

Financing Urban and Housing Development in Latin America and the Caribbean¹

by Ricardo Jordán

1. REGIONAL CONTEXT FOR ECONOMIC AND SOCIAL DEVELOPMENT

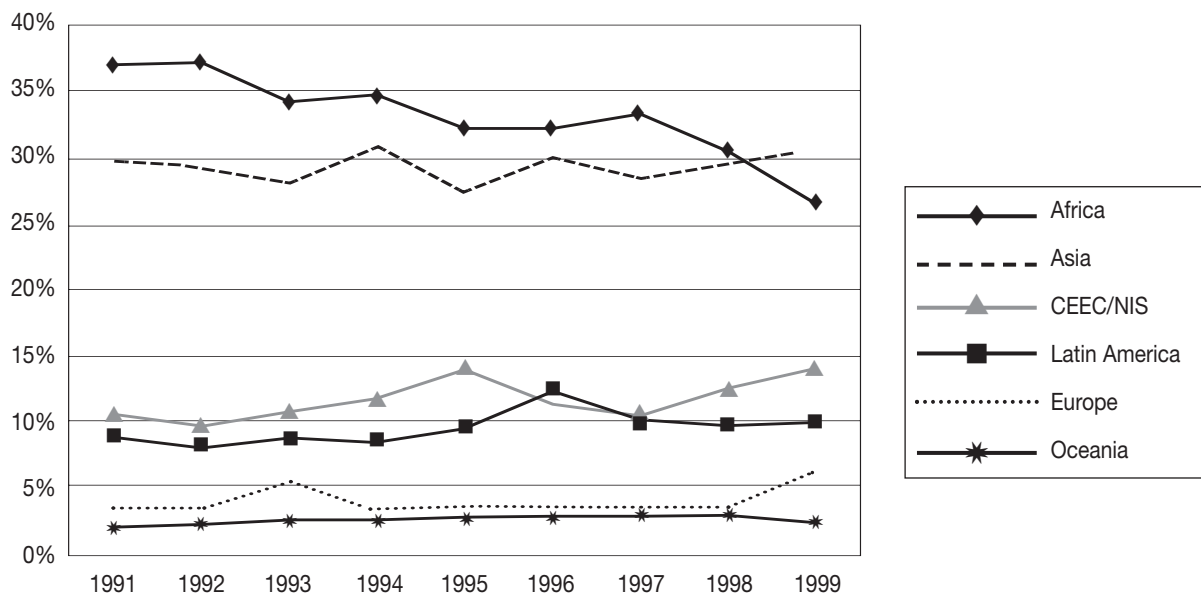
The context of the Region of Latin America and the Caribbean is characterised, without doubt, by globalisation. In the language of the *Comisión Económica para América Latina y el Caribe* (CEPAL) [Economic Commission for Latin America and the Caribbean] and international organisations, this phenomenon is in fact asymmetrical

globalisation, in as much as it differs between sections of the populace, between in-land territories in the regions and between countries. This globalisation is characterised by three important processes: (a) opening into global markets; (b) the flow of business and investment between the countries in the region and the rest of the World; (c) a still incomplete labour market. The context is also characterised by high capital mobility- also called capital volatility; the growth and extension of information technology; an important restructuring of

the role of the State - many countries are embarking on determined reforms in judicial, health and urban contexts; interdependence, and economic and environmental vulnerability.

Upon carrying out an economic assessment of the situation in Latin America and the Caribbean, the following figure amongst its most outstanding features : (a) slow and unstable recuperation of economic growth (after the lost decade of the eighties; some members of CEPAL have already declared

GRAPH 1
Distribution of the Official Development Assistance by Regions, 1991-1999
(Percentages over the total net assistance)



