

Improving urban shelter strategies in developing countries

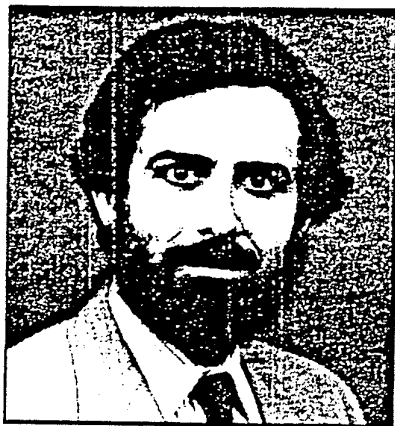
Housing policies in many developing countries are inefficient and inequitable and the wrong solutions are often applied to the problems, says Stephen Malpezzi

CITIES in developing countries are growing at explosive rates by historical standards — from 2% to 10% a year. By the year 2000, 20 of the world's 25 largest cities will be in developing countries and their total urban population will exceed two billion. By any definition, most of the people in these cities are poor. In terms of one specific definition of absolute poverty, in 1980 over 200 million city dwellers lived below a level satisfying basic nutritional requirements; by 2000, this number is expected to double.

Coping with rapid urban growth and widespread poverty strains the resources and imagination of even the most accomplished governments. Yet governments often hinder their ability to deal with such problems because they misunderstand the urban economy and do not employ the right policies and programmes. This is especially true of shelter. Even the most casual empiricism confirms that shelter policies in many developing countries are inefficient and inequitable.

Common problems and common solutions

Many housing problems can be stated simply, and their solutions may therefore appear simple; unfortunately, facile solutions often compound the problems.



Problem: There is a perceived shortage of housing.

Common solution: Government should build housing. This is usually the wrong solution. Housing shortages, when they exist, are the result of fast growth in demand and of impediments to the supply of housing. Governments do not, in general, respond to demand faster or more efficiently than private markets. But they can do much to mitigate or remove market imperfections, improving the private sector's response.

Problem: The quality of housing is poor.

Common solution: Raise standards through stricter building codes and better enforcement. This, too, is

often the wrong solution. Many current standards, based on Western codes, have little to do with basic structural soundness or hygiene, and are simply unaffordable by the bulk of the population. Standards and codes should focus on basic requirements for safety and health. Further improvements will come as development proceeds and incomes rise, provided regulations do not actually prevent upgrading.

Problem: There are too many squatters. Many poor people live on public or private land, contravening land use controls and similar laws.

Common solution: Clear the squatter areas. For many reasons this can be the wrong solution. When people are moved off land, they go somewhere else. Slum housing represents a large part of the poor's capital stock; destroying their capital retards development. And informal housing is sometimes of surprisingly high quality. Policies can be adopted that improve conditions more cheaply and for more people than clearance programmes, even when such programmes include new public construction.

Problem: The price of housing is too high for many families.

Common solution: Control rents and the price of land and building materials. This is usually the wrong solution. When housing prices rise faster than prices in general, that is a

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signal to the market to produce more housing relative to other goods and services. Such price increases are transitory unless the market is prevented from adjusting because of shortages of inputs, excessive government regulation, and similar restrictions. It is far better to deal directly with the causes of rising costs, rather than try to shift the burden of adjustment to landlords, who will then reduce the quantity of housing and land for rent, thereby exacerbating the very problem controls were supposed to solve.

How housing markets work

A schematic diagram of how the housing market works is shown below. Inputs such as land, labour, finance, materials and infrastructure are combined by supply-side agents such as landlords and developers to produce housing services.

Homeowners, and to a lesser extent, renters, are also producers if they maintain and upgrade their houses. Relative prices inform producers of housing services about whether to provide more or less housing, and the input suppliers about providing more or fewer inputs.

It is not a bad approximation to treat the market for housing services as a competitive market. For the activities in the middle box, there are few

barriers to entry or large economies of scale in most countries. This does not mean, of course, that anybody in a poor country can become a landlord or developer. But there are seldom so few landlords or developers that they exert significant market power, except insofar as they also control inputs that are not competitive.

The market for many inputs is not competitive, however: (a) their ownership may be so concentrated that owners can fix prices, as in some land markets; (b) large economies of scale may make the production of some inputs a natural monopoly, as with some types of infrastructure; and (c) government regulations may restrict the competitive allocation of inputs, notably finance.

The implications of this analysis are clear. Problems in housing markets are often caused by problems in the input markets. Government actions that attack these problems directly are the right ones. Rather than adopt this approach, however, many governments intervene in production (the middle box). Governments that try to fix prices — for example, by rent controls — only distort the signals being sent to the market and may exacerbate the original problem.

