

THE CHALLENGE OF AN URBAN CONTINENT



INTER-AMERICAN DEVELOPMENT BANK

THE CHALLENGE OF AN URBAN CONTINENT

**The Work of the IDB
in Urban Development**



**Social Programs Division
Sustainable Development Department
Inter-American Development Bank**

Washington, D.C.

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Foreword

Operating in the most urbanized of developing regions, the Inter-American Development Bank has developed a large and complex portfolio of urban loans. The Bank's contribution to urban development in Latin America and the Caribbean is linked to its origins as a multilateral development institution. The Bank's first loan, granted more than 40 years ago to the Government of Peru, was for the expansion of the water supply of the city of Arequipa. Since then, the portfolio of urban loans has steadily grown in volume and complexity. To date, Bank loans address a wide variety of urban problems including traditional areas of concern for urban governments, like expanding water and sanitation services, and more recent issues, like urban violence and social and spatial exclusion of groups and individuals. Over the decades, Bank lending for urban development has evolved into a complex area of activity with multiple linkages to other areas of development. In the process of providing support the region's cities, the Bank has accumulated a wealth of knowledge. Sharing and disseminating

this knowledge is a significant contribution to borrowers in their efforts to achieve an efficient and egalitarian urban development process in the region.

The present publication traces the history of the Bank's lending for urban development and discusses the Bank's approaches to current urban issues. It is intended for specialists and individuals interested in getting acquainted with the evolution of the Bank portfolio. I hope that this publication will contribute to a better understanding of the Bank's contribution to urban development as, in the next twenty years, the Americas becomes the most urbanized region of the world

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Introduction

Over the next two decades the majority of the world's population will live in urban areas and the number of urban residents in developing countries will double, reaching over two billion persons (HABITAT, 2001). This dramatic shift of the population from rural to urban areas is unprecedented, and brings with it new opportunities and daunting challenges. Latin America and the Caribbean is already one of the most urbanized areas of the world and the process of urbanization is still in progress. Responding to the challenges posed by the rapid urbanization of the population and economic activities, the Inter-American Development Bank has steadily expanded its lending in support of cities. The IDB actively addresses urban development needs in the region by financing the expansion and improvement of urban services, and by building financial and administrative capacity in local governments and public utilities. In its 40 years of activity, over US\$25 billion of the Bank's total portfolio of loans approved has gone toward urban development projects (all figures quoted in this docu-

ment are in constant 1996 U. S. dollars). This level of lending represents nearly 15 percent of the total amount lent by the Bank since initiating operations in 1961.¹ The scope and complexity of the Bank's activities in support of urban development have also grown over the decades.

The purpose of this publication is to present the most salient features of the Bank's lending and technical cooperation activities in support of urban development. It also discusses opportunities and challenges lying ahead for the Bank in order to assist borrowing member countries to take full advantage of the development opportunities offered to them by the urbanization process.

¹ Additionally, more than US\$13 billion of approved loans directly benefit urban areas since they finance capital investments, technical and institutional development activities for the development and strengthening of micro, small, and medium sized business that are mostly located in cities.

