The World Bank’s housing role

By Per Ljung

The World Bank initiated its urban operations in 1972 with a small technical assistance loan to Turkey and a sites and services project in Senegal. Total lending in that year was $US10 million. From this modest start, Bank lending grew steadily and reached $US500 million in 1981, but it remained essentially flat through the first half of the 1980s. Indeed, when the full impact of the second oil shock was felt by the developing countries, it looked as if World Bank support for urban development might come to an end. The Bank’s urban lending was questioned by many of its own macro-economists and by some economic planners in developing countries. They saw housing and urban infrastructure as “social” rather than “productive” investments. Given the shortage of public funds and the need to increase exports, the emphasis was put on industrial and agricultural investments.

This forced a reassessment of the role of shelter and municipal infrastructure in the macro-economy and of the World Bank’s approach to urban development. New types of lending emerged; for example, the Bank’s first loan supporting a housing finance institution — CH in Morocco — was approved in 1983. As a result, World Bank lending for urban development has expanded extremely rapidly during the last five years and the nature of sector work and the composition of lending operations have undergone a dramatic change. Since 1986, lending has averaged $US1.5 billion, or over 8% of total World Bank lending. The expansion of the Bank’s activities in the urban sector has been accompanied by a shift in focus, the emergence of new lending instruments, and an increased reliance on financial intermediaries. Most noticeable has been the expansion of the Bank’s support for housing finance institutions which now accounts for over one-third of urban lending — or a total of over $US1.2 billion over the last two years alone.

This transformation of the World Bank’s urban activities represents a timely and appropriate response to the long-term challenges of unabated urbanisation — aggravated by the economic difficulties of the 1980s — and to the lessons learned from earlier basic needs-orientated urban projects.

I will now briefly review some of the key urban trends and lessons we have learned during the past two decades. I will follow this with a brief assessment of the experience from our traditional shelter projects — ie, sites and services. Finally, I will focus on the agenda that is being pursued in our housing finance operations.

Urban trends and lessons
Continued Demographic Pressure. The urban population in developing countries increased from less than 300 million in 1950 to about 1.3 billion today and a projected 1.9 billion by the year 2000. The average annual growth rate, 4%, is not unprecedented, but the resulting absolute numbers go far beyond what has ever been experienced in the industrialised world. Just the annual increase in the developing world’s urban population is of the order of 45-50 million (compared with 7-8 million in developed countries). The rapid growth in urban population — and the relative decline in rural population — will inevitably shift the locus of poverty from the countryside towards the cities. Up to the end of the century, the number of urban poor will increase by 30% to about 430 million — or one-third of all the people in the Third World who live in absolute poverty.

Harsher Economic Environment. Since the late 1970s, increased inflation, slower growth, more debt and financial collapse define the major dimensions of the economic environment of many developing countries. These macro-economic conditions and resulting adjustment processes have had a major impact on shelter and urban infrastructure investments. Housing investments — as percentage of GNP — fell by about one-seventh between the mid-1970s and mid-1980s. All indications are that urban infrastructure invest-
ments also fell in real terms. A recent Bank review of a number of adjustment programmes found, for example, that infrastructure expenditures were cut more frequently and more deeply than any other major category of public expenditures.

Although less easily documented, the economic turbulence of the 1980s has also had major implications for urban poverty. Real wages have declined in many urban areas — often by 20-40% — and unemployment has increased. There is also clear evidence that an increasing share of the urban labour forces in Latin America and Sub-Saharan Africa has moved into informal sector activities.

The World Bank expects the 1990s to be a little friendlier to the developing countries than the 1980s. However, it is unlikely that the glorious 1960s will return. Thus, we can expect the next decade to be characterised by modest growth and tight budgetary situations.

It is also worth mentioning here that we have learned that inappropriate government policies related to housing and urban development have contributed significantly to macro-economic instability and hardship for the urban poor: in Argentina, an inappropriate regulatory framework for housing imposed a deadweight cost on the economy equivalent to 6-7% of GNP; in Malaysia, housing prices have been pushed up by 50% (equivalent to 3% of GNP); in Poland, infrastructure bottlenecks and housing shortages have reduced labour mobility and increased nominal wages — but reduced real wages; in Bolivia, inappropriate housing finance policies have increased inflation by a quarter; in Nigeria, manufacturing firms have to spend 20% of their capital investments just to overcome infrastructure deficiencies.

Changing Roles for Cities. Recent research has confirmed what intuition has already told us: cities play a key role in the development process. Some 60% of GDP of the developing countries currently originates in cities, and 80% of GDP growth will take place in the cities. If growth is to occur, the cities must therefore “function”. But evidence is that they function poorly. As I mentioned earlier, one reason is the policy environment which governs urban development. But the other is the totally insufficient or dilapidated infrastructure of cities. Telecommunications, which is becoming a crucial dimension of international trade, is hopelessly underdeveloped. Power systems often operate at such a low level of reliability that many industries have to have their own generator. Water supply, which is needed by the industrial sector to the tune of three times the level of human consumption, is equally unreliable and industry must often sink their own wells to supplement public supply. Urban transport is a nightmare which, coupled with the inadequacy of telecommunication, can paralyse commodity and information exchanges. Our understanding of the importance and role of productive urban infrastructure is increasing and, as it does, pointing to the conclusion that its improvement has to be an essential part of any urban strategy.

