustainability for the government (e.g. Struyk 2000, the references in Buckley and Kalarickal 2005; and Gilbert 2004).

Box 5.1 Targeting and Coverage: A Basic Framework

Suppose that a country's population can be divided into two categories of households, "poor" and "nonpoor." Suppose also that the "poor" category is the official target of subsidies. For any given subsidy program, a two-by-two table can be constructed that gives the repartition of the population depending on the poverty category and the benefit of the subsidy program.

Targeting and coverage of subsidy programs

	Poor	*Nonpoor*
Reached		Leakage issues
Not reached	Coverage issue	

If the program were perfect, cells out of the diagonal of the table would be void. On the contrary, the presence of households in the upper right cell of the matrix indicates problems of leakages, i.e. households not included in the target benefit from the subsidy. The presence of households in the lower left cell of the matrix indicates problems of coverage, i.e., populations included in the target are not reached by the subsidy.

Source: Coady, Grosh, and Hoddinot (2004).

The Bank has recently reviewed the developing countries' experience targeting subsidies in a paper by Coady, Grosh, and Hoddinot (2004), which presents a format that is quite flexible and easy to adapt in broad terms to our discussion of housing subsidies. Their basic framework is presented in box 5.1.

Using the Framework to Analyze and Improve Subsidy Targeting

Consider, first, how the two most important housing-related subsidies used in developed countries score in terms of the framework given above: assistance to poor households, usually renters, and assistance to homeowners, usually through a form of tax favoritism.

Homeownership Subsidies

Research by Coady, Grosh, and Hoddinot has found that homeownership subsidies in relatively well-functioning housing markets tend to be regressive. That is, most of the assistance is provided to those in the upper right cell of the matrix in box 5.1. The research suggested that substantial gains could be made by better targeting housing subsidy programs. Correspondingly, as detailed by Turner and Whitehead (2002) many countries did just that, although this form of mistargeting of housing subsidies was significantly reduced in the 1990s.

During the 1990s, France, Sweden, and the United Kingdom, phased out, or drastically reduced, tax advantages for homeowners, the most pervasive of which was the deductibility of mortgage interest from taxable income. The United States also reduced the regressive tax favoritism for homeownership, by reducing the gains free from capital gains and placing limits on the amount of deductible mortgage interest. As the research made clear, not only was this type of subsidy regressive, it also had a built-in bias against poor households, since the latter usually fall below the threshold of the income tax and loan eligibility and therefore cannot take advantage of the deduction.

Rental Housing Subsidies

Analyses of how to most effectively deliver housing subsidies to the poor have also led to prescriptions for the use of voucher schemes (Boelhouwer 1997). Under a voucher scheme, policy makers simply define the rules and then respond to demand. The central idea is that well-functioning housing markets should be best able to respond to the enhanced demand of poor households. Armed with housing vouchers to augment their purchasing power, the poor can search for the best deal. They can select new or existing units of a minimum standard in locations they choose (subject to the

Table 5.2 Characteristics of Housing Subsidy Programs in Selected Latin American Countries

Country	*Program*	*Demand subsidy?*	*One-time subsidy?*	*Is it portable?*	*Does it finance only dwellings built under the program?*	*Does it finance progressive/ self-built housing?*	*Is it constrained to the savings capacity?*	*Is the credit provided by a public agency?*	*Does it include credit programs with private financial interme- diaries?*	*Is the interest rate lower than the one in the market?*	*Does it subsidize fixed costs or risks by financial interme- diaries?*
Argentina	Fonavi	No	n.a.	No	Yes	No	No	Yes	No	Yes	n.a.
Chile	Serviu and others	Yes	Yes	Yes/No[a]	Yes/No	Yes/No[a]	Yes	No[b]	Yes[b]	No	Yes[b]
Colombia	Subsidios a la vivienda de interés social	Yes	Yes	Yes	No	Yes	Yes	No	Yes[c]	Yes[c]	No
Costa Rica	Bono familiar de vivienda	Yes	Yes	No	No	Yes[d]	No	No	No	n.a.	n.a.
Ecuador	Sistema de incentivos para vivienda	Yes	Yes	Yes	No	Yes	Yes	No	Yes	No	n.a.
El Salvador	Programa de contribuciones para la vivienda	Yes	Yes	No	No	Yes	No	No	Yes	No	No
Guatemala	Foguavi	Yes	Yes	No	No	Yes	Yes	No	No	n.a.	n.a.

Mexico	Fovi/SHF Programa financiero de vivienda	No	No	Yes	No	No	No	No	Yes	No	No
Mexico	Prosavi Programa especial de crédito y subsidios a la vivienda	Yes	Yes	Yes	No	No	Yes	No	Yes	Yes	Yes
Peru	Mivivienda	No	Yes	Yes	No	No	Yes	No	Yes	Yes	No
Peru	Techo Propio	Yes	Yes	Yes	No	No	Yes	No	Yes	No	No
Uruguay	Sistema integrado de acceso a la vivienda	Yes	Yes	No	No	Yes	Yes	Yes	No	Yes	n.a.

Source: IDB (2004).

Note: n.a. = not applicable.

a. According to the program.

b. Since 2002.

c. The methodology of financing is not included in the program, but banks must use 25 percent of the increase in credit to finance housing through controlled interest rates.

d. Only for groups already organized.

resource costs of providing the minimum standard unit). If eligible families want a better location or higher level of housing-related amenities, they can rent it in the market. However, rather than using public assistance to augment their demand, they have to use their own resources. In terms of the Coady, Grosh, and Hoddinot (2004) framework, use of people's own resources helps target the neediest, i.e., the lower left cell of the matrix.[2]

Today, even in countries where public housing is widespread, such as the Netherlands, most low-income housing assistance takes the form of vouchers to lower-income families. These programs have different terms and conditions across countries, but the general approach is to use demand-based, portable vouchers, generally referred to as housing allowance schemes. This approach has been found to be the most effective instrument for assisting the poor because it provides beneficiaries with the ability to rely on competitive markets to afford the greatest range of affordable choices at the lowest cost to the government. That is, again in terms of the Coady, Grosh, and Hoddinot (2004) perspective, simple steps can be, and were, taken to improve subsidy targeting. In short, the framework offers a number of simple ways to reduce the mistargeting of public subsidy expenditures, and they were realized in many developed countries.

The Story Gets Complicated

The housing subsidy situation varies considerably in developing countries in a number of important ways. First, the conditions under which the subsidy instrument works best—a competitive supply of housing services, particularly in cities with dysfunctional urban land markets—either does not exist or exists on a very limited scale. Accordingly, the increased purchasing power generated by vouchers generates little or no supply response. As a consequence, while the vouchers provide safety net protection for beneficiaries, they do not elicit an increase in the supply of the targeted level of services.

Second, and more importantly, in most developing countries, reaching the poorest groups of the population is complicated by the size of the informal job and housing sectors. That is, most poor households are de facto excluded from the reach of instruments designed to function within the bounds of formality (vouchers, mortgages income tax deductions, and tax breaks to developers). In addition, information problems related to measurement of income or wealth, and also merely identifying beneficiary households, often complicates the processes of defining eligibility and selecting households for subsidy programs.

Another consequence of the absence of reliable information is the lack of appropriate support to renters in most developing countries. While we have seen that support to renters in the form of vouchers is one of the two pillars of developed systems of housing subsidies, rental subsidies generally do not exist in the majority of developing countries. The bulk of subsidies to households in developing countries have been shifted to homeowners, and private sector renters receive little help of any kind. As a consequence, entire segments of poor populations have been mostly left out of the subsidy system.[3]

Fourth, despite the frequently large share of resources involved, there is still lack of information on the housing subsidy system in most countries. While some subsidies are accounted for in the national budget, others, such as tax expenditures, are less visible; at the other end of the spectrum, land subsidies to public developers or various forms of rent control are often not accounted for at all. As a result, in many cases, governments tend to focus primarily on housing subsidies measured in the budget at the expense of other subsidies. But this subset of housing subsidies is often only the tip of the iceberg, representing no more than 10 to 20 percent of total expenditure on the sector, as shown by Le Blanc for Morocco (2005) Without a broad picture of the system, the coverage of the poor population cannot be properly assessed or managed.