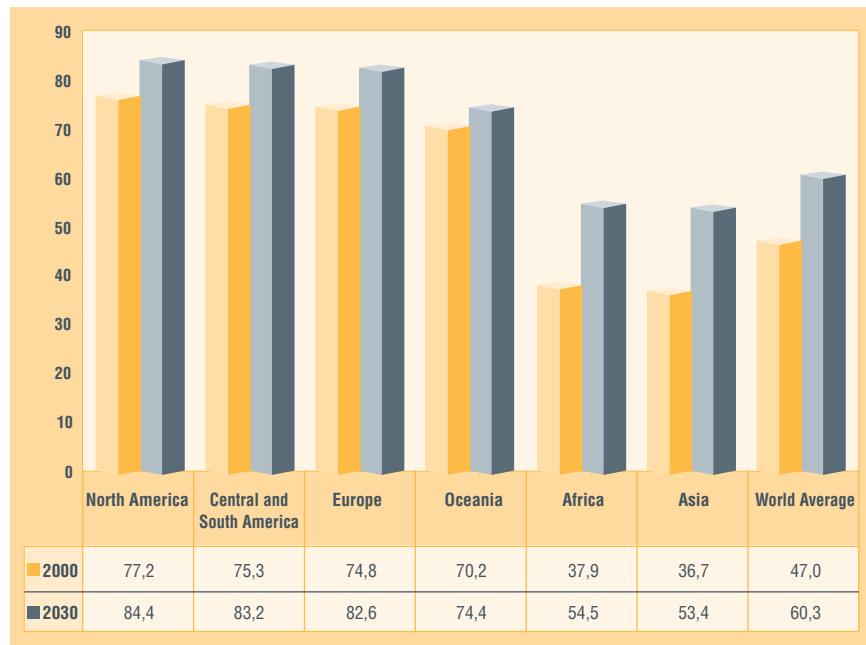
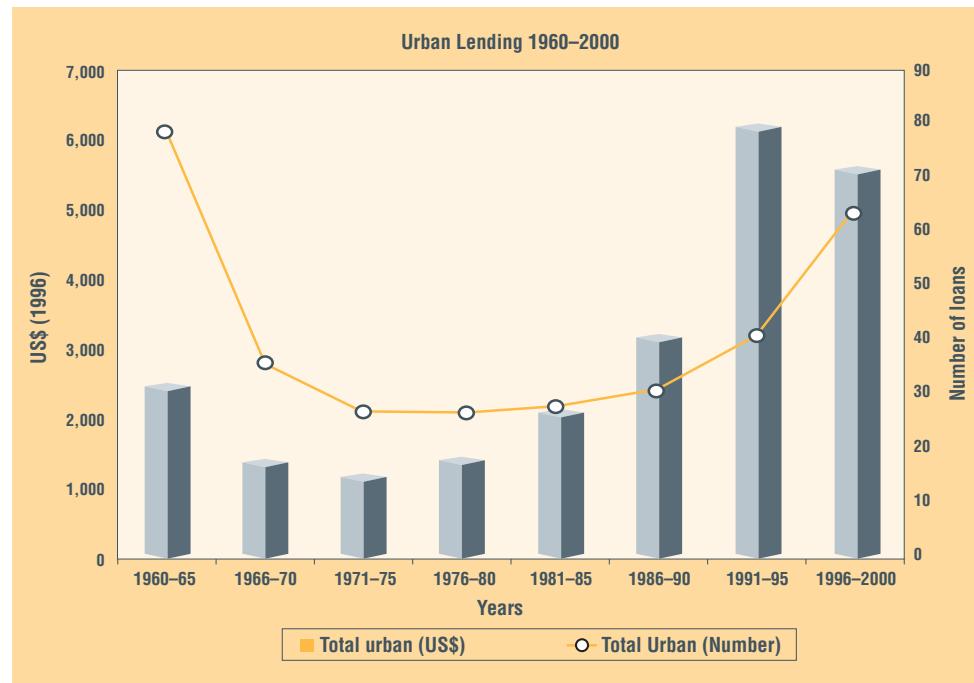


FIGURE 1

Urbanization Trends

(percentage of total population)

FIGURE 2
Lending for Urban Development in Five Years Increments 1960 – 2000
(in millions of 1996 US dollars)



The document has four sections. After this introduction, the second section presents the broad context in which the Bank's urban operations evolved, discussing the overall trends that are shaping socioeconomic development in the region: the urbanization of the population, economic globalization, government decentralization and environmental degradation. The third section traces the evolution of IDB lending in support of cities and provides a detailed discussion of Bank activities in housing, municipal development, integrated urban development projects,

transportation, environmental management and sanitation. Throughout this section there are descriptions of projects financed by the Bank in the late 1990s and early 2000s that show how the Bank's approach is put into practice. The final section explores the road ahead, discussing emerging challenges in urban development and the Bank's response. The Annex contains the data on the number of projects and amount lent (in constant 1996 US dollars) for urban development by the Bank in its over forty years of operations (1961–2003)



**Global and Regional Trends:
The Increasingly Complex
Context for the Bank's
Response to the Urban
Challenge**



Urbanization of the Population and Economic Activities

Latin America has had a unique urban history. From its beginnings as the result of a remarkable settlement effort during the first half of the sixteenth century that led to the establishment of most of the cities that today comprise the region's urban structure, to the explosive growth experienced by these cities in the second half of the twentieth century. The spatial distribution of these cities responded to the needs of the colonial powers. Spanish and Portuguese settlers established themselves in places well suited for trade (Salvador de Bahia), where local labor was abundant (Bogota) or significant settlement already existed (Mexico City) or at important places of worship for the indigenous population (Quito). This process left the region well endowed with urban settlements to house the colonial administration, conduct commerce and exploit the region's natural resources. The political independence of the colonies did not add significantly to the inherited structure but modified the roles of some cities giving greater relevance to national capitals where the new local elite concentrated. After World War II, much of the economic growth concentrated in urban centers as countries adopted import substitution policies to promote industrialization. People migrated to cities in search of better job opportu-

nities and access to basic services that were lacking in rural areas. The high concentration of population and economic activities in specific parts of the territories led to the formation of complex city-regions that are highly integrated into global markets and lead the process of economic growth of their respective economies.