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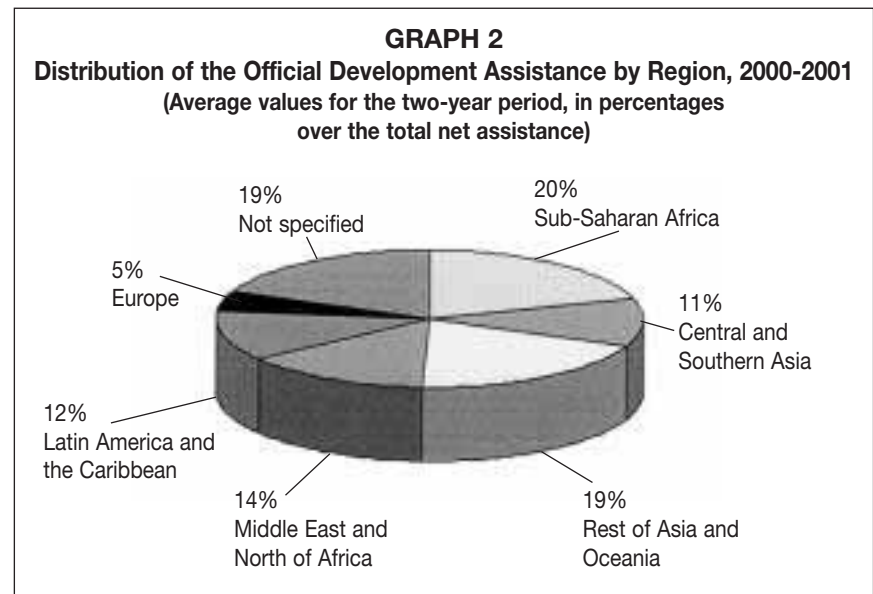
the first three years of the new decade as lost, but in my opinion they are being unduly pessimistic in this case); (b) strong macro-economic control, but continuing institutional vulnerability and instability due to financial crises; (c) growth and diversification in exports, but with greater dynamism in imports, and although there are always exceptions, an unfavourable commercial balance for the majority of countries in the region; (d) significant investment flows originating from outside the region, although concentrated in only a few countries; and (e) extractive export profile in environmentally sensitive industries.

As for social assessment, the region of Latin America and the Caribbean presents: (a) a slight reduction in poverty, but with a deterioration in the distribution of wealth; (b) an increase in social spending, but with a detection of benefits in high-earnings sectors; (c) the extension of democratic systems, but these still remain fragile due to the increase in unemployment and instability - suggesting that internal democratisation in the countries is not easily achieved, rather political democratisation exists more than democratisation in the running of the country itself; (d) respect for equality of sexes, with notable improvements in this area, and also for ethnic and cultural diversity; and (e) a significant expansion in international migration.

2. EXTERNAL FINANCING OF THE REGION

2.1 Official Development Aid

If the question of external financing is considered from a conceptual perspective, one could say that multilateral financing between the region's countries and the rest of the World fulfils, in general, three basic functions: (a) to guarantee access to those countries that have no financing or have difficulty in attaining financing; (b) to partially compensate for the cyclical behaviour of private capital, and as such, in some sense act as a subsidy so that these



cycles are not so severe; and (c) to support the provision of public assets, including infrastructures and urban development. Regarding this last point, it remains to be seen if housing should be treated as a public or private commodity.