Fifth, in developing countries, particularly rapidly urbanizing countries, this information problem about beneficiaries is by no means specific to the housing sector; it applies with equal force to other kinds of subsidies. In delivering housing subsidies to developing countries, it has become popular to combine various direct and indirect methods of targeting, the latter consisting of designing subsidy programs to ensure that the targeted households self-select into the programs. Inventive ways of circumventing these problems have been devised throughout the world (for a review of alternative methods, see Coady, Grosh, and Hoddinot 2004), but there is a long way to go before conceptually simple but administratively complex approaches can be pursued. Indeed, an opposite approach, that is, conceptually complex mechanisms that are administratively simpler to implement, are being pursued.

Finally, in many developing countries, housing subsidies are likely to have multiple objectives.[4] For instance, the occupants of low-income housing in the slum of a megacity more often face difficult social problems that are likely to be targeted by public assistance than do low-income families in developed economies. In the former, attention must be given to many other considerations besides the housing cost problem that vouchers are so well-designed to address. However, as is well known, the tradeoff for pursuit of multiple objectives is usually a reduced ability to achieve any specific objective.

Box 5.2 illustrates many of the points highlighted above. It shows how Moroccan housing subsidy programs perform against different public finance criteria. Subsidies to the housing sector constitute a big drain on Morocco's resources, with an estimated yearly expenditure of around 9 billion Moroccan dirhams per year (2.6 percent of GDP). However, most of these subsidies are implicit and not accounted for.[5] While it is immediately apparent from the figures that gains in efficiency and targeting of the

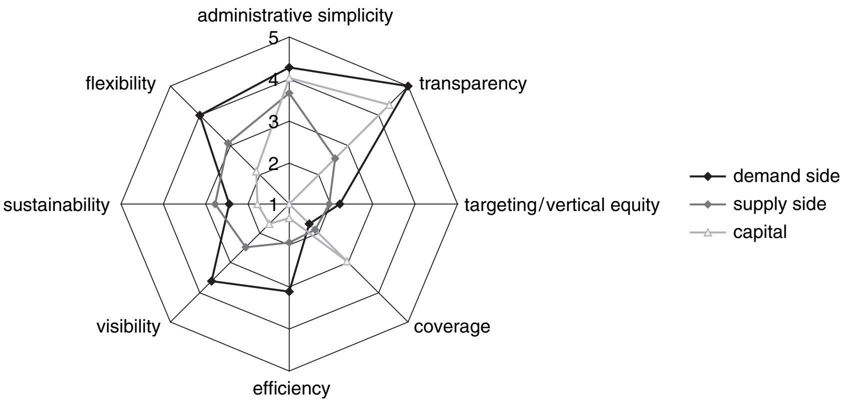
Moroccan subsidy programs could be achieved, it is also apparent from the way the figure arrays the achievements across different possible objectives that in most cases an improvement according to one measure usually comes at some cost in terms of other goals.

Box 5.2 Housing Subsidies in Morocco: An Illustration of the Complexities

In Morocco, interest rate subsidies on mortgages, represent only 4 percent of overall expenditures on subsidies. Income tax deductions of mortgage interest, tax breaks to developers, and land subsidies to public developers represent much higher costs. Interestingly, the single most important subsidy item is a reduction in local taxes for homeowners (not applicable to renters), which is deemed to have little direct impact on welfare or housing construction but constitutes a serious drain to already insufficient local government resources.

The first figure below summarizes the performance of Moroccan housing subsidy programs, grouped into three broad categories, against different public finance criteria (see Le Blanc 2005 for a description of the methodology and data). Overall, all subsidies appear to be insufficiently targeted, do not achieve a good coverage of th e poor population, and are not sustainable in the long run. The shape of the figure also implies that

Performace of Housing Subsidies in Terms of Eight Public Finance Criteria, Morocco, 2002 (aggregated by broad type)

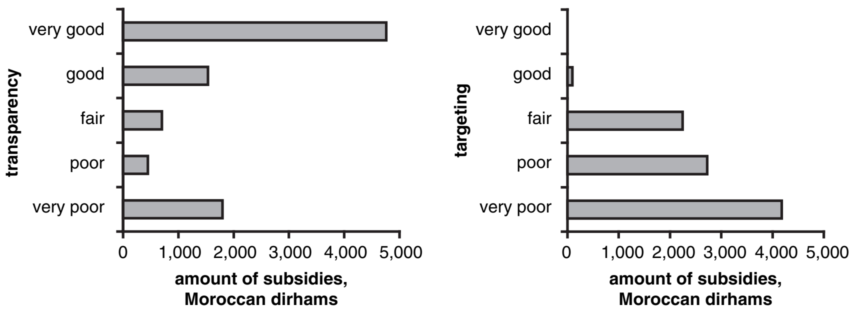


Source: Le Blanc (2005).

achievement of the subsidy goals usually entails reduced effectiveness with respect to other goals.

The second figure below breaks down total subsidy expenditures by degree for two criteria, transparency and targeting. Transparency in this case refers to the clarity of the program's eligibility and participation criteria and effective implementation by the responsible entities. Overall, housing subsidies are fairly transparent (mainly due to the importance of tax breaks, which follow explicit rules accessible to all) but insufficiently targeted.

Aggregated Performance of the Housing Subsidy System: Transparency and Targeting, 2004



Source: Le Blanc (2005).

Lessons Learned

What Works…

Pragmatism. Political economy constraints are particularly prevalent in the area of housing subsidies. As a consequence, there is often a gap between what benevolent governments are willing to do and what can politically be done at any moment in a given country. A pragmatic recognition of these constraints is key to achieving concrete steps in reforming public spending on housing. One concrete translation of this general recommendation is to carefully distinguish policy dialogue on the relative merits (e.g., efficiency and targeting) of alternative housing subsidy systems from operational work (e.g., administrative setting, parameters, and transparency) aimed at designing and refining individual subsidy programs to help them reach their intended beneficiaries. Those two types of activities should be undertaken in parallel.

Sequencing matters. Political economy considerations arise because of the multitude of institutions involved in the management and reform of housing subsidies. Following the specific kind of subsidy at stake, natural champions for reforms vary widely across countries. As a consequence, in any country, the packaging and sequencing of housing subsidy reforms must take into account the local mix of subsidy programs and the interests of their managing institutions.

Reforming subsidy programs takes time. Most of the time, subsidy reforms are better envisioned within a global, long-term (programmatic) framework, as opposed to one-shot reforms. The institution of new systems of subsidies tends to induce long-term financial and administrative commitments that may be difficult to shift or reverse. Indeed, political difficulties associated with changing the welfare system are so high that often, in order to discontinue one subsidy, governments have to introduce another one.[6]

...And What Does Not Work

Lack of clarity as to what is expected from broader housing sector reforms. As argued in the 1993 World Bank housing policy paper, housing subsidies form an integral part of the housing sector, and as such, failures to reform the broader sector often condemn subsidy reforms. For instance, a number of countries have postponed or abandoned structural reforms to the legal and regulatory environment of the land and housing markets while maintaining subsidies known to perform poorly. Examples include continued investment in public rental housing when the local conditions do not allow sufficient collection of rents to even maintain the constructed dwellings, as in Algeria; keeping special funds, or financial circuits, for housing whose structural characteristics prohibit efficient functioning, as in Mexico; subsidizing public rental units so much that the private rental market cannot develop, as in Russia; and subsidizing public land developers and builders who have crowded out private investment in the housing sector, as in Bangladesh.[7]

In summary, the international experience shows that in the majority of developing countries, housing subsidies represent an important item in the flow of public expenditures. However, the extent and incidence of subsidies is often not well known by governments, notably due to the natural fragmentation of housing subsidies between different levels of government and the use of different types of subsidy mechanisms. Nevertheless, the evidence is compelling that in nearly all cases, the efficiency of public spending in housing subsidy programs could be improved, essentially by better targeting low-income households. Such improvements would allow government assistance to serve more households or serve households more efficiently. Altogether, these considerations make the case for further Bank involvement in housing subsidy programs. Fortunately, many of the Bank's largest borrowers share this view. The recent involvement of the Bank in operations supporting big client countries willing to evaluate and reform their systems of housing subsidies (such as Brazil, the Islamic Republic of Iran, Mexico, Morocco, and Russia) reflects a belief by both the Bank and its borrowers in a more pragmatic vision of housing subsidy reform in which political economy considerations are fully taken into account.