In 2000, 75 percent of Latin America's 523 million inhabitants lived in cities. By 1990, more than half of the region's gross domestic product was generated in urban areas (HABITAT, 2001), which are expected to account for over 80 percent of future GDP growth (World Bank, 1991). The change is staggering. At the turn of the twentieth century only one out of four people lived in urban areas (defined as settlements of 2,000 or more inhabitants), whereas by the beginning of the twenty-first century the relation had reversed completely, with three out of every four people living in cities. In 1900 there was no single city in the region with one million inhabitants. In 2000 there were 49 such cities (twice as many as in 1975), and four of them were among the 10 largest cities in the world. These megacities (urban agglomerations of more than 10 million inhabitants) are Mexico City (with 16.6 million inhabitants), São Paulo (16.5 million), Buenos Aires (11.6 million) and Rio de Janeiro (10.2 million). Three other cities (Bogota, Lima and Santiago de Chile) have populations of over 5 million. The urbanization process is expected to continue and by 2025 an estimated 85 percent of Latin America's population will be living in cities. In recent decades, in-

	1950	1950–1975	1975	1975–2000	2000
Total population	179,050		319,893		523,875
Increase in total population		140,843		203,982	
Urban population	74,484		196,094		401,287
Increase in urban population		121,610		205,193	
Urban population as % of total	41.6%		61.3%		76.6%
Agglomerations over 1 million					
Population	16,785		69,534		153,995
Number	7		21		47

Source: HABITAT, 2001.

TABLE 1
Urbanization Trends
1950–2000
(Population figures in thousands)

intermediate size cities (those with populations between 200,000 and 1,000,000) have shown remarkable demographic and economic dynamism, growing faster than any other group.

Urbanization has been a good business. The concentration of the population and economic activities in cities brought remarkable progress to the region. Urbanization is always accompanied by growth in per capita income. In the period 1975 to 2000, with few exceptions, higher urbanization also led to higher per capita product. In most countries of the region, per capita GDP increases as the proportion of the population living in urban areas increases. In addition, the economies of more urbanized countries grow faster than those of less urbanized nations. These outcomes result from the fact that the productivity of urban enterprises and labor is significantly higher than that of their rural counterparts. Urban areas offer better employment opportunities, higher incomes and easier access to public services. Cities are Latin America's engines of economic growth and offer their popu-

lations the best opportunities for social and economic progress. This is shown by the fact that in spite of massive urban population growth (over 200 million urban residents were added between 1975 and 2000) the percentage of the urban population living in poverty has remained constant, at around 30 percent. (HABITAT 2001).

Notwithstanding these developments, urban poverty still poses a significant challenge. One out of every three urban dwellers lack sufficient income to cover the cost of basic needs. The number of urban poor broadly exceeds the number of rural poor, although the percentage of the rural population living in poverty is higher. The economy of the region must grow by at least 3.2 percent per year in the next twenty years just to halve the number of people living in extreme poverty. The causes of urban poverty are many and complex; some are economic while some are social and cultural. The urban economy has shown a persistent lack of capacity to provide formal jobs to all those seeking employment. As a result,