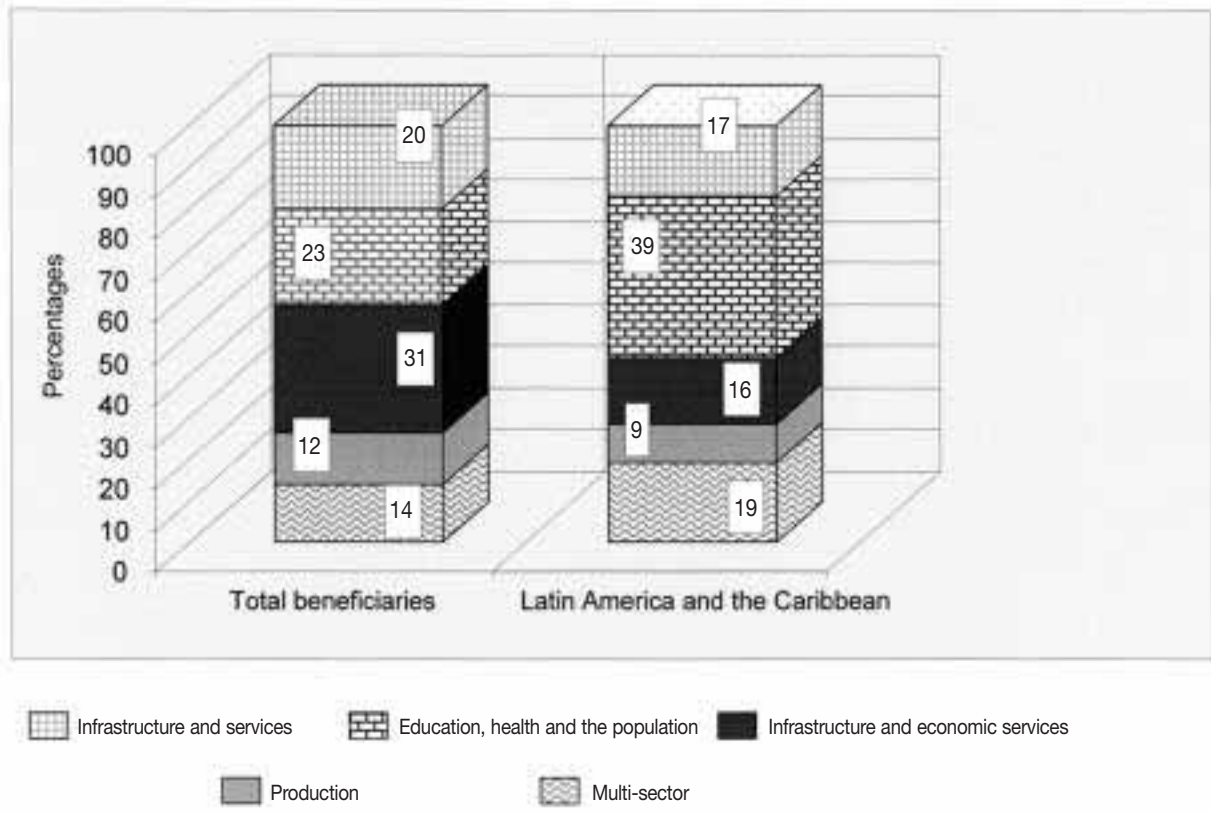
The volume of *Asistencia Oficial para el Desarrollo* (AOD) [Official Development Aid] in 2001 was poor, constituting scarcely 0.22% of the gross national product (GNP) of the donating countries. This figure falls considerably short of the target figure of 0.7% which had been contemplated by these countries. A sizable disparity exists between donating countries: Denmark contributed 1.03% of its GNP, the European Union 0.33%, and the United States scarcely 0.11%. Latin America and the Caribbean received an amount of AOD close to US \$5,000 million, approximately 0.34% of its GNP. It remains to say that the sectors of housing and urban development and infrastructure, in general, receive little AOD, and as such the important task of capturing a greater fraction is still pending. Substantial disparity is also apparent between regions and recipient countries; to give an example, amongst the first 10 recipient countries, there is not one from the Latin American region. Figure 1 shows the distribution of AOD per region during the 1991-1999 period, while Figure 2 shows the

averages for the years 2000-2001, Latin America and the Caribbean being a medium recipient of AOD.

With respect to the distribution of AOD by objectives, it should be noted that education, health care and marginal areas receive 39% of the official aid, whilst infrastructure and diverse social services receive 17%, and infrastructure and economic services 16%. Production uses only 9% of AOD. Figure 3 shows this sectorial distribution relative to Latin America and the Caribbean for the year 1999, comparing it with the sectorial distribution of the total AOD in relation to all the regions.