Governments Can’t Do Everything. Unfortunately, cities often fail to achieve their productive potential, and they appear to act more as brakes on economic development than as sources of energy. Rapidly expanding slums and squatter settlements, increasing congestion, air and water pollution, and deteriorating infrastructure are hardly consistent with the optimistic yet abstract notion of cities as engines of economic growth. Too often, rapid urbanisation — which requires annual investments in shelter and infrastructure of $US100-150 billion — has outstripped many (if not most) governments’ abilities to cope with the demand for even the most basic services. They simply do not have the financial and human resources to do the job.

The urban development model that emerged during the post-war period relied heavily on central government finance and public sector agencies for the implementation of fragmented projects. It also assumed that regulations could effectively — and costlessly — be used to achieve a desirable urban structure at both the national and individual city level. Indeed, this approach to urban development represented the ultimate extension of the state interventionist central planning model. It is now clear that this model puts too much faith in governments’ ability to manage the details of the economic development process. Even though many countries are moving ahead with the liberalisation of their economies and expansion of the role of the private sector, few reforms have taken place in the field of urban management. Thus, for developing countries to cope with the challenges of rapid urbanisation, it is essential that the structure of governments, and the roles they play in the urbanisation process, be changed. This will require, most fundamentally, that governments change from a posture of directly trying to solve urban problems to one of acting in an enabling role as facilitators of solutions.

Worsening Urban Environment. As most of us can attest, the urban environment is deteriorating in most countries. Two-thirds of urban dwellers are not connected with sewage systems, and less than one-quarter of the collected sewage is treated before being released into rivers, lakes and seas. Municipalities do not have the capacity to collect more than about half the solid waste that is being generated and only a small fraction of what is collected is properly disposed of in sanitary landfills, composting plants or incinerators. Emissions of air pollutants from cars and factories in cities are growing by 5-10% a year. Even though it is difficult to establish strict causality, it appears that the eco-
Economic and especially human costs can be heavy. For example, in Manila’s Tondo slum, an area with poor sanitation, infant mortality is two-and-a-half times higher than the national average, and typhoid and tuberculosis rates are respectively four and nine times higher than in the middle- and upper-income areas of the city. Indeed, if measured in terms of the impact on health and mortality, inadequate sanitation in cities stands out as one of the major environmental problems in developing countries. Not only money but also major technological, institutional and regulatory innovations are needed if environmental conditions are to be significantly improved.

Growing Urban Poverty. As stated earlier, at the turn of the century the number of urban poor is likely to exceed 400 million. However, the fears that urban migrants would create an exploding mass of unemployed or under-employed people have generally turned out to be unfounded. The migrants tend to find jobs relatively quickly and, when adjusted for skill levels, they earn about as much as the long-term city dwellers. This means that enhancing the productivity of urban jobs is more important than employment creation per se. Small and medium-sized enterprises are the most important employment sources for the urban poor. However, it is these smaller — often informal — enterprises that suffer the most from inadequate infrastructure and costly government regulations. This means that if we can improve the efficiency of cities, we will also enhance the living standards of the urban poor. Furthermore, we have learned during the last decade that it is government induced distortions on the land and housing markets that have prevented the urban poor having access to adequate shelter at affordable prices.

Lessons from traditional shelter projects

The sites and services projects made up the bulk of the World Bank’s early shelter interventions. These were complemented by projects that were aimed at extending basic infrastructure facilities to existing settlements. Thus, while the upgrading project helped to improve the living environment for millions of urban dwellers — many of whom were poor — these projects cannot really be classified as “housing”. Thus, I will limit myself to give some lessons from our sites and services projects.

The sites and services projects were designed to capitalise on the untapped resources of the poor through self-help construction. Typically, the projects involved:

- (i) provision of land tenure;
- (ii) selected trunk infrastructure to connect new areas with existing networks;
- (iii) on-site infrastructure (water sanitation, roads, drainage and electricity) often based on communal solutions;
- (iv) core houses ranging from a simple wall with utility hook-ups to completed buildings;
- (v) social facilities such as schools, health clinics, community centres; and
- (vi) financing for the plots, core houses and for self-help building materials.

There is little doubt that these projects represented major improvements over existing approaches to publicly sponsored housing in developing countries. They were universally cheaper than publicly built apartment complexes. They were economically viable. However, the beneficiaries tended to belong to the middle class rather than the poor. Although subsidies in nominal terms were limited, there tended to be large hidden subsidies: interest rates tended to be below market rates and below the prevailing rates of inflation; land was sold at prices far below its replacement costs, etc. There were large implicit subsidies through mortgage loans because of slack recovery performance by the lending institutions. This is not really surprising since mortgage loans were usually provided by construction orientated project agencies rather than by financial institutions. Furthermore, the sites and services projects tended to become foreign supported enclaves. Few governments adopted them on a large scale.

