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Shelter Strategies for the Urban Poor: Idiosyncratic and Successful, but Hardly Mysterious

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Abstract:

In 1986, the World Bank prepared a strategy for low-income housing in developing countries. This work grew out of the Bank's efforts to support the urban poor through an extensive housing assistance program that was launched by Bank President McNamara's speech on urban poverty. By that time, the Bank had provided more than $4 billion of such assistance, and had undertaken an extensive research effort to design support for that lending. Much has changed since that time, not only in the way the Bank provides shelter assistance, more than doubling its support since that review, but also in the changing consensus as to what shelter strategy should be. This paper reviews the emerging consensus. It examines three new research areas: the empirical analysis of the effects policy has on housing supply; the richer understanding of the effects that land market regulations have on specific projects and on the functioning of urban areas; and the alleged mysterious effects that de Soto, for example, claims that effective property rights have not only for shelter policy but for development more generally. It also examines the emergence of both a new financial innovation – micro-enterprise finance – and the increased emphasis given to project design based on community participation, showing how these approaches more fully reconcile the incentives faced by beneficiaries and donors. In sum, the paper argues that the evolving consensus on shelter strategy is not nearly as mysterious as some would claim. Housing markets in most developing countries remain highly idiosyncratic and constrained. Nevertheless, the evolving consensus on shelter strategy appears to recognize these idiosyncrasies and policy constraints as evidenced by the strong and improving performance of the Bank's shelter lending.

I. Background and Introduction

In 1986 a World Bank study distilled the implications of a multi-year research effort to draw together a strategy for low-income housing in developing countries. This work grew out of the Bank's efforts over the previous 14 years to develop ways to support the urban poor through an extensive housing assistance program, an effort that was formally launched by Bank President McNamara's Nairobi speech on urban poverty (McNamara, 1975). As the study documents, the Bank had provided more than $4 billion to support housing assistance targeted for the poor, and had undertaken an extensive research effort to help structure that lending.[1] The study, by Mayo, Malpezi and Gross (1986), summarizes the research that went into developing this program, as well as the lessons learned from the Bank's shelter projects. This article reviews subsequent research and the changing consensus on shelter policy since that study.

The plan of the paper is as follows. In the next section, we briefly discuss the nature of the World Bank's shelter projects and the evolution of the strategy over the last 30 years. The third section reviews the implications of more recent research and the changes in the world economy for shelter strategy. A final section concludes.

II. The Changed Policy Environment

Much has changed in the last 18 years; perhaps most important is the change in public governance. There are now twice as many democratic governments and they are overwhelmingly much more decentralized. These governments also operate in a more open and stable, if sometimes volatile world economy.[2] Secondly, with the fall of the Soviet

[1] The research effort also resulted in a large number of publications, documented in the *Handbook of Urban and Regional Economics* (Malpezzi 1999), and which includes work by Malpezzi and Mayo (1987 a and b). This work in turn, followed and complimented work undertaken by a group of urban economists brought to the Bank to help analyze and shape this new policy initiative. See bibliography for working papers.

[2] Freedom House measures indicate that 46 percent of the countries were 'not free' in 1973. This figure falls to 25 percent in 2002. At thee 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

Union in 1989 and the adoption of market-oriented economic policy in China and India during the 1990s, the central planning approach to policy has largely been discarded. Almost all countries now rely on a public policy approach that augments and compliments market processes rather than substitutes for them. For Bank-supported shelter projects, these changes mean that the projects are no longer implemented by project specific Implementation Units which substituted for non-existent local governments, and which often paid little attention to resource costs. It also means that arguments about the comparative advantages of the public and private sectors are considerably less likely to cloud the discussion. Finally, most of the Bank's borrowers now have more sophisticated and diversified economies and financial systems. For instance, many developing countries now have access to market rate housing finance to assist them. This was not the case in 1986.[3]

On the other hand, by no means have all of the changes been benevolent. There have been financial crises that led to capital flight and massive simultaneous mortgage defaults, as in Mexico where in 1995 most of the mortgage loans made under a Bank loan were forgiven. Indeed, in some cases, over-heated real estate markets seem to have precipitated the crises.[4] Moreover, urbanization is no longer thought of only as an engine of growth that occurs as societies grow and specialize. Instead, as argued by Fay and Opal (2000), in many Sub-

world doubled to just over 120. Finally, the *World Development Report* (World Bank 1999) reports that 95 percent of democracies had initiated some for of decentralization process by the year 2000. As for macrostability, 23 countries had inflation rates over 30 percent in 1985 or 1986 as compared to 14 countries in 1999 or 2000, and the median inflation rate fell from 7 percent to 3 Percent.

[3] In 1973 the per capita incomes in India and Senegal, two of the first shelter projects, was $218 and $623 in 1995 dollars. In contrast, in the last year the Bank supported projects in Mexico and Latvia with per capita incomes more than seven times that level. Similarly, in terms of financial development, in 1973, half of the Bank's borrowers had financial systems smaller than the Bank's credit union. In 2001, this share had fallen to less than one-third.

[4] See Quigley (2001) on the role the property market played in the Asian financial crisis.

Saharan African countries urbanization without growth characterized the 1990s, creating a new type of housing demand in a much more urbanized if poorer world.[5]

For shelter policy in developing countries, perhaps the most notable change in recent years is with respect to the spatial dimension of poverty. This pattern had changed in rather fundamental ways. Though the majority of the world's poor continue to live in rural areas, poverty is rapidly becoming an urban phenomenon. Today, unlike the situation in 1985, in many of the Bank's biggest borrowers – e.g. Russia, Brazil, Mexico - most of the poor already reside in urban areas. Moreover, while in India most poverty remains in the countryside, in most of its larger states the poverty rate in urban areas is for the first time higher than it is in rural areas.[6] By some estimates, over 50 percent of the world's poor will be living in urban areas by 2035, see Ravallion (2002).