In the Latin American zone, the principal countries that received AOD in 2000 were Nicaragua (US \$562 million), Bolivia (US \$475 million), Honduras (US \$449 million) and Peru (US \$401 million). As a percentage of the gross national income of the recipient countries, AOD represents fundamental support in countries such as Nicaragua (27%), Honduras (8%) and Guyana (16%). It should be noted that 72% of all AOD directed to Latin America and the Caribbean consisted of donations, whilst conditional or partially conditional aid fell in the last decade. Figure 4 presents the evolution of AOD for Latin America and the Caribbean in

GRAPH 3
Latin America and the Caribbean: Distribution of the Official Development Assistance by Sector, 1993
 (Percentages over the total)



the period 1990-2000 separated according to type (conditional, unconditional, partially conditional, and technical cooperation).

2.2 International, private capital flows.

Private, international capital flows represent 86% of the total capital flow which reach the developing countries, six times more than AOD. Until the recent economic crisis, these flows increased in a constant manner, encouraged by privatisation and the opening of the countries to direct foreign investment. This type of financing is concentrated in very few countries - something similar occurs with AOD - with China, Mexico, Singapore, Malaysia, Argentina and Brazil being the principal destinations. Great disparity may be observed in the evolution of these flows.

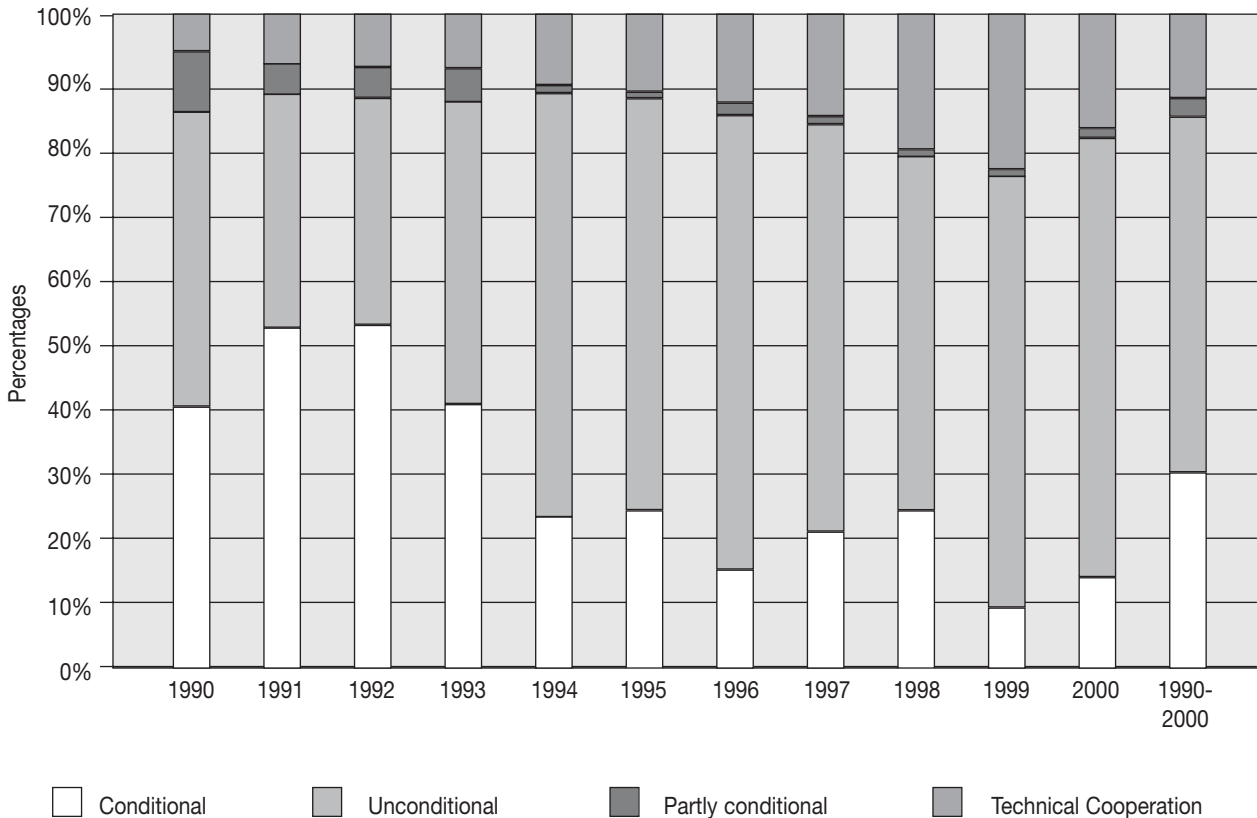
Thus, in some countries, Argentina and Bolivia for example, the annual average reduction in these flows between 1991 and 2001 was greater than 60% and 25% respectively, while in the same period, Mexico and Ecuador registered an annual average increase of 50% and 45% respectively. This is another way in which we may measure how asymmetric globalisation is currently affecting the countries of the region. On the other hand, in the Nineties there began to be a tendency for direct foreign investment to turn away from extractive activities and towards services; this trend, which continues to the present day is ushering the countries into an important dynamic of change.