6
The World Bank's Direct Involvement in Low-Cost Housing

Most of the World Bank's initial low-income housing projects were in capital cities. They attempted to show that basic housing services, such as shelter, water, and sanitation, could be provided at much lower cost than the housing then being provided by the public sector. The objective, in many ways, was to show that in rapidly urbanizing, low-income countries, very basic shelter designs that were affordable could be provided on a larger scale. While this may seem a relatively straightforward notion now, at that time there was considerable resistance to it. Public housing agencies in most developing countries produced expensive and heavily subsidized housing that met only a fraction of demand.[1] These projects also provided an alternative to demolishing squatter settlements, which was being done in many developing countries at the time. Peru was one of the early countries to carry out an early sites-and-services program, as discussed in box 6.1.

In a number of countries, private sector emulators provided sites on legally owned land with few or no services, and often illegally subdivided the land. Some middle-income countries, including Brazil and Mexico, partially incorporated sites-and-services policies into their low-income housing strategies. Nevertheless, with some exceptions, sites-and-services projects failed to go to scale as a low-income housing option in the poorest countries.

From the mid-1950s, slums began to grow beyond city centers, to the periphery of cities. As land became scarcer, slum dwellers began to occupy environmentally vulnerable and hazardous areas. In response, the Bank started lending for slum upgrading projects. The Bank launched these projects in the late 1970s and 1980s, which included some successful large-scale projects in the East Asia, notably in the Philippines and Indonesia, as detailed in box 6.2.[3] During the 1970s, slum upgrading projects had the second-largest share of urban lending, over twenty percent. Upgrading projects countered the slum removal philosophy with the paradigm of upgrading in situ. Under this approach, settlements were relocated only when necessary in order to address hazardous environmental or other conditions. Given

Box 6.1 Going to Scale with Sites and Services in Peru[2]

In 1975, the leftist military regime of Velazco Alvarado decided to do something about the booming informal settlements in and around Lima. South of the city, dwellers had already built Villa El Salvador, which housed some 4,000 families in a well-designed settlement with clusters of blocks organized around recreational and service areas. The design was reached through discussions between an ad hoc government agency and the incipient community. Building upon this experience and armed with a metropolitan development plan, SINAMOS identified a vast area northwest of the city, where plots were surveyed and where thousands of families were relocated from squatter settlements that occupied hazardous areas or areas destined for other uses. The community provided most of the labor, laying out the plots and then building the homes. In addition to providing legal land for the program, the government provided transportation for households, brought in water with tankers, and established a military field hospital. At the time, a small boy living there was asked what he did. "I'm an engineer," he said. He explained that he was helping the surveyors draw chalk lines for the lots and therefore was an engineer. A generation later, the area is an integral part of metropolitan Lima, with a series of low- to-middle-income neighborhoods that have paved streets, piped water, and street lighting. These communities are now the target of a Bank-supported land registration and titling program.

Source: Authors.

the inherent complexity of slums, upgrading projects, however, took a large amount of time and resources to prepare.[4]

Community participation became fairly standard practice in slum upgrading projects in Latin America. Projects in El Salvador (1974), Peru (1976), and República Bolivariana de Venezuela (1998) all relied heavily on active community involvement.[5] Similarly, in El Mezquital in Guatemala (1988) a highly organized slum community initiated an upgrading program, first with the assistance of the United Nations Children's Fund (UNICEF) and then with the Bank. In some ways, the now institutionalized community-driven development initiative had its origins to a great degree in urban projects, which in some cases had notable success, such as described in box 6.2.

As a general rule, however, low-income housing projects undertaken by the state did not empower the poor, and therefore the Bank's approach to involving the community did not replicate or become institutionalized in the

Box 6.2 Sustainable Slum Upgrading in Indonesia

The Kampung Improvement Program (KIP) started as an Indonesian initiative in 1969. The Bank became involved in 1977 through the Jakarta Urban Development Project, supporting the program through 15 integrated projects that covered 200 communities. It is arguably the largest slum upgrading program anywhere, and ranks among the best in terms of urban poverty relief. Residents are better educated, household sizes have declined, and more residents are employed. Piped water and sanitary education have had a significant impact on water-borne disease and child mortality. Several factors contributed to the program's success: (a) KIP was an indigenous initiative that built upon a long tradition of mutual aid and self help; (b) KIP had strong political support over the years; and (c) multidisciplinary local KIP teams replicated the program, following strict design, engineering, and cost standards. The governor who launched the original KIP was convinced that his staff had to go out into the *kampungs*, talk to the people through the existing political structures, and attain basic improvements in a short period of time at minimum cost. These KIP units, with selected staff from local governments and infrastructure sector departments, carried out detailed planning and implementation of the physical works, emphasizing wide and rapid coverage of the target areas through an integrated package of improvements across the sectors. This set the stage for further improvements by the participating communities. KIP has since been replicated throughout the country, benefiting hundreds of thousands of urban poor.

Source: Authors.

first phase of sites-and-services projects. The result was that the early Bank supported sites-and-services projects became, in effect, low-cost public housing programs rather than an exercise that captured the initiative and imagination of the beneficiaries. In many ways, as shown by Baross (1990), in these projects, the aspirations of enabling and empowering the poor to house themselves remained unfulfilled. In these places, Bank projects helped scale back the costs of the units produced, but the public sector often remained the producer.

Progressive development was a key feature of sites-and-services projects and slum upgrading. In sites-and-services projects, this approach was manifested in a range of options, including supplying just a surveyed plot, supplying a plot with a sanitary core (known as an "embryo" housing unit), and targeting different income levels. Over time, these became solid dwellings and the main asset of most households. Even when this approach was accepted in many places, however, it still ran contrary to official building codes and land use regulations, and involved lengthy discussions and compromises by both sides.

Lessons Learned

Aside from the issue of overall impact on slums and urban poverty, a number of lessons can be distilled in terms of what worked and why. Some broad conclusions are below.

What Worked…

The concept of progressive development that underlies sites and services, upgrading, disaster reconstruction, and other low-income housing is sound. Indeed, it is the way most low-income housing is traditionally built and hence is readily adopted by beneficiaries. Accepting this principle in building codes and land use regulations is key to enabling the poor to provide for themselves. However, many countries still have a long way to go. For instance, secondary cities in less developed countries frequently copy capital city building codes, regardless of their applicability.

Upgrading in situ, when possible, makes economic sense in many country contexts. Though cases of bulldozing slums are less frequent now, some countries still resort to this approach as part of urban renewal programs. Bank experience has shown instead that upgrading does not exclude urban renewal. There are examples of successful urban renewal that involve increasing the density of urban areas to accommodate low- and middle-income households and mixed uses without having to relocate large numbers of slum dwellers.