FIGURE 3
World Urbanization
and Per Capita GDP
1975–2000

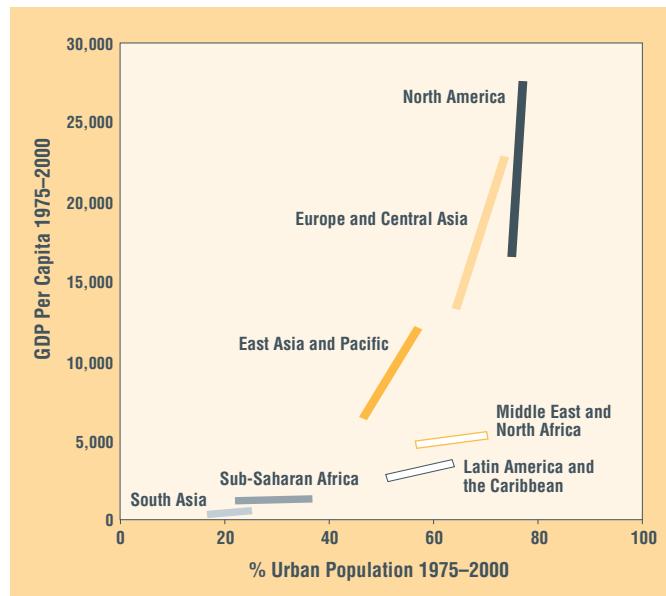
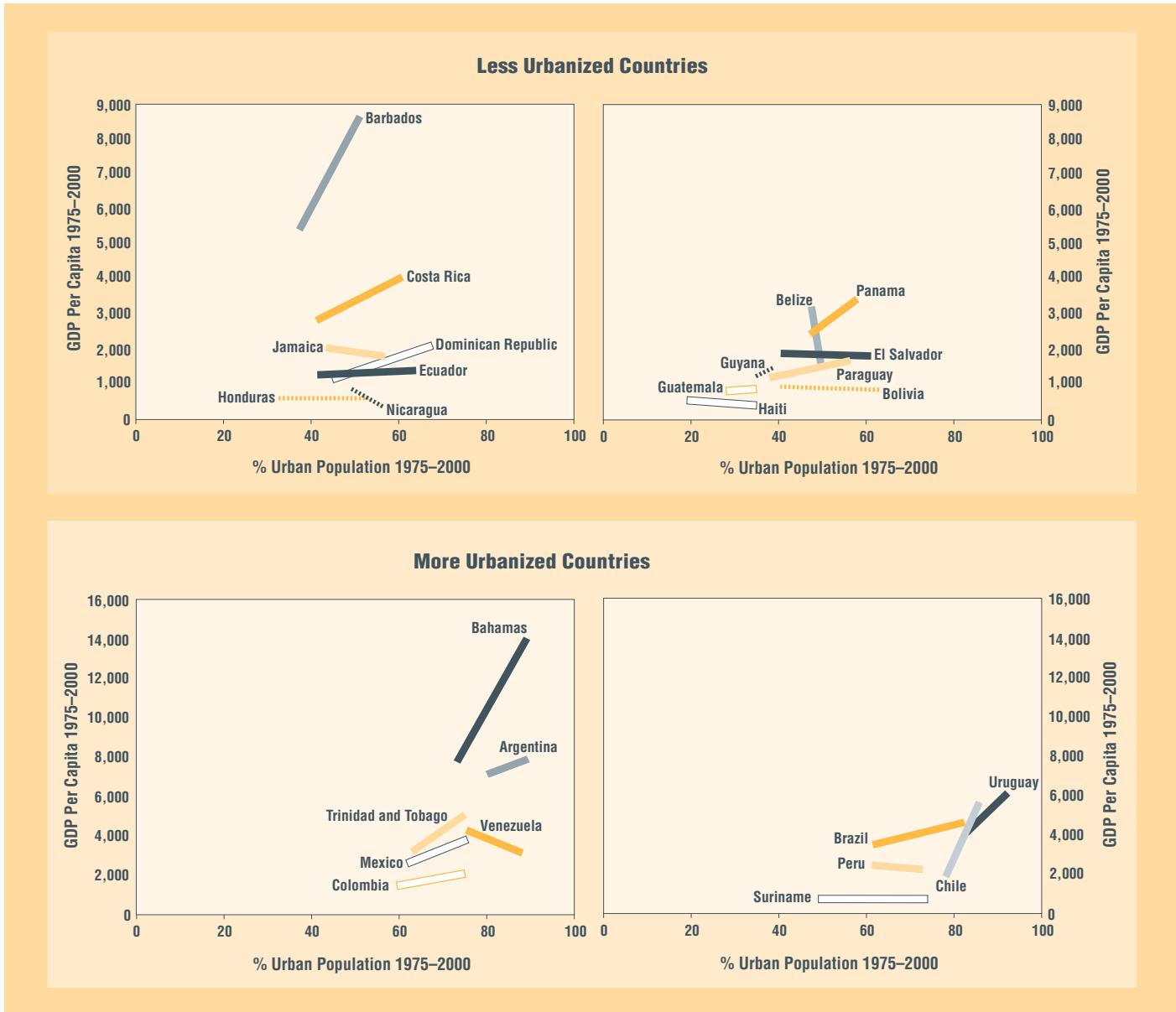