2.3 Proposals for the management of international capital flows

The following are included as proposals for the management of international capital flows at regional level:

- (a) Access by a greater number of countries to the multilateral banks, producing parity between countries in terms of access to multilateral banking.
- (b) Fulfilment of the objectives of *Asistencia Oficial para el Desarrollo* which, as has already been shown, is far from the figures that the donating countries are currently registering.
- (c) Explicit redefinition of the role of conditionality, in an attempt to reduce it

GRAPH 4
Latin America and the Caribbean: Distribution of the Official Development Assistance by Modality, 1990-2000
 (Percentages over the total)



and, moreover, respect for the autonomy and the diversity of development strategies.

- (d) Establishment of a multilateral framework for the management of countries' problems of extreme debt.
- (e) Greater participation by the developing countries in the multilateral financial institutions, particularly trying to increase the participation of the recipient countries in the proposals to improve these institutions.
- (f) Greater macro-economic co-ordination between countries.
- (g) Strengthening of local, regional and national institutions to access

international finance and achieve a healthy economic situation and financial transparency.

- (h) Reinforcement of the role of national development banks and multilateral banks in order to support private investment.

3. URBAN DEVELOPMENT IN THE REGION

3.1 Growth and Urbanisation.

There is an initial concept that deserves analysis: urban transition. According to CEPAL's information, 75-80% of the population in the Latin America and Caribbean region live in cities. That is, the

process of urbanisation, which characterised the last century, and which refers to the transference of people and of the productivity of the countryside to cities, from agricultural areas to urban ones, is a process that has already finished. For that reason, we are now facing what some thinkers denominate as urban transition, which arises as an opportunity for improvements in the standard of life of the population and a reduction of poverty.

In this sense, urbanisation is not considered as a problem, but as an asset that allows an increase in growth and development, and a reduction in poverty. It is at this point where a powerful connection appears, although often overlooked, between urbanisation and the economy. This potential, which we consider exists, is critically conditioned by

the quality of urban management and the national and local policies that affect it.

This is the fundamental starting point for the proposals relating to globalisation and urban reforms. In the first place, the productive restructuring of the countries in the region determines, amongst other things, a change in business and production to centres - referring to city level, urban level- that present market advantages. And here is where the discussion starts about how to generate a means of management that is capable of creating the conditions so that the market is localised in these places. In the second place, the reforms of the public sector will not be sufficiently linked to national development if they are not suitably implemented at municipal level. Fundamentally, in non-capital cities a kind of championing of public management can be seen, based upon greater responsibility of the municipalities in their role as development agents. In this respect, it should be noted that in Cuenca, Ecuador, a public municipal company for urbanisation and housing has just been created. This is a rather atypical case within the region, given that in this city a council with a very long tradition in the management of companies exists, and has just created a local company.