Relocation, particularly from encroached infrastructure, can also be an effective strategy. In many densely populated cities, transport infrastructure—roads, railways, and canals—is so encroached by slum dwellers that the service degradation exceeds the cost of relocating the families to another site with better facilities. Relocation also makes sense when slums are located on high-risk or environmentally dangerous areas.

Subsidiarity, that is, devolving responsibility and accountability to the lowest appropriate level, is arguably the most critical factor in the success of urban upgrading. Ownership and empowerment are the underlying principles behind successful community-driven development, as there is a direct relationship between the degree of beneficiary participation and the sense of ownership and prospect for ongoing sustainability.[6] Indeed, following Appadurai (2004), many parties now coming to recognize that the empowerment of the poor through such projects is at least as important as the investments undertaken. Though local community groups cannot build and maintain power and water companies and should not be expected to do so, the Bank has recognized that in the right circumstances, greater community involvement, not only for slum improvement programs but more broadly for poverty alleviation efforts, can play a significant role in improving project outcomes.

Finally, the success of the KIP (as discussed in box 6.2) continues to the highlight the importance of mobilizing local political in any slum upgrading or sites-and-services program.

…And What Did Not Work

Despite the success of sites-and-services and urban upgrading projects, these projects encountered problems. Frequently, sites-and-services projects became enclaves of relative privilege in the larger urban environment. They failed to go to scale for a number of reasons, including the fact that as pilot programs, they were exempted from building codes and land use regulations. The policy environment was often not addressed by these projects. Few citywide programs, such as the program in Lima, Peru, were launched, and only later were projects cast with a larger scope, such as the national program in Tanzania.

Most sites-and-services and urban upgrading projects relied on varying levels of community participation, at least involving labor and financial contributions from the poor. For a number of years, debate took place about full cost recovery versus explicit subsidies in shelter projects.[7] Despite success stories of community participation, some projects were still seen as central government endeavors, not as community or local efforts. In such projects, patronage, clientelism, and co-option often occurred.

Sustainability remains a critical issue. Both pilot projects and larger programs assumed that the relevant utilities and urban services would eventually take over maintenance and operation of infrastructure and services. This was improbable in urban areas, where utilities and urban services were poorly managed and covered only a fraction of the city. Once subsidies ended, the level of urban services declined. This is discussed further in chapter 5 of this book.

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:

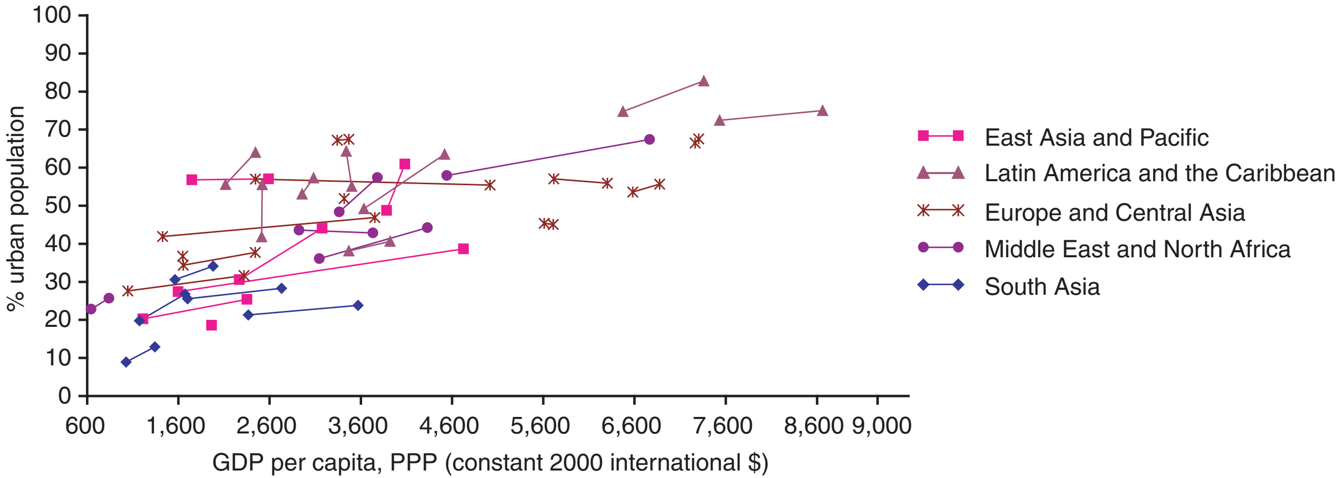
- Successful innovations are occurring with considerable frequency in slums throughout the world;
- The situation of the urban poor in many cities is deteriorating; and
- Bank assistance has markedly shifted away from providing shelter support to slum dwellers, particularly in low-income countries.

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.

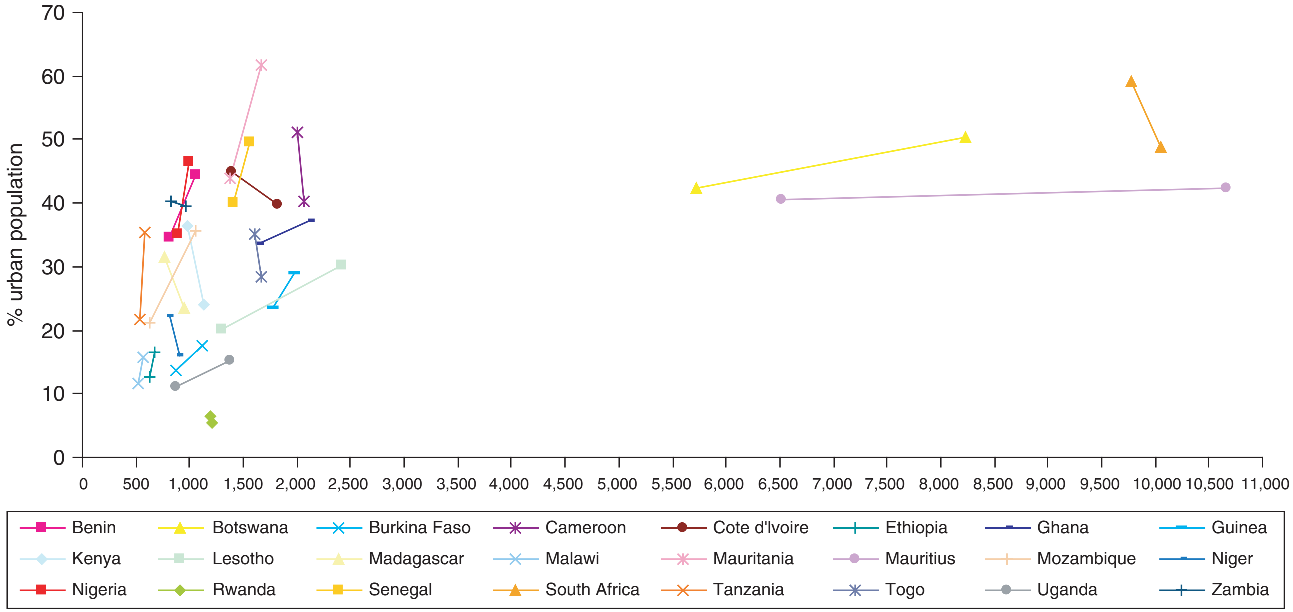
Figure 2.1a Per Capita Income and Urbanization for Non-African Developing and Transition Economies, 1990–2003



Source: Kessides (2004).

Note: The left point of each line segment in the figure shows per capita income and urbanization for 1990 and the right point shows per capita income and urbanization for 2003.