In such an environment, it is not surprising that urban slums are not being absorbed into formal urban economies. Surveys in Brazil and India, for example, indicate that in many places slum dwellers are no longer participants in a temporary demographic transition process as was earlier thought to be the case. It is now recognized that many slum dwellers are not new immigrants who recently arrived from rural areas in search of better livelihoods. Today, many of the 100,000 pavement dwellers in Mumbai, for instance, are second-generation residents, see SPARC (2002), as is the case in Rio's Favelas, see Perlman (1976 and 2002).

[5] There is some debate about the finding that sub-Saharan Africa has experienced rapid urbanization without accompanying economic growth. Since there have been few censuses available for recent years, the data used in many such studies have relied on projections of urban population growth from the 70s and 80s. 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 (2003). Nevertheless, even with this qualification, it is clear that in many large African countries, Ethiopia, Nigeria, Kenya to mention a few, urbanization accompanied impoverishment.

[6] In 11 states which include Haryana, Kerala, Rajasthan, Andhra Pradesh, Maharashtra and Madhya Pradesh, the poverty rates in urban areas were larger than rural areas (see 10th Five Year Plan (2003).

Finally, two changes in the approach to development assistance have taken place which also have implications for shelter strategy: first, greater accountability for aid has been embodied in a series of quantitative development goals – the Millennium Development Goals -- which includes a target of improving the lives of 100 million slum dwellers over the next 25 years; and second, the structure of official development assistance (ODA) has changed in both composition and level.[7] In the more globalized world economy, ODA now accounts for a smaller share of international credit flows, and within that lower overall level of assistance, support for infrastructure investments has declined sharply.[8] Therefore, while Bank shelter assistance has not followed the overall trends in ODA or in infrastructure lending, having almost doubled since the last review, it has done so against a background of lower overall development assistance, as well as an assistance that is more quantitatively targeted on directly assisting the poor.

In sum, since the last review much has indeed changed. This assistance is now provided in a very different world environment and uses a variety of new instruments.[9] In addition, a considerable amount of additional research has been undertaken. A more robust understanding of how housing and land markets in both developed and developing countries work has emerged. As argued by Renaud (1999), there is now an active body of research on real estate economics in general and for developing countries in particular. This is a very different situation than existed 18 years ago. It is against this evolving background that we

[7] The eight MDG goals are: 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.developmentgoals.org/ For a review of progress on the International Development Goals see www.paris21.org/betterworld.

[8] The last decade saw a twenty-five percent decline in Infrastructure lending by the World Bank.

[9] See http://www.worldbank.org/urban/housing/ for a quantitative inventory and summary statistics for the Bank's shelter lending since 1972

review how this new environment and evolving policy perspective affects the strategies to improve the conditions of the millions who live in substandard housing throughout the world.

The Evolution of Bank Shelter Assistance

The Bank's earliest shelter projects were usually designed to help develop sites and services in low-income countries. Most of the initial projects were in capital cities and attempted to show that basic housing services, e.g. 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, and particularly low-income countries, very basic shelter designs that were affordable could be provided on a larger scale. While this may now seem to be a relatively straightforward notion, at that time there was considerable resistance this idea. Most developing country public housing agencies produced expensive and heavily subsidized housing that could only meet the needs of a fraction of the demand.[10] These projects also provided an alternative to demolishing squatter settlements as was done in many developing countries.

The overarching idea of the assistance was to suggest that rather than attempting to replace the informal sector, or see this sector as a "problem", public assistance could be used so that the strengths of this sector could be built upon. As argued by Turner (Turner and Fichter, 1971), providing just basic services and shelter allowed poor families to expand their units over time as their savings and resources permitted. It also allowed them to use their own labor to maintain and increase their wealth.

Over time, the types and locations of World Bank shelter assistance changed. The first change came in the early 1970s with a shift to upgrading of existing slums rather than just the development of new sites. The Bank's first policy paper in this area, *Housing* (World

[10] "As recently as 1975 there were few countries willing to contemplate the types of projects that the Bank was sponsoring. Now [i.e. in 1980] the Bank has helped finance more than thirty-two projects in twenty-six countries and has projects in preparation in 11 additional countries." (Churchill and Lycette 1980, p. 16)

Bank 1975) recommended this change. The second change was to move from projects focused on one city to national programs, as occurred in the Tanzania project in 1978. This nation-wide orientation became a common feature of subsequent sites and service projects. A few years later in 1981, the Bank made its first completely non-shelter urban loan to Côte d'Ivoire. This project was to begin a totally separate branch of Bank support that included issues such as municipal finance, urban management and inter-governmental relations. In retrospect, it is somewhat surprising that it was a full decade after Bank Urban lending began that an urban loan without a shelter component was finally made. This non-shelter related share of urban lending has grown rapidly and now comprises 55 percent of total urban lending.

In 1980 a third type of shelter project, one that over time would become increasingly important, was developed. We refer to this type of project as a policy-based loan, one that views the project as a way of embodying accompanying policy changes in a specific investment.[11] An example of such lending is the Mexican project of 1992 which focused on reforming local housing market regulations to make the housing being financed more affordable.