Urbanisation contributes to growth through: (a) the sector itself, through an increase in productivity in output and employment, which is useful when one goes to the bank to ask for finance; (b) the financial sector through mobilisation and intermediation in savings and investment, allowing the accumulation of wealth through the consolidation of a strong urban property development sector; and (c) fiscal flows, because it is precisely in urban areas where a large part of fiscal tax is generated.

3.2 Urbanisation and market

The urban policies relating to land use and investment in housing have important ramifications in the economy and in national development as demonstrated by the Asiatic crisis. The Asiatic crisis in the Nineties was produced by the collapse of

the financial markets provoked by the lack of financial regulations and by the existence of weak sectorial policies. A known sequence exists that explains why a crisis in the property development sector may arise, which is:

- (a) Lack of development in the property sector: produces a lack of land and increases speculation.
- (b) The previous point has an impact upon the financial markets: it produces recession and reduction in investment.
- (c) Due to new national strategies, a link exists between urban economic activities and the performance of the macro-economy and also the micro-economy.

An urban strategy for growth and the reduction of poverty is based upon four aspects:

- (a) Management of public services, both supply and demand.
- (b) Policy reforms and institutional change.
- (c) Partial regulation with increased development of incentive systems, paradigms for associations between the public sector, private sector and informal sector; new sources of finance; and something that is being discussed at urban level, the recuperation of capital gains which are intrinsically related to investment in the public sector.
- (d) Association between national and local policies, which will produce dual responsibility relating to the question of city management and development.

3.3 Financing infrastructure and urban development

The infrastructure of local management is a basic factor in economic development and reduction of poverty. The infrastructure is not simply a pending need, but rather a basic factor, especially in Latin America

where the urbanisation rate is around 75% and a high level of brute internal income is generated in the cities.

The measure of financial efforts alone for the mobilisation of additional resources does not in itself resolve the deficit of resources for the financing of local infrastructure; an active private sector is a fundamental requirement in this case. In this sense, greater links are advised between the public and private sectors. Similarly, in countries with greater relative development, private savings, principally pension funds, are an important source of finance.

A complementary system between the public and private sectors could be structured in such a way that the private sector participates in the administration and offering of public services, through grants, BOT (*Building Operating and Transferring*) projects - a way of financing investment in infrastructure which originated in France, construction works, and sub-contracting. For its part, the public sector takes care of the aforementioned partial regulation, fiscal administration, partial financing, free services, and community representation. In this way, the link is strengthened between economic growth and development and the decrease in poverty.

3.4 Financing for local development

According to recent studies by the World Bank, the principal source of finance for local development is the surplus generated by positive, sustainable cash flows, which are the basis for receiving credit. Cash flows have as an input the savings generated by operations in the municipalities, utilities, depreciation of public service companies, and users' and developers' tax payments.

Access to credit has been prohibited for so-called sub-national governments. Recently, the *Banco Interamericano de Desarrollo (BID)* [Inter-American Development Bank] has been working on the way in which sub-national governments may access credit; in general, they have been granted credits, but only with the guarantee of the State.

Access to credit depends on credit capacity and the degree of development of the financial sector. Credit capacity depends on: (a) cash flow; (b) the ability to give guarantees; and (c) institutional operative capacity - often, at municipal level, scarce institutional capacity exists, and considerable efforts are being made for local level training in order to generate this capacity. As far as the financial sector is concerned, its degree of development depends on macro-economic stability, banking regulation, the existence of financial institutions, the capital market and, fundamentally, on competitiveness as a process where all of these variables occur.

The financial scenarios that one finds in Latin America from a local government viewpoint (although the same occurs at a national level) are the following:

- (a) Low credit capacity and a weak financial sector. When this combination exists, what is required must be translated into direct technical assistance and non-refundable aid; these institutions cannot be asked to return significant quantities of resources in any way.
- (b) Good credit capacity, but insufficient financial sector development. In this case, the policy will be to inject dynamism in the sector, and extend the financing time periods.
- (c) Developed financial sector and low credit capacity. In this case, the policy will be one of institutional strengthening, risk reduction, and municipal reforms and adjustments.
- (d) Good credit capacity and financial sector development. This is the best of all the situations, but that does not mean that there is less need for its support and maintenance. In these cases, it is possible to imagine a municipal or local credit market; a self-sustaining strategy - allowing these institutions to in some way become sustainable over time and the creation of so-called local development funds.