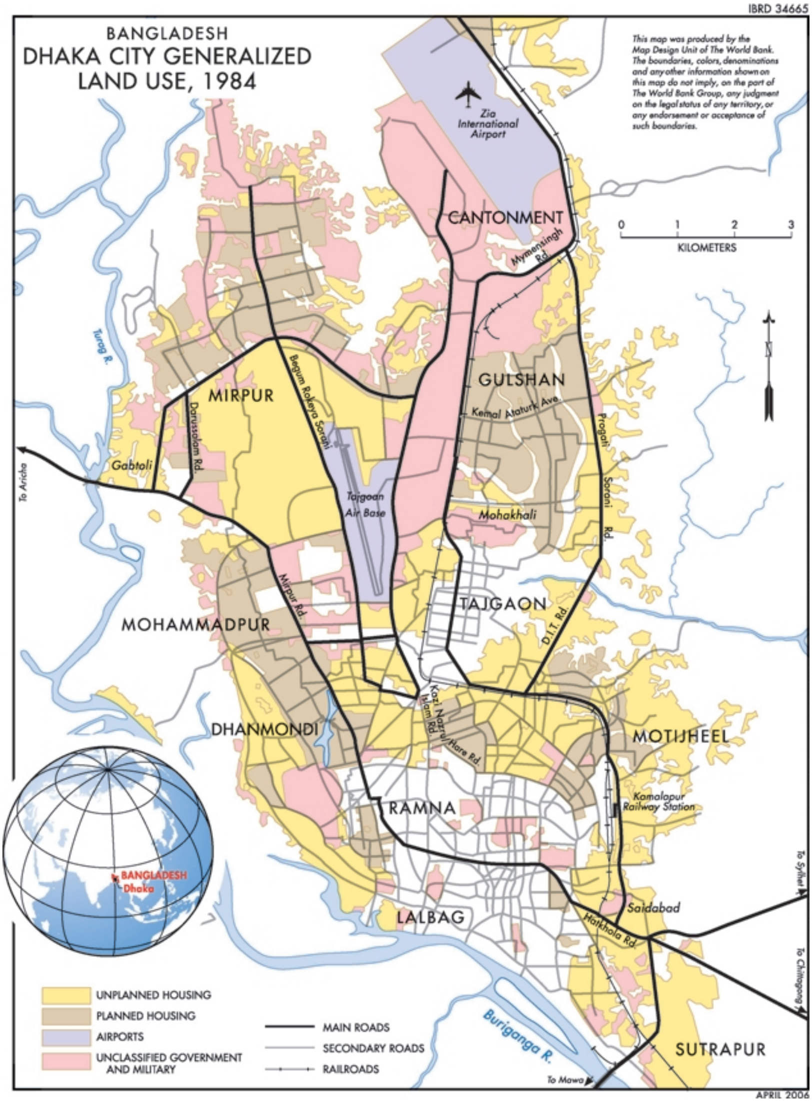
Figure 2.1b Per Capita Income and Urbanization for Sub-Saharan African Countries, 1990–2003



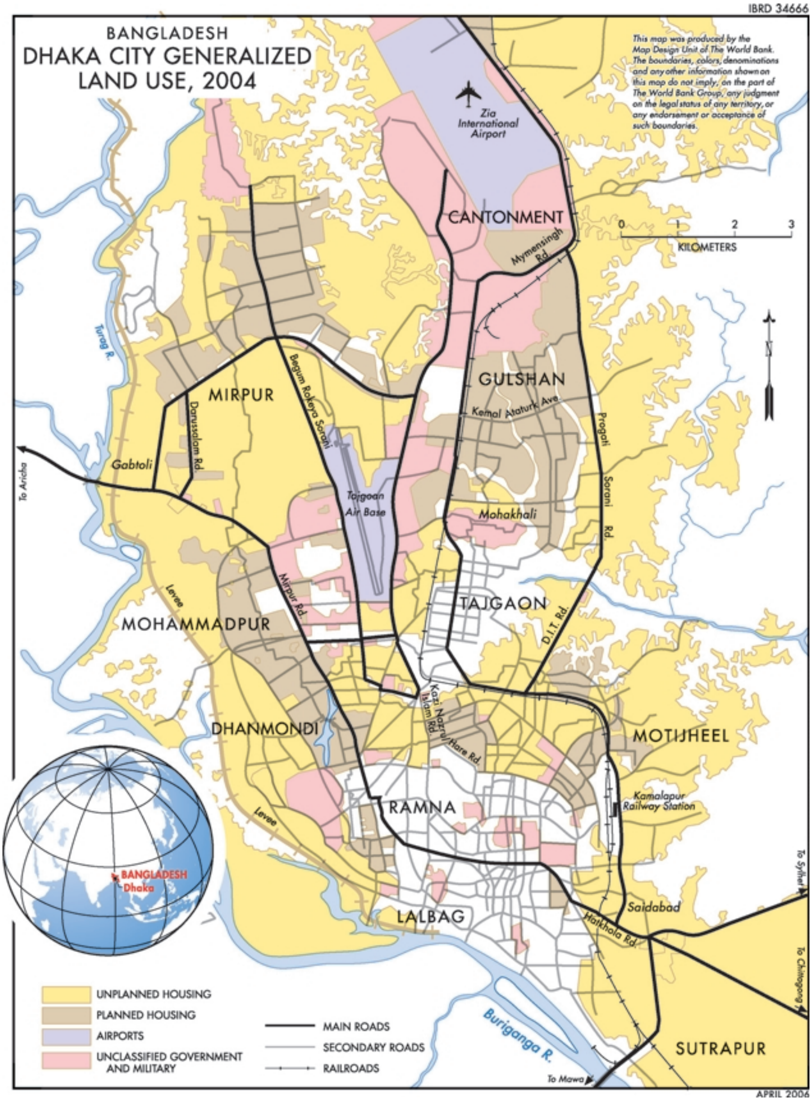
Source: Kessides (2004).

Note: The left point of each line segment in the figure shows per capita income and urbanization for 1990 and the right point shows per capita income and urbanization for 2003.

Map 3.1 Land Use in Dhaka City, 1984



Map 3.2 Land Use in Dhaka City, 2004



Appendix: The Data

The database was constructed using the listing of urban development projects in the OED's "Twenty Years of Lending for Urban Development 1972–92." The list was updated to 2003 using OED's "Improving the Lives of the Poor through Investment in Cities: An Update on the Performance of the World Bank's Urban Portfolio." This listing was supplemented through searches in World Bank databases, Imagebank and the Projects Database, for projects with shelter components. We also consulted with IFC staff to get a listing of IFC projects. We then discussed with OED the range of definitional issues involved in defining a data set and after a number of discussions agreed on a list of projects.

Many of these projects included urban housing as one of many components. Hence, we examined project documents for each loan to find the approximate the amount allocated to the housing component. In cases where there was no clear demarcation of loan amounts for different components, we made an informed estimate based on the project documents.

The loans are identified by the year of approval. This differs from the typical OED classification, which uses the year of completion. This was done for several reasons. First, it allowed us to observe trends over longer time periods. Including loans by their year of closing would effectively have truncated our data to 1978–2005. Second, by using the year of approval for analyzing loan composition and performance, we can accurately analyze the strategy of the shelter lending of that era or decade. For example, many sites-and-services loans approved in the 1970s were still closing in the 1980s, when new loans emphasized housing policy and housing finance loans. Third, using the year of approval allows us to include active loans in our portfolio thus allows us to create a more accurate picture of the current portfolio. Classifying closed loans by their year of completion and active loans by their year of approval would make the data internally inconsistent. In the final analysis, considering projects by either year of approval or year of completion is acceptable as long as it is done consistently. The loan, after all, is disbursed throughout the duration of the project.

Project outcomes were obtained from OED evaluations for loans that were already closed. For loans that are currently active, ratings from the Operations Projects Portal were used. These active projects are rated for development objectives and implementation progress. If a project was rated satisfactory in both categories, it was coded as a satisfactory project. If a project was rated unsatisfactory in both categories, it was coded as unsatisfactory. This is a technique that has been used in past OED reports when the focus was on a new and rapidly growing line of support, such as microenterprise finance (see Buckley and Vogel 1999). Finally, if the project was rated satisfactory in one category and unsatisfactory in another category, then the project was not given an outcome.