More important, however, was the fact that the low-cost, affordable model for urban development — as represented by the sites and services approach — had little impact on local zoning and building codes. There is now mounting evidence that it is government regulations — rather than speculation or disinterest by formal sector housing developers — that prevent the urban poor from obtaining land and adequate shelter. In Malaysia, for example, more than 50 permits are required for the development of a housing area — a process that takes four to seven years. In Jordan, the minimum legal plot size is four times larger than what low-income families can afford. Similarly, in the Indian state of Tamil Nadu it is illegal for the private sector to duplicate the successful sites-and-services schemes financed by the World Bank. In Bombay, the urban land ceiling legislation has stopped virtually all official and most unofficial land transactions, pushing up land and property prices to incredible levels; a simple shack in a typical slum area is now selling for $US20,000-30,000. In Karachi, most newly serviced plots are bought by middle-class “land speculators” — to serve as a safe savings instrument with a positive return after inflation — and, as a result, remain vacant for a decade or more.

In these kinds of situations the urban poor have little choice but to go “underground” and live in informal or illegal settlements. However, we have seen in countries that have a rather straightforward and simple system of building regulations and sound macro-
economic policies that the organised private sector can respond to the shelter needs of low-income people. This is happening on a massive scale in Thailand today and the same move "down-scale" can be seen among private home builders in Indonesia.

Other constraints to a well-functioning housing market that the sites and services projects did not tackle straight on were related to weak housing finance institutions and outdated land information systems.

The new urban agenda

The broad-based approach to urban problems that is emerging from the trends and lessons that I have described can best be summarised as follows:

Decentralise government decision making and strengthen local governments to make them stronger partners in the urban development process.

Encourage the private sector to play a greater role in the financing, construction and operation of urban infrastructure — especially in the areas of housing, urban transport and solid waste collection where there are few, if any, economies of scale.

Enhance the productivity of urban enterprises through better provision of basic infrastructure and through regulatory reforms.

Improve the functioning of land and housing markets through better macro-economic policies, reform of zoning and building regulations, strengthening of land registration systems and housing finance institutions.

Reduce and rationalise subsidies so that they better reach those who are truly needy.

Adopt a more systematic approach to deal with urban environmental problems and give special emphasis to safe water and basic sanitation.

Address urban poverty through broader-based policy interventions that help to improve the productivity of urban jobs and regulatory and policy reforms to remove obstacles that prevent the poor from gaining access to affordable shelter.

The housing finance agenda

The reform of housing finance policies and strengthening of housing finance institutions constitute important elements in this longer-term urban development strategy. However, they have come to the forefront in the World Bank's urban development lending also for other reasons.

Housing is a major economic sector in all developing countries. Housing investments typically amount to 3-8% of GNP. It is therefore clear that the manner in which resources are mobilised for housing, how well they are invested and how efficiently they are utilised have a major impact on the prospects for economic adjustment and resumed growth.

However, housing is not only an economic good, it is also a basic human need. Thus, housing plays a central role in the social policies of virtually all governments.

Finally, housing is also a long-lived and costly asset which is heavily dependent on people's ability to borrow. During the last decade, higher and more volatile inflation and real interest rates have increased the risk of making long-term loans. This has also reduced the ability of financial systems to mobilise the resources needed to finance long-term assets such as housing. We have also found that when governments try to intervene in the housing finance system through mandatory lending targets, interest subsidies, etc., the ultimate effect has been to further destabilise the economy. Thus, the rapid expansion of World Bank lending for housing finance is largely a reflection of a desire to create a greater symbiosis between not only social and financial sector concerns, but also with urban development and fiscal concerns.

Indeed, housing finance lending has become a major component of the Bank's strategy to support structural adjustment and financial sector reform.

Although my housing finance colleagues in the Bank could give a mile-long agenda for the Bank's housing finance operations, I want to limit myself to three points:

(i) The projects must encourage domestic savings and this requires that interest rates are positive in real terms and in line with general market conditions;

(ii) The burden on the government budget should be minimised;

(iii) Subsidies — if any — should be up-front, targeted to the poorest segments of the population and designed in such a way that they do not create macro-economic distortions or jeopardise the financial system.

Although much is needed to achieve all these three objectives, there is one item that stands out in most countries that have experienced macro-economic instability, i.e., high inflation, etc. This is a well-designed mortgage instrument which contains some form of indexation to even out the repayment burden over time and thus makes the mortgages more affordable without subsidies. However, it should also provide for an equitable risk sharing between borrower and lender. We have seen such innovations in a number of Latin American countries, but many more need to follow suit.

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