Role of the public sector

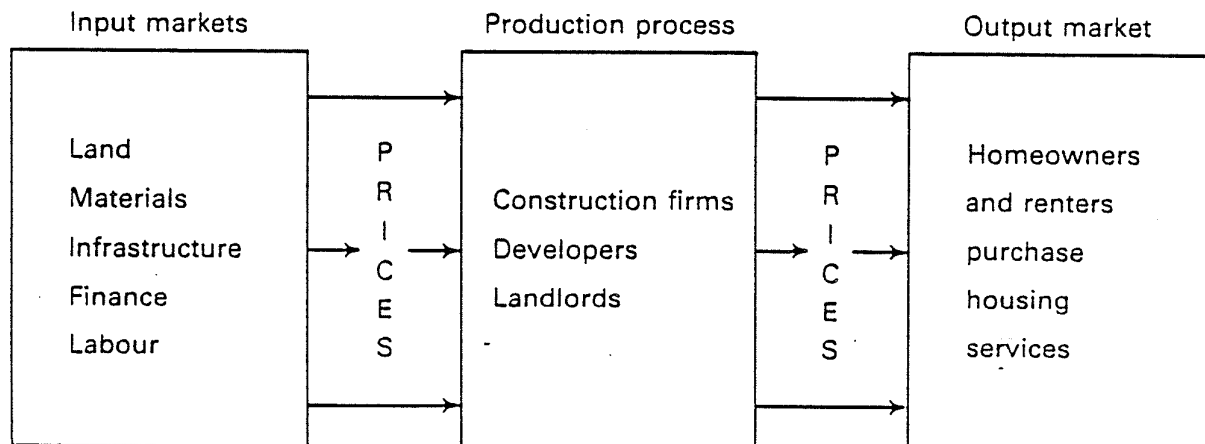
Until the early 1970s housing policies in developing countries often followed the model of many industrial nations, relying on heavily subsidised blocks of public housing. By and large, those policies did not work.

By the late 1960s and early 1970s many governments started to build on the success of informal housing. They introduced sites and services projects and slum upgrading, encouraged by the World Bank and other international organisations. These projects tried to set design standards on the basis of what people could and would pay, rather than on some arbitrary and inflated notion of "housing need."

The new approach involved two important related principles: affordability and full recovery costs. Only self-financing projects can be replicated on a large scale. Governments also tried to encourage self-help in building houses and community facilities and also in producing low-cost building materials.

Now it is increasingly recognised that even improved projects must be accompanied by fundamental changes in related government policies. New projects and policies focus even more directly on housing finance, infrastructure, and land mar-

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ket imperfections rather than direct production of housing units. There is a new awareness of the important impact of government regulations — zoning, standards and codes, taxes, financial policies, rent controls, and other pricing policies.

Improving shelter strategies in developing countries

An integrated housing strategy requires a clear statement of objectives, an understanding of local conditions, a sense of how policy and programme features are linked to outcomes, and a plan for generating and applying the resources needed to implement the strategy. Even though local political and other conditions will have a strong influence on the content of a strategy in a given place, enough is known about developing-country housing markets to suggest some general strategic guidelines.

Two points in particular are worth emphasising: that general economic development is the most effective way of improving housing conditions in developing countries; and that to ensure maximum benefits, governments should promote the efficiency

of the housing sector and should avoid policies that cause significant market distortions and produce counter-productive results.

Economic development

Research demonstrates that, as development proceeds, housing conditions improve more rapidly than incomes. Housing investment as a share of GNP increases rapidly, as does the fraction of income that people spend on housing.

In low-income countries, housing investment relative to GNP is only 2%; in middle-income developing countries the fraction is from 6% to 8%. Households in very low-income countries spend only 5% to 10% of their income on housing; in middle-income developing countries, the fraction may be 25% to 30%.

To a considerable degree, what is good for the economy is better for housing. Improving the performance of the shelter sector is therefore linked to appropriate policies in other sectors, and appropriate macro policies.

While this is an encouraging long-run prescription, it does little to solve immediate housing problems. Nor does it show how the gains from economic development are most effectively channelled into improving housing conditions. These questions require a careful choice of policies and programmes by government.

Required actions

Government activities that deserve emphasis include:

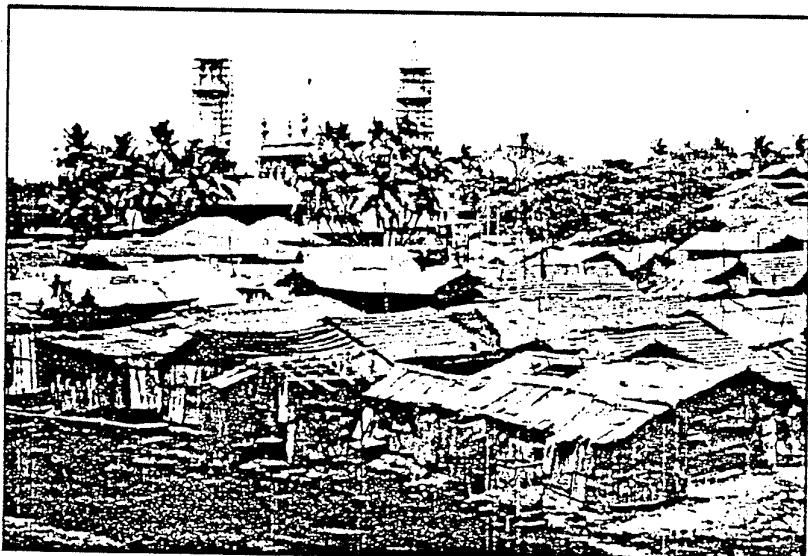
The provision of infrastructure with appropriate and affordable standards. The benefits of infrastructure investments are considerable: rates of return to investment are high (often higher than in housing alone), household spending on housing is often spurred, and *de facto* security of tenure is established for many informal households. However, cost recovery is required for large-scale investment and for continued maintenance, otherwise enormous social and private economic costs result, as demonstrated by the high costs of small-scale private provision of water and electricity in Lagos, for example.