One possible critique of this rating mechanism is that a rating for the whole project is not necessarily a proxy of the rating for a subcomponent. However, given that very often the various subcomponents are rarely delineated perfectly, let alone rated separately, we believe that this is the best estimate of project outcomes. Implicit in this estimate is the assumption of a strong correlation between the outcome of the project and the outcome of the components of the project. This, we argue, is a reasonable assumption.

Each housing loan was categorized as one of the following five project types:

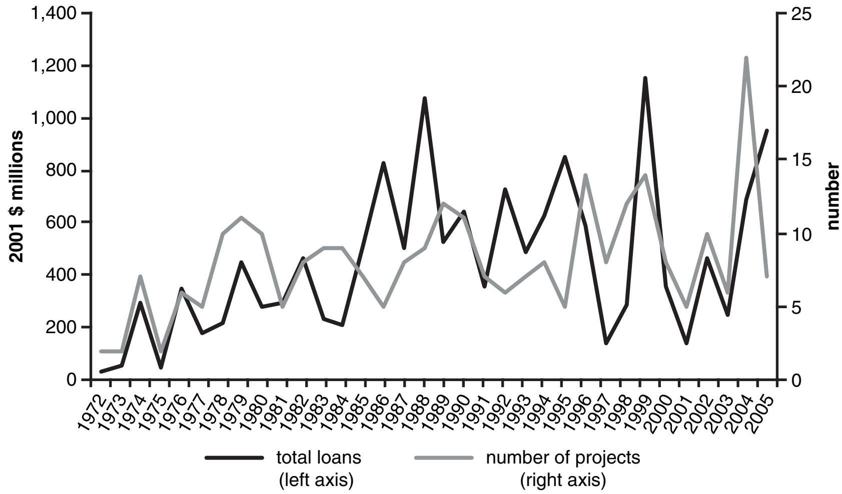
- *Slum upgrading*. These loans include any form of upgrading to actual houses or infrastructure within a slum.
- *Sites & services*. Such loans primarily provide infrastructure needed for new housing developments. These loans range from land development (infrastructure), to self-help programs, to construction of core housing.
- *Housing policy*. These projects include loans that attempt to reform housing and land use policy and the ancillary items necessary for the formation of policy, such as cadastres and technical assistance, to help country governments create and implement policy. These projects also include institutional development loans.
- *Housing finance*. This refers to money given to help develop a sustainable financial market for housing, including finance to support mortgage schemes and subsidies and credits to support mortgage markets.
- *Disaster relief*. These are loans provided in the aftermath of a major disaster that include a housing construction component.

Since some loans had multiple housing components, as defined above, we approximated the amount of loan allocated to each component.

Measuring the Shelter Portfolio

To measure the shelter portfolio, a few assumptions were made (see figure A.1). International Development Association (IDA) loans include only loans that were purely IDA. Loans that were purely International Bank for Reconstruction and Development (IBRD) and combinations of IBRD/IDA loans were counted as IBRD loans. IDA loans were made at an interest rate of 0.75 percent with a 10-year grace period and a 30-year maturity.

Figure A.1 Urban Housing Lending, 1972–2005



Source: World Bank.

Endnotes

Chapter 1

1. Gorbachev's advisers, in a report titled *The First 500 Days,* discussed the reforms needed in the beginning of the *peresroika.* It reforms identified the housing sector as the least efficient in the Soviet economy (Kosareva and Struyk 1993).

2. Data on housing costs in Dhaka and Mumbai come from a Bank report on Bangladesh's housing finance system (World Bank 2004c), and various reports on Indian real estate including *The Economist*, which in the late 1990s identified Mumbai as having the most expensive real estate in the world.

3. For an account of Mumbai, Rohinton Mistry's novel of Bombay during the emergency years of the late 1970s, *A Fine Balance*, also captures much of this perspective. A quite vivid example of extralegal enforcement of ill-defined property rights took place recently in Kenya, where a BBC report from December 7, 2001 by Tom McKinley, "Kenya's Slum Wars," described tension heightened in a Nairobi slum, Kibera, following a speech by President Daniel Arap Moi in October 2001 in which Mr. Moi said that the landlords should reduce the rent since they did not legally own the land. Many were killed in the rioting that followed. Of course, the argument that slum housing markets can function quite savagely is not to say that rental housing markets themselves are undesirable. As Gilbert (2004) pervasively argues, in many circumstances the poor can be expected to be better served in rental markets.

4. For example, a recent study in India by McKinsey & Company (2001) argues that urban land markets in India are the binding constraints on growth.

5. While there has been rapid growth in financial sectors across the world, many remain small. In 1973, more than half of developing countries had financial systems smaller than the World Bank employees' credit union. By 2001, this share had fallen to less than one third. On the other hand, in terms of new housing finance, in recent years such systems have been established in Chile, China, India, Jordan, Kazakhstan, the Republic of Korea, Malaysia, Mexico, Poland, Singapore, and the Baltic states among others. In the 1980s, Colombia was the only developing country that had a functioning housing finance system. Thus, the situation has changed from one where few residents of developing countries had access to market-based mortgage finance to one where most do.

6. Laidler (1976) argues that the widespread use of fully adjustable mortgage rates in the United Kingdom in the 1970s exposed households to such large payment shocks that the government was forced to follow monetary policies that did not allow interest rates to completely adjust to choke off demand. The result is that monetary policy is less effective in controlling inflation. More recently, similar concerns led the United Kingdom to identify housing finance as one of the risk factors involved in its integration with the common currency of the European Union.

7. See Burra, Patel, and Kerr (2003) for a discussion of the effects of a new approach to sanitation in one of India's large cities, Pune.

8. Freedom House reported in 1973 that 46 percent of the countries were "not free." This figure fell to 25 percent in 2002. At the other end of the spectrum, only 29 percent were classified as being "free" in 1973, whereas by 2003, 46 percent were considered free. Between 1986 and 2002, the number of democracies in the world doubled to just over 120. As for decentralization, the *World Development Report* (World Bank 1999) reports that 95 percent of democracies had initiated some form of decentralization process by the year 2000. Finally, with respect to macrostability, 23 countries had inflation rates over 30 percent in 1985 or 1986, as compared to 14 countries in 1999 or 2000. In that period, the median inflation rate fell from 7 percent to 3 percent. On the other hand, in 1986 shocks like those experienced in Mexico, East Asia, and Russia had not been experienced since World War II. Nor had the Great Depression levels of recession experienced by the transition countries in the 1990s affected such a large portion of population (see Buckley and Mini 2001).

Chapter 2

1. There is some debate about the finding that Sub-Saharan Africa has experienced rapid urbanization without accompanying economic growth. Since few censuses are available for recent years, the data used in many such studies have relied on projections of urban population growth from the 1970s and 1980s. By some accounts, these figures might exaggerate the urbanization rates in some Sub-Saharan African countries. For a more detailed discussion of these issues, see Satterthwaite (2004). Even with this qualification, it is clear that in many large African countries, such as Ethiopia, Kenya, and Nigeria, urbanization accompanied impoverishment.

2. See the Housing and Land Thematic Group Web site for a definition of policy-based lending as well as details on all projects data reported here: http://www-int.worldbank.org/jsp/sectors_view.jsp?tab=2&gwitem=474019

3. Our measure of shelter loans includes 34 for $1.7 billion that are not mapped to the urban sector and 45 IFC loans for $1 billion. We use this broader definition for three reasons. First, presentations of our earlier results to the sector board

suggested we may be missing other closely related projects. Second, when we worked with OED to make sure we had the correct universe of projects, they recommended the inclusion of many of these projects. Finally, the mapping is in many ways idiosyncratic and simply the result of changes in task managers. Hence, cumulatively, the broader search was much more time intensive but necessary. The amount of $16 billion is based on commitments to housing components at the time of approval. If we take actual disbursals into account, there has been over $14.3 billion in lending to housing since 1972. The figures given are in constant 2001 dollars.