FIGURE 4

**Latin America and the Caribbean.
Urbanization and Per Capita GDP 1975–2000**



The concentration of economic activities and population in cities increased business productivity of and improved living conditions.



there has been a rapid increase in informal employment, which is less productive, less stable and less well paid than employment in the formal sector. The informal sector, predominantly in service activities, accounts for more than 70 percent of new jobs generated in cities and has shown the fastest rates of growth during the last decades. Incorporating this labor force into the formal economy, where the levels of pay, social protection, and productivity are higher, is the main challenge of urban economic policy (Brakarz, Greene and Rojas, 2002). Urban poverty can result in a broader cumulative deprivation, characterized by squalid living conditions, risks to life and health from poor sanitation and air pollution, crime and violence, traffic accidents, and natural disasters. Also, it is not uncommon to witness the breakdown of traditional family and community safety nets, which become stressed by the growing needs of the urban poor (World Bank, 2000). Cities offer governments better opportunities to address poverty issues since

reaching the urban poor with services and goods to enhance their living conditions, assets and income-generating capacity, is cheaper than doing it for the rural poor.



Cities Competing in an Increasingly Global Economy

Globalization is not a new phenomenon. Periods of intense economic and cultural exchange among distant countries and cultures have occurred in the past, but its most recent manifestation differs in fundamental ways from previous episodes. The current processes function at a much faster speed and operate at a much greater scale than what the world saw at the peak of the Spanish and Brit-

ish empires in the seventeenth and nineteenth centuries, respectively. The scope of global connections is much broader and its dynamics create new levels of complexity (HABITAT, 2001). The broad liberalization of trade, finance and labor markets benefits the entire population by providing more jobs and cheaper goods and services, although its impacts are not evenly distributed. Globalization has expanded the mobility of capital and knowledge, but has left cities with the less mobile components of the production equation, the physical capital and the unskilled labor force.

The contemporary global economic context presents significant challenges to cities in Latin America and the Caribbean and has a considerable impact on those cities where global economic operations are concentrated. Cities compete for highly mobile capital, knowledge and skilled labor to fuel local economic growth through manufacturing and service activities geared to supply world markets. As competition increases, the disadvantages of smaller

urban areas vis-à-vis intermediate size cities and large metropolitan areas become more evident because most investment is directed to larger cities with greater economies of agglomeration. There are growing differences between city-regions that are well positioned to enter world markets and cities and territories that are left behind by the process. Even cities that are able to attract foreign and local investment confront significant challenges, given the conditions under which the transnational economy operates. The changes in employment modalities—that are increasingly project-oriented rather than linked to companies, knowledge-based, less protected and stable and the sustained trend toward a service-driven economy that requires mostly skilled labor prevent many urban dwellers from enjoying the benefits of economic growth. Global integration has been accompanied by worsening income distribution in most countries and these differences become dramatically apparent in the cities. In addition the growing incidence



The production of Latin American cities compete in increasingly global markets.

of informal employment already mentioned, ensuing problems include the spatial isolation and social exclusion of the poor, the fragmentation of informal networks and the aggravation of latent social problems.



Decentralization for Greater Efficiency and Equity

One of the most remarkable features of the recent evolution in the management of cities in Latin America and the Caribbean has been the sustained and growing transfer of government functions to local governments, the process of decentralization. To enhance competitiveness and foster local economic growth, national governments seek to improve services and infrastructures by transferring responsibility to subnational governments, which are usually more attuned

to the needs of local economies and better able to work with local entrepreneurs and civil society organizations.² Subnational governments are also asked to assist in promoting a more equitable development process by efficiently providing public services, such as health, education and sanitation, that are essential for the well-being of the population and also critical for achieving greater equity, both among different groups of the population and areas of the country. Argentina, Brazil and Colombia are highly decentralized while Bolivia, Mexico and Venezuela have made significant progress in transferring resources and responsibilities to subnational entities. There is still much room for decentralization (15 percent of government expenditures are handled by local authorities in Latin America and the Caribbean compared to 35 percent in industrial-

² Subnational governments encompass a wide variety of entities with jurisdiction over territories within a nation state including states, provinces, regions, and municipalities.