The Bank began a fourth type of shelter project 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 that carefully monitored loan recovery. Housing finance projects were to become a significant portion of Bank shelter assistance in the 1980s and have now become an active line of IFC business. Finally, in the late 1980s and early 1990s, following earthquakes in Mexico and Iran, shelter assistance for countries hit by disasters became more than just an occasional project.

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

To summarize the Bank's shelter lending, by 1986 over two-thirds of the 97 Bank shelter projects and almost 50 percent of all urban projects were for either sites and service projects or slum upgrading. A few years before that review, two new types of loans – for housing finance and to encourage housing policy change – were introduced. Finally, since 1986 a new instrument for disaster relief was implemented that now accounts for about 15 percent of annual shelter assistance. In total, since 1972, the Bank group has provided over $13 billion in shelter assistance in 249 loans. These loans have had a remarkable degree of success, as measured by the Bank's independent Office of Evaluation, with more than 88 percent of the lending having a satisfactory outcome versus 75 percent for the Bank over the entire period, and more than 95 percent having a satisfactory outcome in the last decade.[12]

III. Research on Housing Markets

The Research for the Last Review: In light of this evolving pattern of assistance the question arises as to what role research played in developing this shelter strategy. This question, in many ways, is what Mayo, Malpezzi and Gross (1986) attempt to answer. In particular, they emphasize the policy implications of the following aspects of Bank-supported research findings.

- First, the regularity of housing demand across time and space, drawing out the implications this finding has for both revising project design and building codes;
- Second, the importance of the provision of property title, with the associated need to make sure that beneficiaries received formal titles for their properties;
- Third, the potentially important role of the development of housing finance; and

[12] In the same period, overall bank lending had a satisfactory rating of 82 per cent. Among the 15 sectors, only two sectors had higher satisfactory outcomes while eleven sectors had satisfactory outcomes less than 90 per cent. (Global Information/Communications Technology and Social Development) For more information on how programs are rated see: http://www.worldbank.org/oed/

- Fourth, the effects land market regulations had on the efficacy of specific projects.

The first research finding – that housing demand across the world was highly regular – provided some perspective on how the Bank could most effectively structure many of the components of the housing projects. In retrospect, this finding may now seem almost naïve, but it is important to remember that it was only 10 years prior to that review that the first cross-country empirical study of housing investment was undertaken, by Burns and Grebler (1977). In addition, and more importantly, in the year that study was undertaken public housing production and ownership was the main vehicle of housing assistance throughout much of the developing world. For instance, at that time, China, the 15 countries established since the 1991 dissolution of the former Soviet Union, as well as India, Korea, Mexico, Argentina, and many African countries all had very active public housing programs.[13] Many of these countries also proscribed or discouraged private production of housing.

The work on housing demand also provided a basis for understanding what kind of standards and units were affordable to low-income families. It sought to demonstrate how and why the unaffordable standards pursued in most places left the public sector not only unable to meet housing demand, but also drove so much housing supply into the informal sector and illegality. It also showed why it was so important to focus on the details about the kind of housing units that the poor could afford without the aid of subsidies. That is, the work emphasized why the units produced could be sustainably financed only if modest housing standards appropriate to beneficiaries' lower income levels were used.

[13] At about the time of the last review, Tolley in work subsequently published in 1991, demonstrated the importance of rents based on a cost of capital perspective in China, contributing to China's initial housing reform program. Shortly thereafter, in 1992, Renaud wrote "Why the Former Soviet Union Needs Housing Markets." (1992)

The second research finding stressed the importance of providing security of tenure and title to those in the informal sector, see Jimenez (1984), Follain and Jimenez (1985) and Friedman, Jimenez and Mayo (1988), and it often involved the empirical estimation of just how much value low-income beneficiaries would place on having this title.[14] While this work focused largely on econometric estimation of this valuation, it foreshadowed the subsequent work of de Soto (1989 and 2000) that started a lively debate on the importance of property rights in transforming the economic opportunities of the poor.

The central policy implication of this work was how important it is to provide a clear property title. This was a view that, in many respects, was at odds with what might be described as both the mainstream property rights literature of economics, such as Demsetz (1967) and the anthropological research, such as Peattie and Aldrete-Hass (1981). The former argues that property rights develop when there is sufficient demand for them. Property rights, according to this formulation, will develop when the benefits of internalizing the externalities exceed the costs of not doing so. Based on this perspective, the absence of such rights reflects the absence of demand for such rights and is not a supply constraint. The latter, anthropological perspective, suggests that the notion of property rights is not a discrete choice but rather a spectrum of choices depending very much on idiosyncratic circumstances. The Bank work, in contrast to both of these perspectives, suggested that the lack of institutional capacity to deal with rapid urbanization had prevented the benefits of title from being realized. This perceived institutional imperfection played an important role in the structuring of Bank shelter projects during the early years of assistance.

The concern with housing finance arose because by 1986 it had become increasingly apparent that it was not just the specific kind of asset being financed that was important, but

[14] By no means did the work on the importance of tenure security start in the 1980s. Work by Mangin (1967), Turner and Fischer (1971) and Turner (1976) among others had emphasized the importance of secure titles and tenure security in the late sixties and seventies.

how funds were to be mobilized to support the demand for these assets. In a sense, the shift recognized that in virtually all developing countries not only were insufficient assets of affordable dimensions being produced, but so too there was also not a system of finance to support the funding of these investments.[15] Renaud (1984) documented how the interest rates charged on Bank-supported projects by specialized, usually public lenders were usually 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 on-lend.