4. Ravillion (2002) on the first, World Bank (2004) on the second, and Buckley and Mini (2001) on the third piece of evidence.

5. The eight MDGs are to eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality and empower women; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria, and other diseases; ensure environmental sustainability; and develop a global partnership for development. The commitment to significantly improve the lives of 100 million slum dwellers is listed under the commitment to ensure environmental sustainability. For more information on MDGs, see http://www.development-goals.org. For a review of progress on the International Development Goals see http://www. paris21.org/betterworld.

6. Though housing is not considered a sector per se within the Bank, most of the housing loans fall under one of the themes (access to urban services for the poor and housing) of the urban development sector.

7. This amount is gathered from actual disbursals for closed loans and commitments for active loans. If only commitments are taken into account, the Bank lent over $16 billion over the same period.

8. This is just one way to look at the 30 year period. This particular split was motivated by the 1986 review of shelter lending by Mayo, Malpezzi, and Gross (1986), which reviewed the analytical work that informed housing projects until that time. Another way to look at the 30 year period would be to divide it into three decades, which is what we have done in figure 2.3.

9. Admittedly, the period 1992–2005 covers a longer period than the first two periods. This was done to capture the trend and the outcomes since the time of the last review.

10. Of the first 25 projects, 18 were in either African or low-income countries.

11. The 1975 paper is not considered a policy paper because it predated almost all the bank shelter loans. It was more of a clarification of Bank objectives noted in box 1.1.

12. See the appendix for a definition of policy-based lending and details on all project data reported here.

13. The urban development portfolio for Sub-Saharan Africa did show an increase in municipal finance lending as decentralization became a key emphasis

in the Bank's development work. However, it is also possible that there was greater competition for lending to Sub-Saharan Africa in the face of emerging threats in the form of the AIDS crisis, postwar reconstruction, and continuing developmental challenges in child and maternal health. In this scenario, shelter lending was probably seen, and rightly so, as a lower priority.

14. For example, since 1988, Bank support for HIV/AIDS went from zero to more than $2 billion, an essential reorientation of Bank support for an urgent need. Nevertheless, according to OED, only two-thirds of this lending had a satisfactory outcome.

Chapter 3

1. Kabul Urban Reconstruction Project (IDA Cr. 39670).

2. The Urban Management Program was a joint initiative of the UNDP, UN-HABITAT, and the World Bank. These included Dowall (1995) and Dowall and Clarke (1996).

3. The focus of this report was largely on rural land issues.

4. In addition, in 2004 the EU published *Land Policy Guidelines.* However, these guidelines focused primarily on rural land issues. In 1999, the World Bank undertook what was known as the Land and Real Estate Initiative (LARI). This effort attempted to review the portfolio of land projects within the Bank from 1989–99. It made an inventory of projects focusing on land and real estate and evaluated a subset of these projects, finding that their outcomes were similar to that of the Bank's overall portfolio. It also funded a number of papers on these issues and developed an approach to measuring the distortions implied by real estate policies.

5. The Bank's position on the importance of title was not limited to research and policy papers. Many Bank-funded projects also supported this perspective. For example, the most common type of urban land interventions aim to increase security of tenure and the marketability of real property. The most common example of such interventions have been land titling and associated property rights registration programs with, or more commonly without, associated land adjudication exercises. Other interventions include tenure regularization in upgrading programs and dispute resolution and regularization of property claims, especially postconflict and postdisaster countries. About 20 programs involving urban spaces in this category of intervention have been funded by the World Bank since fiscal year 2002. These have been spread throughout East Asia and Pacific (Indonesia and the Philippines), Africa (Algeria, Côte d'Ivoire, and Mauritania); Europe and Central Asia (Georgia, Kyrgyz Republic, Moldova, Russia, and Slovenia); Latin America and the Caribbean (Brazil, Colombia, Peru, and República Bolivariana de Venezuela); Middle East and North Africa (West Bank and Gaza); and South Asia (Afghanistan, India, and Sri Lanka).

6. These include a range of intermediate instruments such as: declarations of possession and future use rights in Colombia; housing permits in francophone

Sub-Saharan Africa; certificates of comfort in Trinidad and Tobago; credit contracts in Bolivia; certificates of rights in Botswana; concession of the real right to use in Brazil; community land trusts in Kenya; temporary occupation licenses in India and Kenya; communal ownership in South Africa; and land rentals in Thailand (Payne 2002; Durand-Lasserve 2003). In some cases, such as Trinidad and Tobago, these alternative instruments have the added advantage of being part of an incremental process of acquiring secure tenure. In Trinidad and Tobago, the State Land (Regularisation of Tenure) Law of 1998 paved the way for the progressive issue of certificates of comfort, statutory leases, and deeds of lease to informal settlers on state land. Moving from one step to the other required increasing documentation and investment on the part of both the settler and the government. A similar model has been under development in Namibia since the late 1990s and proposes a continuum comprising starter, landhold, and freehold titles (Christensen, Hoejgaard, and Werner 1999).

7. A publication on Street Addressing and Urban Management (Farvacque-Vitkovic et al. 2005) was published in English and is will be published in three other languages.

8. This is a conclusion the Bank also reached in relation to rural land in Deininger 2003.

9. The use of this tool requires careful mitigation of risks through various measures including multiple valuations, consideration of spatial alternatives, timely submission of regulatory applications, early practice of full disclosure, thorough title searches, social and cultural research related to land claims, regular site visits, baseline population surveys, careful compliance with all statutory procedures, legal review, and counterpart training.

10. In the Indonesia Surabaya Urban Development Project, for example, despite stated objectives, land tenure issues were largely unaddressed. Interdepartmental disputes and coordination problems were cited as contributing to the delays in allocation of building permits and land certificates for plots and kiosks. Similarly, in the Morocco Land Development Project, limited funds for land acquisition undermined the choice of project sites, as did inappropriate allocation of responsibilities across implementing agencies, leading to a reduction in the number of plots produced and the abandonment of some sites during the course of the project. In the Algeria Low Income Housing Project, the objective to strengthen institutional capacity for tenure regularization was not achieved partly because the State Property Department was not involved in coordinating land auctioning for the project—a necessary condition for beneficiaries to gain conventional titles. By contrast, in the Bank's Urban Property Rights Project in Peru, where substantial attention was given to institutional mechanics and new arrangements, both Bank and borrower performance were highly satisfactory.

11. The law redressed the excessive authority and ensuing conflicts of interests associated with the State Department of Land Management, established a framework for privatization of urban land, and greatly expanded property rights under government leases.

Chapter 4

1. See chapter 15 of the IDB review of housing finance development in Latin American countries (2005).

2. The answer to this question is being addressed by a Financial Sector Report on Housing Finance which was completed at the end of 2005.

3. See Abiad and Mody (2005) for evidence on the timing and amount of financial liberalization in both developed and developing countries.

4. The use of one specific year in the figure is no doubt affected by cyclical factors. Nevertheless, the broader trend of expansion in the latter period and relative stagnancy in the first is clear.

5. The high growth rates of India and China are well known. The situation in the transition countries is also encouraging. For instance, from 1998–2003, the average economic growth rate of the 18 European transition countries was more than double the EU rate. In addition, since 1998 the median inflation rate fell from more than 10 percent per year in the earlier period to less than 5 percent, with 6 of the 18 countries having a less than 1 percent rate in 2003. Finally, EBRD reports that by 2003, only three of the 18 countries had "well functioning financial systems" and but four others had almost achieved this status. Nevertheless, it also reports that all of the 18 transition countries, except Russia, had significantly improved their financial system, typically having made substantial progress on bank recapitalization and auditing and supervision, and with a significant presence of private banks and little to no preferential credit. A decade earlier, the "average situation" in the same countries, again according to EBRD, was one of dictated interest rates significantly influencing the allocation of credit, little confidence in the systems, and correspondingly little private sector involvement. In short, while there is a way to go, there has been remarkable progress on macro/financial conditions.