The development of land information systems and a legal and administrative framework that promotes efficiency in land markets. The costs of developing land are unnecessarily high in most developing countries, largely because of poor land information, backward systems of titling and property rights, and a cumbersome legal and administrative structure.

The reform of land tenure systems in order to promote private spending on housing. Most cities in developing countries are being built largely by the informal sector, with houses that are often illegal and with insecure tenure. Research shows that even very poor households place significant monetary premiums on security of tenure and that incentives to improve property are often dramatically increased when tenure in illegal or squatter settlements is legalised.

The development of financial markets and institutions. Development or

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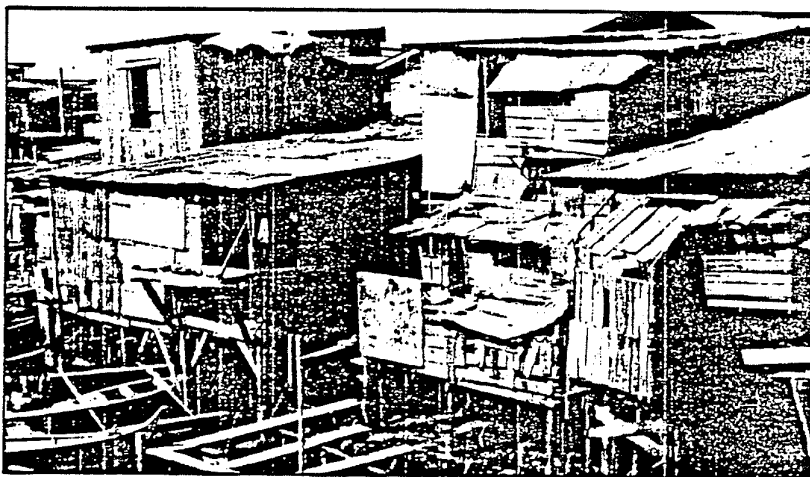
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reform of housing finance institutions should be a part of the overall process of financial reform and thus of promoting savings, financial intermediation, and the free movement of capital throughout the economy. The objective of a sound housing finance system is not to provide ever larger amounts of subsidised money for housing, but to facilitate required investment in a sector that is growing rapidly as development proceeds and to encourage savings.

The critical review of housing subsidies, with the goals of increasing their effectiveness, avoiding unintended side effects, minimising costs to the public and private sectors, and distributing benefits fairly in relation to need. By necessity, subsidies must be carefully targeted to groups that have a specific demonstrable need. In most developing countries, subsidy policies suffer from an almost total lack of strategic planning. The scale, distribution, and impact of subsidies are not usually known. Such evidence as exists shows that subsidies often do not reach their intended targets.

The pursuit and further improvement of sites and services and slum upgrading projects as solutions for the housing problems of low-to-moderate-income households. The best of such projects provide appropriate and affordable housing and services to low- and moderate-income groups, recover costs and minimise subsidies, target such subsidies as there are to those in greatest need, have high economic rates of return, and improve the ability to replicate projects on a broad scale. Many such projects, however, often fall short of these potential benefits in practice. Research indicates that planning assumptions are frequently incorrect, which leads to problems as the projects develop.

The promotion of private housing, including rental housing. It is worth noting that most housing policies have implicitly or explicitly focused on the owner-occupied sector, and with reason. However, the rental sector in most developing-country cities



... Displacing slums to other areas may encourage the development of larger squatter settlements ...

is large and growing, usually comprising at least 50% and sometimes as much as 90% of the housing stock. The sector is often hampered by unfavourable treatment such as inappropriate regulation, including rent controls, and discrimination in access to finance, land and infrastructure.

Of the policies that governments should avoid, three deserve special mention:

The creation of unrealistic and costly building codes and zoning regulations. These increase costs, often without corresponding benefits, and may encourage development of illegal informal areas.

The destruction of squatter settlements. Slum removal and urban renewal programmes that simply displace the slums to other areas may encourage the development of larger and more militant squatter settlements.

The displacement of private investment by public activities. One study in the United States recently found that each 100 new units of publicly subsidised housing caused a drop of almost 85 units in private construction; other studies indicate that public housing actually has a negative economic rate of return (it is worth

less than what it cost to build). Similar displacement effects and inefficiencies undoubtedly exist in many developing countries and are to be avoided at all cost.

These general guidelines are the basis for development and improvement of shelter strategies in most developing countries. Many of these principles are also of some relevance to developed countries. Detailed formulation of housing strategies must, of course, be informed by data collection, research, planning, and monitoring and evaluation of the programme involved. ■

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