In some ways, like the earlier argument about the regularity of housing demand, the notion that competitive financial systems could generate more resources appears now to be an almost foregone conclusion. However, it is once again useful to consider just how much conditions have changed since that time. In the 1980s, as noted in Diamond and Lea (1992), most European financial systems operated under extensive financial controls – credit controls, limits on the terms for loans -- and were segmented and subsidized. At the same time, the US was in the midst of the savings and loan crisis. That is, as recently as 1986 the financial systems in developed countries were tightly controlled, directed, and not nearly as liberalized as they are today. Against this backdrop, the Bank's view that developing countries should move to rapidly liberalize housing finance systems could in many ways be said to have been more market-oriented than the systems of market-oriented developed economies at that time.

Finally, like the concern with finance, the interest in land market regulations arose with the realization of how important the physical layout of sites and service projects could be to the success of these projects, see Bertaud, Bertaud and Wright (1988). The work

[15] Colombia represents an exception to the lack of housing finance in developing countries at that time. See Buckley (1996) for a discussion.

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 higher-income groups. Ultimately, this work suggested that projects that did not consider the broader land policy dimensions could become enclaves that would not be 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, with the coming of the 1990s this aspect of support received particular attention in places such as Mexico and Russia, and resulted in the fourth type of housing assistance mentioned above -- policy-based loans.

Subsequent Research Findings on the Bank's Strategy. Since the 1986 review, the findings of earlier research were subjected to additional scrutiny both by further research and by events.

Evidence on the Effects of Policy on Housing Supply

At the time of the last review, in contrast to the path-breaking work of Reid (1962) on housing demand, little was known about housing supply. In part to support the Bank's 1993 *Housing Policy Paper: Enabling Markets to Work* more empirically based cross-country evidence on sector performance was accumulated. This data collection effort was initiated under a World Bank-UN Habitat exercise called *The Housing Indicators Program,* which was initiated in 1989. This program addressed the dearth of comparable cross-country (or city) data on housing and urban development outcomes. In order to fill this gap, data were collected on basic urban and housing indicators for a sample of 51 cities in both developed and developing countries. This program provided the first empirical basis to analyze the cross-country effects that policies could have on housing market supply conditions, and, like the earlier work on housing demand, resulted in a variety of published works such as Hegedus, Mayo and Tosics (1997), Malpezzi and Mayo (1997a), Angel (2000), and Murray (2001). This effort has now become part of an on-going monitoring program continued by UN Habitat.

The basic proposition of this work is that the effects of policy on housing supply matter, and in some cases matter a great deal, see Angel (2000). Policies that restrictively regulate the housing market and/or the building industry decrease housing supply elasticity. When supply is inelastic the same increase in demand – driven by, say, rapid urbanization – results in a much larger increase in price and a much smaller increase in quantity supplied. These results imply that implicit regulatory taxes that limit supply of housing can more than offset the direct assistance to the poor, as argued by Das and Lobo (2001) for India.

While the intuition behind the notion of an inelastic supply curve is straightforward, the empirical support for it was not. That is, it was not until the late 1980s when in a widely-cited article, Mankiw and Weil (1989) argued that because of the combination of a low housing supply elasticity and a housing market that operated with less than perfect foresight that demographic changes in the US were likely to have extraordinary effects on house prices. This paper generated a cottage industry concerned with estimation techniques which, in turn, had the salutary effect of producing sufficient evidence of both supply inelasticity, and of the degree to which policy contributed to the inelasticity for the US and UK, see Woodward (1992), Mankiw and Weil (1992), and Green and Hendershott (1996).

For example, Glaeser and Gyourko (2003) examine why the price of housing in some markets in the US is so expensive relative to its cost of production. They find evidence that markets with the highest housing prices are areas where the constraining effects of land use regulation are also the highest.[16] They also find little evidence that high prices lead to smaller lot sizes as would be expected if supply were elastic. Finally, they find that measures of regulation are highly correlated with house prices. In sum, they, like Quigley and Raphael (2004), conclude that local regulations are largely to blame for the high house prices observed in many cities in the US. Similarly, in the U.K, a study by Cheshire and Sheppard (1989) compares house prices in two comparable cities that differ in the relative restrictiveness of land development regulations. They also find that policies that are more restrictive lead to higher prices.

For developing countries, similar results on the effect of policy on housing supply elasticity have also been obtained. Bank work on Malaysia, for example, was generalized by Malpezzi and Mayo (1997a) in an empirical analysis of the housing supply elasticities in three countries: Malaysia, Korea and Thailand.[17] The evidence supported their hypothesis that Malaysia and Korea would have unresponsive housing supply due to a more constraining regulatory framework. Finally, Green, Malpezzi and Vandell (1994) find similar microeconomic results on the importance of supply constraints for South Korea.[18]

To sum up, research on the effects of housing policy on the supply of housing in the past decade has provided empirical support for the view that housing policy reform is essential to improving housing outcomes for low-income groups. This work suggests that if development assistance is to provide help to more than the limited number of direct

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[16] Glaeser and Gyourko (2003) look at two ways of valuing land. First, they use a housing hedonic model to find out the value consumers put on larger plots. They then compare this price of land with the price of land that is calculated by subtracting the construction costs from home value (and dividing by the number of acres). In a competitive market, the two prices of land should be equal. They find that the hedonic price of land is on average only 10 percent of the value calculated with the second methodology, suggesting that factors other than production costs drive house prices.

[17] For further discussion on the findings from this research see Baken and der Linden (1993), Malpezzi (1994) and Jones (1996).