3.5 Financing Strategies

Amongst finance strategies, the following may be considered:

- (a) Creation of credit mechanisms and not just international financing. The barrier has to be crossed of having to depend solely or principally on external finance, and here credit banks, and banks in general have a very important role.
- (b) Participation of the private financial sector in the assigning of credit and acceptance of risk. It is not just the public sector financial entities that should be appealed to in order to cover the demand for capital, rather there should be some kind of combination of responsibilities with respect to credit.
- (c) Solution of cash flow problems, guarantees and institutional capacity. The inappropriate use of financial instruments has to be overcome along with the indiscriminate demand for technical management assistance in the region.
- (d) Separation of subsidies from credit operations. Subsidised interest rates must not be always solicited, even when this possibility is available.
- (e) Determination of the specific nature of obstacles, market flaws and optimal design solutions. This is a call to avoid the transference of instruments and strategies without understanding the originating causes. This is very important from the perspective of treating the case as a process rather than a static situation from one day to the next.
- (f) Designing strategies for the local financial market to achieve more active participation. This is done to avoid the creation of financial agencies and institutions that are unsustainable over time.

It is important to underline that the consideration of these elements does not mean that they should all be implemented;

rather they are elements that may be evaluated in relation to each case with the idea of choosing that which is perceived to be the most suitable.

4. THE HOUSING SECTOR IN THE REGION

4.1 Housing situation of the region

No great changes have been observed in the housing situation of the region. Despite the efforts, there are still important housing deficiencies. The housing needs in the region are estimated at approximately 38 million units. 45% are quantitative deficiencies and the rest are basically related to improvement requirements. In general, few programs have been developed which address the requirements of new and deteriorated properties.

Population growth has slowed down in the region - as in, for example, Chile - and this has created a new form of housing association which has diversified the demand. The demand of traditional family models is starting to evolve and there are cases, for example, where the head of the family is a woman, and this is a very interesting issue which incorporates the gender issue into housing policies. In addition, there is a creation of demand associated with replacement needs, explained by the historical lack of maintenance programs and measures. Efforts are starting to be implemented through historical recovery programs in large cities with a significant cultural heritage and patrimony.

The supply of public and private housing has not increased greatly due to the decrease in the expenditure on housing, mainly from the Eighties, with a significant time lag in existence. Several countries still implement housing policies that are based on programs that obtain resources from social security and salary related contributions. Other programs have employed alternative strategies, based on obtaining external resources, including those resources from multilateral and bilateral cooperation financial entities.

These new methods differ from the national funds since they are associated to more realistic standards, for example, the progressive housing and service batch programs.

Therefore, the housing needs have increased, the demand has diversified and the policies are trying to address, on the one hand, the need for a new conceptual evaluation - the way of achieving a harmonised and efficient solution - and, on the other hand, the discovery of new complementary financing methods, also including traditional methods.

4.2 New approaches to housing and property financing policies

The new housing policies have started to appear as a consequence of the adoption of more complex standards that are focused on progressive integral development practices with the participation of housing as a vital element, i.e., properties are not considered as constructions with walls, ceilings and floors, but as an environment that is an integral element of the city.

The traditional housing financing models based on loans with nominal rate interests, fixed payments in inflation scenarios have not succeeded in including the poorest sectors of the population as potential mortgage loan customers. Therefore, the current housing policies are being based on three main factors: State subsidies, prior savings and mortgage loans.