6. To place this forecast into context, in Greece, Ireland, Portugal, and Spain, housing finance grew at more than 15 percent per year over 1992–2002, according to Suarez and Vassallo (2004), and, as noted in footnote 48 of their paper, conditions for mortgage lending have improved much more rapidly in the transition countries.

7. Bank loans to Argentina, and two to Russia, in a volatile inflationary environment failed, accounting for a significant share of the unsatisfactory housing finance loans.

8. Much of this section is based on Buckley and Van Order (2005).

9. See Englund (1999) on Sweden and Koskela, Loikkanen, and Virén (1992) for Finland and other countries. The Bank has supported public housing finance institutions in Jordan, the Republic of Korea, and Lithuania. In addition, two of the most successful private-sector-oriented loans—to Ghana and India—both had large public sector involvement at the time of the loans.

10. The U.S. system was established in response to the Great Depression; the role of bond-based finance was modified after the savings and loan crisis. The

German system, according to Goedecke, Kerl, and Scholz (1998), arose in 1769 out of the pressing need for credit, especially in Silesia following the Seven Years' War. The Danish system was established following a large fire in Copenhagen in 1795. The French system, which is only beginning to have bond-based lending (but which is nevertheless the system on which the German bond-based system is modeled) was developed in 1852 in the Credit Foncier de France as a way to fund Baron Haussman's rebuilding of Paris.

11. One of the main changes in this pattern in recent years is the growth of mortgage securitization in a number of countries, such as Spain, that had traditionally relied almost exclusively on a large public mortgage bank. Ireland has also innovated, with various forms of mortgage securitization funding a rapidly growing mortgage market. See Chiquier, Hassler, and Lea (2004) for a more complete discussion of recent patterns of financial innovation.

12. Laidler argues that the widespread use of fully adjustable mortgage rates in the United Kingdom exposed households to such large payment shocks that the government was forced to follow monetary policies that did not allow interest rates to completely adjust to choke off aggregate demand. The result is that monetary policy is less effective in controlling inflation. More recently, similar concerns led the United Kingdom to identify housing finance as one of the risk factors involved in their integration into the common currency of the EU.

Chapter 5

1. An illustrative, and by no means exhaustive, categorization may consider the following groups: direct subsidies to homeowners or renters, from interest rate subsidies to rental allowances and upfront subsidies to ownership; on-site interventions in the form of upgrading or sites-and-services programs; tax cuts directed to certain categories of households; subsidies allocated through housing finance instruments; public rental housing; direct construction of housing units by the public sector; tax cuts in favor of housing developers; and utility subsidies. There is no standard definition of the items that should be included in housing subsidies accounts, nor of the methods for calculating related expenditures. Even in countries such as the United States or France, one can never be sure that all subsides are accounted for in publicly available figures. Thus, it is prudent to consider such figures as lower bounds for total public expenditures on housing subsidies.

2. This approach to augmenting market outcomes stands in sharp contrast to the approaches used by developed countries at the end of World War II. At that time, most developed market economies, particularly in Europe, adopted fairly strict rent control regimes which constrained housing supply and simultaneously undertook active housing production programs. Draconian rent controls often killed market incentives, with the result that the public sector production effectively replaced private producers. Even in the United States, where public

production never reached very high levels, the public sector intervened extensively in the housing market through rent control regulation and a variety of selective credit policies which were "fine-tuned" to help smooth business cycles.

3. For example, promoting homeownership has been an explicit policy choice in most countries of Latin America. Nonetheless, the rental market still houses between 20 percent and 40 percent of households in Argentina, Brazil, Chile, Mexico, and Peru, and data on those countries show that the homeownership rate among the poorest households (first quintile) has declined in all those countries during the last decade (World Bank, 2004). In other regions of the world the rental sector is by far the dominant tenure status for the poor ; yet a negligible proportion of housing subsidies is reaching them.

4. Gilbert (2004) mentions 7–10 goals for the upfront subsidies programs in Chile, Colombia, and South Africa.

5. Implicit subsidies are not a Moroccan problem alone. In fact, implicit housing subsidies are often as large as explicit subsidies. A study by Modeen (2002) shows that in Lithuania, implicit subsidies amounted to more than double the explicit housing subsidies.

6. See Gilbert's (2004) discussion of this in Latin America.

7. The Bank could address this problem by encouraging sector-wide evaluations of the whole subsidy system. This piece of information is currently missing in many countries, but potentially yields high returns. Such reviews, by their very nature, help in assigning more precise objectives to particular subsidy programs and getting rid of or adjusting conflicting or partially duplicating subsidy programs. Furthermore, there is a need for independent and rigorous evaluation of the impact of housing subsidies and development of mechanisms for the results of such evaluations to feed into the design of the subsidy program.

Chapter 6

1. "As recently as 1975, there were few countries willing to contemplate the types of projects that the Bank was sponsoring. Now, [i.e. 1980] the Bank has helped finance more than thirty-two projects in twenty-six countries and has projects in preparation in eleven additional countries" (Churchill and Lycette 1980, p. 16).

2. Peru, First Sites and Services Project (P007959), and Burkina Faso, First Urban Development Project (P000257).

3. The Tondo Foreshore project, in Manila, was the first large scale urban upgrading project.

4. One of the main pieces of performance evidence presented in the Bank's Urban Sector Paper, "Learning by Doing," was to demonstrate that this perspective was inaccurate.

5. A wide range of methods of community participation exists, including local comanagement groups, comprising project staff and community representatives

to manage upgrading activities, community action planning, in which the community participates in the preparation of a neighborhood improvement plan, and social assistance outreach programs, in which communities are mobilized at all stages of implementation and beyond.

6. Many of the most successful sites-and-services and urban upgrading projects relied largely on community participation. In El Salvador, the sites-and-services projects with FUNDASAL demonstrated how participation eventually led to well-developed communities with a strong sense of belonging. In Angola, a striking example of ownership and empowerment took place during preparation of the Lobito Benguela Urban Environmental Rehabilitation Project (1990). The simple introduction of know-how in building latrine covers spawned a local industry based on local resources that produced over 2,000 covers before the loan was even signed. In Asia, the Tondo Foreshore project involved the community in both slum upgrading and sites-and-services projects; the community was empowered and thus developed into a strong local political force. The Kampung Improvement Program in Indonesia was supported by several Bank projects but retained a strong sense of local decision making and local construction methods.

7. There is an emerging consensus that while full cost recovery might not be possible in some slum upgrading programs, every effort should be made to ensure transparency and targeting.

Chapter 7

1. These figures compare to 71 percent and 75 percent satisfactory outcomes for all Bank lending and projects over the same period.

Appendix

1. In the last decade, 56 percent of the total loan amounts were from active loans. Including active loans improved the overall shelter loan ratings from 66 to 79 percent because all but one of the active loans which had ratings were considered satisfactory.

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The current magnitude of urban population growth is unprecedented. In 2008, the world's population is expected to become primarily urban. By 2020, the population of cities in developing countries is expected to increase by more than 1 billion. These figures suggest 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.

Thirty Years of World Bank Shelter Lending: What Have We Learned? reviews how $16 billion of World Bank shelter assistance lending since the 1970s—278 loans to more than 90 countries—has performed and how the policy environment for such lending has evolved. While shelter projects have performed quite well according to independent evaluations, this review identifies lessons learned and makes a number of recommendations for how the World Bank should respond to increasing demand for shelter assistance.

This book will be of special interest to urban development specialists, economic policy makers, and land policy administrators.

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ISBN 0-8213-6577-0