[18] For more empirical work on the relation between housing prices and regulations, see Fischel (1990), Malpezzi (1996), Evans (1999), and Malpezzi (1999).

beneficiaries of assistance programs, more attention must be paid to the often idiosyncratic and city-specific policies which control the type, location, and standards of housing.

From Supply Conditions to Greater Community Participation. Recent research has revealed that very often highly variable local supply conditions matter greatly. These conditions have implications for the structure of the projects themselves. For example, the implications of the finding of strong regularities with respect to housing demand lead to an emphasis on affordable design standards, and an understanding of beneficiaries' likely willingness to pay. In the early years of Bank lending, little attention was given in this perspective to involving the beneficiaries in the projects in any way other than as direct consumers.[19] The result was that the Bank's sites and services, projects, in effect, often became 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 the early Bank shelter projects, Turner's (Turner and Fichter 1972) aspirations for enabling and empowering the poor to house themselves remained unfulfilled. Bank projects had helped scale back the costs of the units produced, but the public sector often remained he producer.

In recent years, the nature of the involvement of beneficiaries has changed. The importance of community involvement and the importance of using social capital to leverage Bank resources has become a major thrust of Bank policy. Efforts to stimulate community driven development have grown rapidly as Bank studies, such as Gibbs, Fumo and Kuby (1999), have shown the strong positive effects community-based organizations (CBOs) and non-governmental organizations (NGOs) can have on Bank-supported projects. As a consequence, rather than the engineering, technocratic approach

[19] This is not to say that community participation was completely ignored in the early urban projects. Many projects did indeed have community components to them but these were constrained by absence of techniques available today as well as highly centralized decision making structures in client countries.

embodied in early Bank projects, the current approach embodies a much more community-based perspective, one that focuses on providing local public goods for urban shelter projects. Under this approach, NGOs and CBOs help address questions about the provision of shared goods, such as water and sanitation, as well as help with shelter design and the targeting of assistance to the most needy.[20]

Land Markets and Urban Spatial Structure

At the time of the last review the over-riding analytical perspective governing urban and housing economics was based on an abstract model of the urban economy supported by what Mills and Tan (1980) refer to as "…one of the most pervasive and best documented trends in the developed world…" – the monocentric city model (developed by Alonso, Muth, and Mills, see citations). This model predicts a radial city with residences located in rings around a central business district. The rent and land price gradient (and density) falls with distance from the central business district. Land use in a monocentric model is determined by a trade-off between the desire for space and the desire to minimize commuting costs; and housing supply elasticity, as Muth (1969) inferred, is close to infinitely elastic.

Mohan (1994) shows that this simple if abstract model characterized both developing and developed country cities over time. His results support the 1951 aphorism of Colin Clark (1951) that "all cities west of Budapest and east of Los Angeles" i.e. the market-based cities -- had the negative density gradients implied by the model. This finding, in turn, implied that

[20] In Bank-supported work the success of this approach is perhaps most vividly demonstrated in the slum-dweller relocation in Mumbai, financed under the on going Second Mumbai Urban Transport Project. Under this project the Bank, working with Mumbai NGOs – SPARC and the National Slum Dwellers Federation – was able to support the relocation of more than 20,000 families who lived in slums along the railroad tracks into the city. The relocation improved the living situation of the slum dwellers and simultaneously improved the effectiveness of the city's transport infrastructure. It would not have been possible without the active engagement of the community as has been documented by Appadurai (2001) among others. This sort of project was essentially unthinkable at the time of the last review.

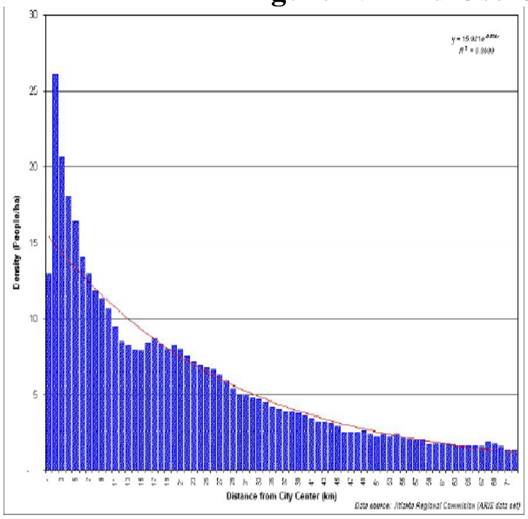
the ability of policy-makers to affect the structure of cities and the functioning of housing markets was severely circumscribed.

Not surprisingly, given this presumption, most of the land market concerns of Bank strategy focused on the microeconomic aspects of land use regulations. Like the focus on the empirical regularity of housing demand, this perspective led to a neglect of idiosyncratic, localized conditions. Subsequent world events, however, such as the fall of the Soviet Union and the end of Apartheid in South Africa permitted cities in the part of the world outside Clark's ambit to be subjected to empirical analysis. Based largely on the first set of comparable data on more than 50 cities - much of which is summarized in Bertaud (2003) -- the results provide increasing evidence that urban spatial patterns diverge substantially from those predicted by the standard urban models.[21] Moreover, the divergences are particularly strong in environments where policy superseded market processes in determining urban land use.