The problems that have been identified in relation to these factors are:

- (a) Regarding subsidies, the solutions to the problems encountered address the need to ensure adequate focalisation and transparent selection mechanisms are implemented. The CEPAL is currently providing technical assistance to Colombia, in order to overcome these problems which have been present in the direct subsidy system implemented in the country.
- (b) In relation to past savings, problems have arisen when realistic payments

have been requested; therefore, work is required in this area. This requires a solid financial system that ensures minimum levels of profitability, safety and liquidity of savings funds. In the case of Chile, assets and liabilities are expressed in a common accounting unit whose value is adjusted in accordance with inflation.

- (c) Regarding mortgage loans, two difficulties have been encountered: the lack of medium and short-term funds and the underdevelopment of the financial market.

It is important to highlight that in some countries, the development of long-term capital markets and secondary mortgage markets - especially securitisation, has been based on social security reforms existing in other countries. In addition, sources of medium and long-term liquid resources have been created, which has supported the possibility of financing the housing sector. Another important initiative has been the new mortgage loans offered by commercial banks, and the creation of warranty schemes, insurance and subsidies for transaction costs.

Bad debt is an important issue that is being addressed. The efforts are oriented towards the implementation of more realistic standards and maximum loss insurance that safeguard the mortgage loans. During the last few years in the Caribbean countries, financial market incentives for supranational housing have been implemented, generating a mechanism that groups different countries. In this sense, a critical group has been created to carry out large scale operations.

4.3 Adjustments and pending housing agenda

In the framework of globalisation and terminal urbanisation, "housing policy" is observed as a list of standardised recommendations but has not been able to reflect the current diversity, situations, problems and potential difficulties in cities, and in particular, housing issues.

Therefore there is a need to implement a policy that allows the definition of a group of minimum standards in a highly selective nucleus of policies; and maximum flexibility to consider each case on an individual basis. This is very important for the transfer of private capital to the sector.

The State focuses on the coordination problems between the demand and supply of homes, not necessarily through subsidies, but often through particular institutional agreements, which are capable of improving the negotiations between demand and supply agents. It is very important to take into account the concern for the protection of basic needs of the underprivileged sectors of the population, considering housing as a fundamental part of human rights.

In this sense, the integral housing policy being discussed must consider many different elements, such as safe tenure, infrastructure, and all related services. The nucleus of the integral housing policy includes the following aspects:

- (a) The creation of a Welfare State that can guarantee the efficient operation of markets and community organisations.
- (b) The concentration of actions related to the supply of solid medium-term factors - land and finance - to achieve a greater coherence in the urban expansion and infrastructure. In countries like Chile, access to land by the housing programs with subsidies for the underprivileged sectors of the population is one of the current critical issues, due to the tight link with urban expansion, which surpasses the housing problems and issues.
- (c) The coordination of housing production and economic, social and environmental development objectives, mainly in relation to the construction of the environment to decrease poverty and create employment.

Therefore, this new focus on the existing housing policies involves changing the point of view on housing as a commodity

provided by the market to a new concept, where housing is considered as a vital economic, social, cultural and family commodity, without forgetting its value as an economic asset.

The short-term focus on policies is explained in the following aspects:

- (a) The explicit incorporation of financing alternatives for the improvement and expansion of housing, acknowledging the growing qualitative problems in the housing deficit.
- (b) Attention to supply characteristics as a complement to demand subsidies. We are now used to the injection of resources in the form of subsidies during the last few years, as a measure to satisfy the effective demand. However, the supply side has been ignored. The objective is to meet the supply requirements with a motivated and capable business and technological base in the low cost housing market, taking into account the importance of expanding the markets.
- (c) The need to ensure land is available at levels that are compatible with the requirements and costs of state-subsidised housing. Therefore, the creation of a land policy that is based on the realisation of capital gains generated by the investment in the infrastructure and improvement and densification programs is required.
- (d) The implementation of housing and community area maintenance and recovery programs that lead to a decrease in the obsolescence and deterioration of property and equipment.
- (e) The need to achieve, beyond the flexibility of design, housing mobility of the different sectors of the population. The application of subsidies to the purchase of second-hand properties and the creation of a secondary market of state-subsidised homes is a compliment that has an effect on the equilibrium between *stocks* and *flows*.