TABLE 2
Levels of Decentralization by Country

Emphasis of decentralization effort	Level of decentralization (percent of public expenditures accounted for by subnational governments)			
	Over 20%		Between 10 and 20%	Less than 10%
Intermediate level (states and provinces)	Argentina Brazil Mexico Venezuela	(49.3) (45.6) (25.4) (19.6)	Peru (10.5)	
Local level (municipalities)	Colombia Bolivia	(39.0) (26.7)	Uruguay Chile Honduras Guatemala	(14.2) (13.6) (12.3) (10.3)
				Ecuador (7.5) Trinidad and Tobago (7.2) Paraguay (6.2) El Salvador (6.0) Nicaragua (5.2) Panama (3.2) Dominican Republic (2.9) Costa Rica (2.3) Barbados (0.0) Bahamas (0.0)

Source: IDB, 1997a.



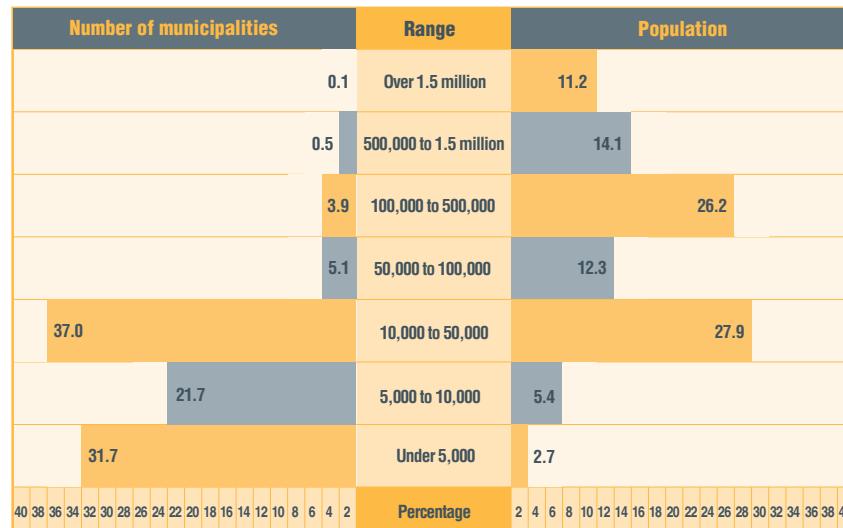
Decentralization of services, resources and decision making power allows communities a greater say in decisions that affect them.

ized countries) and the trend is well established in the region. Local government is turning democratic in most countries. In 1980 only in three mayors were elected by popular vote while in 1997, 17 out of the 26 borrowing member countries of the Bank had direct elections for mayors. In other six mayors were nominated by elected municipal councils (IDB, 1997a).

The financial and institutional capacity of subnational governments to take on more responsibilities varies significantly. There are more than 100 states and provinces (also known as departments or regions) and over 15,000 municipalities in the region. Some states have very large populations (the state of Bahia in Brazil and the province of Buenos Aires in Argentina have populations that are larger than those of most Latin American and Caribbean countries) and others are the economic powerhouses of their countries (the state of São Paulo accounts for over 50 percent of industrial production in Brazil). There are also small and poor states

that command fewer resources than a medium-size municipality. There are enormous differences in the institutional capacity of subnational governments in the countries of Latin America and the Caribbean. The institutional capacity of municipalities like São Paulo, Buenos Aires and Mexico City is greater than that of many small states. On the other hand, some small municipalities often do not have a permanent staff or the services of a professional accountant. Their financial capacities also show staggering differences. However, there are positive elements in the current state of affairs. Over 60 percent of the region's population lives in municipalities with 50,000 inhabitants or more, a demographic size that usually can support local governments capable of providing efficient services. Furthermore, the emergence of medium-sized cities as major actors in the social and economic development of the region is advantageous. If managed properly, they are capable of providing services in an efficient manner. Decentralization

FIGURE 5
Number of Municipalities and Population
(in percentages)



Source: IDB, 2001a.

often clashes with the outdated legislation that frames intergovernmental relationships. The devolution or reassignment of responsibilities has not always been backed with the corresponding allocation of resources or the right incentives for local governments to raise sufficient revenue. These are areas of reform still in need of attention.