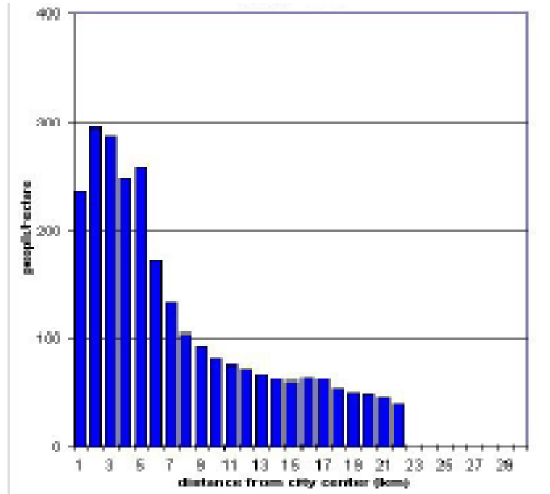
Figure 1 presents the density gradients for two very different but market-oriented cities – Paris and Atlanta -- as well as two of the more extreme policy-controlled city density structures, Johannesburg and Moscow. Cumulatively, these four images provide both some sense of how much policy can disrupt both the functioning of land markets and the underlying structure of cities and housing markets, as well as just how idiosyncratic urban spatial patterns can be across cities.

[21] The bibliography provides a number of citations to this data. The most comprehensive source is the website: http://alain-bertaud.com/

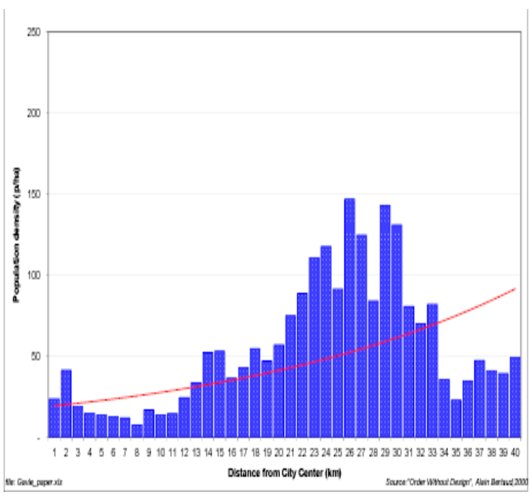
Figure 1: Land Use Gradients for Various Cities



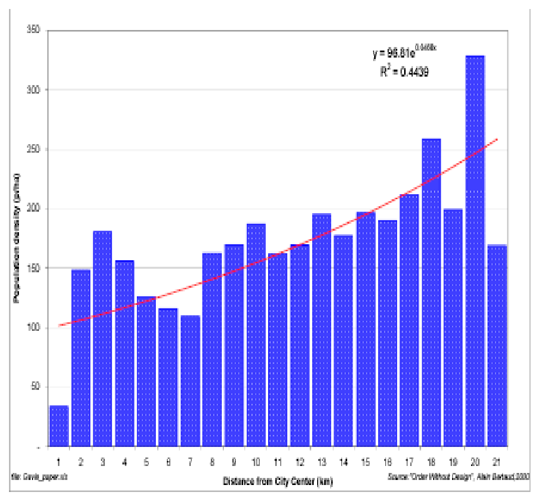
Atlanta – Density Profile



Paris – Density Profile



Johannesburg – Density Profile



Moscow – Density Profile

Source: Bertaud, various studies.

The first two graphs depict Atlanta and Paris, two very different cities, but also two places characterized by negative gradients over most of their built-up area. The former city is among the least densely populated cities in the world and its automobile-based spatial structure has a significantly different structure from Paris, or for that matter most European cities. Nevertheless, in both cities the observed patterns generally follow the predictions of the monocentric city model.

This consistency with the model disappears in the next two graphs: In both Moscow and Johannesburg the negative gradient disappears. The Moscow graph is from Bertaud and Renaud (1997), which examines the spatial structure of Moscow after 70 years of non-market planning. They show that a tightly controlled government investment and rationing system created rusting factories in prime locations, and high-density residential areas in distant suburbs. Such a spatial outcome, they argue, reduces economic and social efficiency, and worsens the city's environment.

The Russian work was followed by work in South Africa, where the Apartheid system also had similarly rigorous laws controlling land use, in this case by race. The Group Areas Act required black workers to live in dormitory towns separated from the white core cities by buffer zones. This law resulted in extremely long commutes and economic hardship for black South Africans. Brueckner (1996) models the welfare gains that might result from the repeal of the Group Areas Act in 1991. He shows that allowing all South Africans the freedom to locate where they could maximize their utility would increase aggregate welfare. Thus, like Bertaud and Renaud's (1997) conclusions about Moscow, he also implies that the Apartheid policies, apart from being racist, were also highly inefficient.

From the perspective of the effects of land market restrictions, the fundamental points of the graphs in figure 1 are two: first, land use restrictions can and have imposed heavy costs on urban dwellers, decreasing both efficiency and equity; and second, these constraints are undoubtedly highly variable across cities and history. To get a sense of just how variable such costs might be, it is useful to contrast Bertaud and Brueckner (2004) who examine the welfare impact of what is known as Floor Area Ratio (FAR) restrictions in the Indian city of Bangalore with those of Bertaud, Buckley and Owens (2003) who analyze the same sorts of restrictions in Mumbai. In both cities, policies that restrict the density of jobs and population in the city center led to the expansion of the cities – and resulted in longer commute times and inefficient energy use. In the first case, the authors find that these restrictions imposed welfare costs between 3 and 6 percent of average household consumption. That is a costly result, but it is nowhere near as costly as the latter study estimates is the case in Mumbai. In that severely topographically constrained city, the same methodology suggests that the same sorts of FAR restrictions impose much higher welfare costs.

The main lesson from this literature is that land market policies go well beyond the project-specific concerns given such prominence in the Bank's earlier strategy. These policies fundamentally affect cities' ability to provide the agglomeration gains and thereby serve as growth centers. In so doing these policies constrain opportunities for higher more equitable growth.

New Form of Market Failure

Perhaps the biggest conceptual challenge faced by the Bank's low-income housing strategy in recent years has been the questions posed by the fall of the Soviet Union. The challenge arose because the nature of the problems is so different. In transition economies, migrations of the rural poor do not envelop rapidly urbanizing areas. In fact, exactly the opposite situation has obtained. Lower-income workers were already often in cities, and in the FSU, often in one-industry cities, where they often experienced some of the worst recessions recorded (see Buckley and Mini 2001). As a result, low-income workers quickly became the unemployed poor as the manufacturing base imploded. At the same time, there was no physical shortage of housing. By international standards as shown by Hegedus, Mayo and Tosics (1997), the urban population could even be described as over-housed even if administrative rationing systems caused severe misallocations. These very different housing problems led to a broad range of Bank projects and a sharp increase in Bank lending in the region.[22]

This work also led to the discovery of one of the first new forms of market failure observed in the past 50 years. This new market failure is identified by Heller (1998) in an analysis of the factors that constrained the privatization of real estate in Moscow. He argues that the way transition governments transferred property rights – by not endowing anyone with a bundle of rights that represents full ownership – prevented effective resource usage. In other words, he argues that in Russia the transition produced a contractual situation that in many ways is the opposite of the traditional "commons problem" in which no one has clear ownership rights to a shared good. In the Russian case, too many were given some form of claim on a particular piece of property. Just as too little control leads to over-usage of a resource in the commons situation, too much control in an anti-commons situation leads to under-usage and under-maintenance. Heller's work was subsequently formalized in an economic model by Buchanan and Yoon (2000 and 2001) and applied to other industries, such as the pharmaceutical industry by Heller and Eisenberg (1998).[23]

Certainly if one looks at the continuing problems with the privatization of the estimated $1 trillion dollars of residential real estate that was undertaken in the transition countries during the 1990s, World Bank (2001), an anti-commons problem seems to be very much the problem. In most transition countries, the government privatized individual apartment units under essentially give away terms, but the fabric of the buildings – the roofs, elevators and general energy efficiency of the buildings – remain unmanaged. Congested and ambiguous ownership rights to common property areas constrain the emergence of effective

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[22] See http://www.worldbank.org/urban/housing/

[23] While the formalization of Heller's work by a Nobel prize winning public choice theoretician and its application to another industry suggests that his "anti-commons" problem is an interesting one, in many ways, most of the arguments were raised more than 50 years earlier by von Mises (1949).

property management throughout the region, and that gives the sense that Heller's argument has considerable force. More than a decade after reform began, in only a few countries in the region, e.g. the Czech and Slovak Republics, Hungary and Estonia have effective ownership structures developed even though in most places the rule of law is now in place.

Is Capitalism So Mysterious?

Hernando de Soto's most recent book, *The Mystery of Capital*, makes a widely cited claim that secure property rights to land is in fact the answer to the mystery of why capitalism is such a productive economic system in the West. A corollary of this argument is that the absence of secure tenure explains the failure of capitalism to take off in the developing world. He makes a compelling case, at least at first reading, 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."[24] 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" blaming the absence of such well-defined property rights for the failure of capitalism in the developing world. As noted earlier, his views in this regard echo those of the early Bank research on this topic and would appear to confirm them.

However, on closer study, the strength of de Soto's claims seems problematic. Though there is good reason to agree that improving property rights should be an essential part of any reform process, a growing body of analysis reviewed by Woodruff (2001) argues that titling programs should be carried out in conjunction with the changing spectrum of property rights definitions that characterize tenure in developing countries.

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[24] De Soto (2000). p. 47

This argument implies that there are not likely to be "quick wins" of the sort identified by de Soto. Among other practical problems that reduce the seemingly large gains that could be realized are the following. First, 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. Second, an apparent paradox accompanies any titling program for informal residents. Much of the land on which informal houses are built is obtained through illegal squatting on private property without any compensation 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. Third, as Lee-Smith's (1997) analysis of property contracts in Kenya shows, this contract's value depends in large part on other existing and often unwritten contracts such as the degree of access women are allowed to exercise with respect to property. This broader web of societal contracts may well reduce the value given to property titles in isolation.

Besides, there is also less value to a title if it cannot offer value as collateral. Such a result occurs in most of Sub-Saharan Africa – and many other parts of the developing world – because there is no effective formal financial system that can help realize the value of the collateral. 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, with the result that it is difficult for them to show proof of income – a necessary condition to obtaining credit from formal financial institutions. The result is that in most of the developing world the collateral value of property title remains low.

These problems do not mean that housing policy should not include policies that improve tenure and the legal framework for individual ownership. Rather, it is to say that it would be dangerous to promote formal titling programs as the sole solution necessary to solve the problems of the urban poor as some have suggested. In many cases, formal titles are unquestionably valuable. Nevertheless, in most developing countries, where the capital markets are undeveloped and a spectrum of ownership structures exist, titling alone will not "unlock" capital. While such property rights may often be a necessary condition to develop a fully functional housing market, they are not a sufficient condition to unlock the trillions that are now locked up in dead assets. A set of interlocking, complementary reforms are also necessary. In short, while capitalism may well be mysterious it is so in subtle ways. The poor are not impoverished because a simple panacea has been ignored or simply misunderstood.