Environmental Degradation

One of the often-cited drawbacks of urbanization and rapid growth of urban areas are the multiple negative impacts cities have on the natural environment. As cities expand, they demand growing quantities of environmental goods and services, including land to expand the urbanized area; water and energy for the population and

economic activities; and land, water and air to deposit wastes. This process often stresses the carrying capacity of the environment, resulting in air, soil and water pollution, the loss of agricultural and forest land and the general degradation of the quality of life in cities. National and city governments are responding to this challenge by engaging in environmental planning and regulation, and investing in environmental cleanup.

Remarkable progress has been made after decades of investments to expand access to clean water to urban and rural populations, and the institutional reforms brought about by partial privatization of public utilities. Some countries report nearly universal coverage of potable water for the urban population. Deficits in sanitation services, however, are still high. Aggregate figures on current urban coverage of sanitation services hide the large shortages faced by poor neighborhoods in the periphery or the inner city. The rapid expansion of cities (particularly metropolitan areas) through illegal or substandard settlements continues to increase the number of people affected by the problem. In addition

to limited coverage of low-income communities, solid waste collection services in Latin American cities generally lack safe final disposal procedures. The disposal of industrial and toxic waste poses a significant challenge that is not currently tackled systematically by cities in the region. Economic expansion and growth in the motor vehicle fleet has increased air pollution in most cities. Lack of adequate land use regulations and enforcement, and inappropriate site selection for low-income housing, increases the population's exposure to natural disasters. Intermediate size cities face a difficult environmental challenge and are gaining priority in government programs, as they have to accommodate fast demographic and economic growth with insufficient service capacity.

National and city governments are increasingly aware of the long-term problems of urban environmental degradation and are undertaking institutional reforms and investments to improve a poor

environmental record, particularly in air pollution. Well-known preventive actions, such as control of pollution from fixed sources and the introduction of more efficient public transportation to discourage the use of cars, are stabilizing or reducing air pollution in certain cities in spite of sustained population and economic growth. Cities are also investing in wastewater treatment and environmentally sound solid waste management practices. Well-designed and supervised privatization programs of public utilities, as well as new private-public partnerships for expanding services are playing a significant role in reducing these problems in many cities. Good performance on environmental matters will depend on the integrated and coordinated use of a plethora of instruments and interventions ranging from appropriate urban land use planning to establish incentives for good resource management in the public and private sectors.



Rapid population and economic growth create environmental problems that cities must mitigate.



**The Evolution of Urban Lending
at the Inter-American
Development Bank**

Over its four decades of activity, Bank lending has changed dramatically. These changes roughly coincide with the evolution of the region's urbanization and decentralization processes and the growing concern with environmental problems. Early lending focused on responding to the most critical demands of rapid urbanization, urban sanitation and housing construction. Thus, for much of the 1960s the Bank's urban portfolio was dominated by housing and sanitation loans. The 1970s were characterized by reduced lending mostly focused on sanitation that remained a pressing need in most cities. The 1980s saw a surge in interest in urban loans, particularly in support of municipal development, a response to the decentralization process underway in the region. Sanitation maintained its predominance in the Bank's portfolio and low-income housing (mostly in the form of sites and services and settlement upgrading loans) grew in importance in response to the growth of informal settlements. The 1990s added greater complexity to the urban portfolio. In addition to municipal loans that grew significantly as a result of the decentralization efforts of many countries, there was a renewed interest in housing loans to support sector reforms. Demand for loans in support of new areas of investment also grew in the 1990s. These new areas included the rehabilitation of urban heritage areas, transportation and environ-

mental cleanup, and programs to tackle growing urban social ills, violence, exclusion and the number of people living in the street (the Annex contains detailed data on Bank lending by year and area of lending).



Housing

Bank participation in the housing sector shows significant changes in approach and lending volume. The Bank lent for housing in the 1960s, withdrew from the sector in the 1970s and lent again in the 1980s, but restricted its operations to sites and services projects. Early Bank lending for building affordable finished houses for low-income households was a well-intentioned, albeit unsustainable, effort to help countries cope with the acute shortage of housing brought about by the rapid urban population growth. Houses financed with funds from Bank loans proved unaffordable to the intended beneficiaries (even with access to subsidized loans) and were eventually acquired by households in other income brackets. Subsidized