Housing Finance

The last review placed considerable emphasis on the need to develop a sustainable supply of finance to fund low-cost housing investments, and there has indeed been an increasing Bank Group involvement in this area. For example, housing finance has emerged as an increasingly important vehicle for Bank shelter assistance particularly through the IFC's ability to engage the private sector directly. During the 1990s, the IFC undertook more than 20 projects, usually taking the form of loans, for over $640 million and 14 percent of the Bank Group's shelter support during this period.[25] In addition, Bank assistance, along with that of the IFC and USAID, also contributed in important ways to the development of a market-based housing finance system in India, a country that had previously effectively proscribed the provision of mortgage credit. As argued by Buckley (1994) improving housing finance can have any number of beneficial effects on savings behavior, financial soundness, and housing conditions, but in few instances have Bank projects been able to

[25] See http://www.worldbank.org/urban/housing/ for more details.

directly assist the development of such finance for the poor, as was conjectured in the last review.

However, this result does not mean that housing finance for the poor is not developing. Rather, it means that the real promise for assisting low-income families with housing finance is emerging largely outside of the Bank's operations. It is emerging through one of the most promising financial innovations of recent years -- the success of micro-finance institutions in the developing world. This successful innovation offers the possibility of finance for the poor and is increasingly being used to support housing upgrading, see Ferguson and Navarette (2003), and ACCION (2003). This financial innovation offers the possibility of sustainable, leveraged finance in ways that were not possible even a decade ago. However, as Buckley and Vogel (1999) show, just as local housing market supply conditions are highly idiosyncratic, microfinance operations are even more so: so far they have only been successful when built on locally-developed methods which insure that repayment incentives are grounded in local mores.

IV. Conclusion

In a word, perhaps the main argument of the Bank's Shelter Policy is that it is distortions of markets, oftentimes well intended, that create the shelter-related problems faced by low-income families that can most easily be addressed. As a result, the 1986 study argued that with such a long-lived, spatially specific, socially-freighted good as housing the public sector would not be a good producer, owner, or financer of housing units. Nor would it be an effective designer of subdivisions for land development. The 1993 *Housing Policy Paper* carried that argument forward in more detail and with considerably more empirical evidence.

The research reviewed here indicates that in recent years empirical evidence largely, but not completely, in support of these views has accumulated. This is not to say that the shelter problems faced by low-income families in poor countries can be completely addressed by changes in government housing and land market policies. Rather, it is to emphasize that many sector-specific policies exacerbate rather than improve the shelter situation of the poor and that improved policies, by themselves, without additional resources can improve the situation. Land market regulations matter more than was thought to be the case; secure formal titles matter less. The earlier literature also gave little emphasis to community participation in project design but this oversight is being corrected by subsequent literature and experience. But, besides the findings of subsequent research, there is another altogether different metric against which the Bank's strategy can be measured: that is, have practices recommended by the strategy been adopted by many countries?

According to this standard, the Bank's strategy appears to have been very robust. For example, President Gorbachev's main advisers on transition argued that the FSU's public production and ownership of housing caused it to be the least efficient sector in the economy.[26] Similarly, in 2002 the Government of India began an Urban Reform Initiative Fund to reward states that eliminate real estate market regulatory constraints, such as binding rent control and urban land market ownership restrictions. This approach is extremely different from the perspective on the public role in housing policy that has characterized India's shelter policies for more than 30 years.

Reforms in developed countries follow a similar pattern. For instance, the emergence of private housing finance in the 1990s in much of Europe, and even in a number of developing economies, such as China, India, Malaysia and Mexico, is certainly consistent

[26] This report prepared by Grigory Yarlinsky and Stanislav Shatalin for Gorbachev as part of the early efforts to focus on what reforms should be undertaken in the first 500 days.

with the perspectives underlying the Bank's strategy. It is now a widely held view that directed credit systems are considerably less resilient and more prone to shocks. As the increasing IFC role suggests public sector housing banks are gradually being superceded by market-oriented private lenders. Finally, the wide-spread adoption of housing vouchers as the central vehicle to provide housing subsidies across almost all developed economies (see Boelhouwer (1997)) implies a similarly wide-spread recognition of the superiority of transfer mechanisms that use market incentives. This is a welcome change to mechanisms that replaced market incentives, as many public housing programs did even in OECD countries in the 1980s and early 1990s.

In sum, shelter policy has indeed evolved over recent years. Perhaps the foremost lesson we have learned is that the maintained hypothesis of the Bank's shelter policy has been confirmed – a targeted and limited public role is a sine qua non for a well-functioning housing sector. At the same time, there is no mysterious, straightforward capitalist panacea that can address all of the shelter problems faced by low-income families in developing countries. Circumstances vary widely and policy must be designed to exploit local conditions. Just providing titles, for instance, will not magically transform the housing situation of the poor. We have also achieved a better empirical understanding of the sometimes profound effects that regulatory policies can have on the functioning of housing markets, and a much stronger sense of the need to incorporate the views of the poor in how to effectively address their concerns. Increased community involvement is not only good social policy, it also improves project performance.[27] This

[27] A recent Bank study "Overview of the World Bank's Experience in Urban Projects with Community Participation" found that 31 percent of Urban Projects in the 1991-2001 period has a Community Participation component compared to 11 percent on the 1981 –1990 period. In the 1991-2001 period, projects which had a community participation component were found to have a satisfactory outcome rate of 86 percent when compared to all urban projects which had satisfactory outcome rates of 71 percent.

improved empirical understanding, along with the more widespread commitment to a reliance on private markets, should enable the Bank's shelter assistance to continue to function as one of the most effective of all Bank sectors.

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