Sector	Amount lent		Number of loans	
		%		%
Housing	3,028.3	11.9	65	17.1
Settlement upgrading	1,476.4	5.8	20	5.3
Integrated urban development	1,429.5	5.6	13	3.4
Urban heritage conservation	137.1	0.5	4	1.1
Municipal development	6,040.7	23.7	69	18.2
Urban transportation	1,139.7	4.5	14	3.7
Environment	1,681.3	6.6	14	3.7
Sanitation	10,574.4	41.5	181	47.6
Total urban lending	25,507.4	100.0	380	100.0
Total Bank lending	175,312.6		3,100	

Source: Annex

TABLE 3

**IDB Urban Lending,
1961–2002**
(1996 US\$ million)

lending eroded the capital of the government-owned housing finance institutions, preventing housing provision and finance mechanisms from being duplicated. Lending for housing was interrupted in the 1970s and replaced in the 1980s by loans that provided site and services solutions to low-income households. The low standard of housing solutions was to discourage higher income households from stepping in. However, in most countries the lack of supply of housing solutions for lower middle-income households led to the displacement of low-income households as final beneficiaries of these projects.

Recognition of these failures, and the early success of housing reforms in Chile, led borrowing countries to request Bank assistance for housing sector reform (Rojas, 2001). The Bank expanded its housing finance activities in the 1990s, shifting its support to-

ward sector reforms that expand the capacity of housing finance and delivery mechanisms to cater to the needs of low-income households. Sector reform was geared toward enabling housing markets to operate more efficiently by withdrawing the public sector from directly building or financing houses and centering its activities in improving the regulatory environment and supporting low income households in accessing mortgage financing for home purchase through direct subsidies. Since the early 1980s, the Bank has maintained an active portfolio of settlement upgrading loans that are an integral part of its activities in the housing sector (Brakarz, Greene and Rojas, 2002) To properly account for the complexity of Bank activities in the sector, the analysis that follows is divided into a section related to activities supporting housing sector reform, and another dealing with loans for settlement upgrading.

FIGURE 6
Structure of IDB
Lending for Urban
Development,
1960 – 2000

	Component	Decade				
		1960	1970	1980	1990	2000
Emerging Issues	Social inclusion					■
	Local economic development					■
Municipal Development	Subnational sector development					■
	Municipal fiscal management				■	■
	Municipal infrastructure			■	■	■
Integrated urban Development	Urban rehabilitation					■
	Urban heritage preservation				■	■
	Integrated urban development programs			■	■	■
Housing	Housing sector reform				■	■
	Settlement upgrading			■	■	■
	Sites and services		■	■		
	Finished houses	■				
Urban Transport	Urban transportation systems				■	■
	Transportation infrastructure			■	■	■
Sanitation	Urban environment				■	■
	Urban sanitation	■	■	■	■	■

	Approach					
	Finished Houses	Sites and Services	Settlement Upgrading	Enabling Housing Markets		
	Decade					
	1960	1970	1980	1990	2000	
Component	Construction industry development				■	
	Real estate development industry				■	
	Urban land markets reform				■	
	Financial markets development				■	
	Microcredit for housing				■	
	Secondary mortgage market development				■	■
	Primary mortgage market development				■	■
	Government sponsored progressive housing				■	■
	Direct subsidies supporting demand				■	■
	Housing sector institutional reform				■	■
	Community development				■	■
	Settlement upgrading programs			■	■	■
	Sites and services programs		■	■		
	Development of government housing institutions	■		■		
	Finished houses	■				
		Finished houses for low income families and institutional development of national public housing institutions	Sites and services programs for low income families	Sites and services programs for low income families, settlement upgrading and institutional strengthening	Support for housing sector development and settlement upgrading programs	Housing sector reform
	Type of Project					

FIGURE 7
Housing Lending Timeline

BOX 1**Key Points of the Bank's Urban and Housing Development Policy (OP-751)**

The Bank provides selective support for projects that contribute to developing the capacity of the borrowing countries to respond to the challenge of urban growth and to improve the living conditions of the low-income population, according to the priorities established by each country. This support is offered in the form of loans and technical assistance for operations that pursue the following goals:

- Finance projects that contribute to the generation of income and opportunities for productive employment, especially for low-income households.
- Quantitative and qualitative improvements in basic urban services for urban populations, especially for low-income persons.
- Reductions in the adverse effects of urban growth on the environment.
- Strengthening national urban systems and improving the internal functioning of cities.
- Increasing the effectiveness of the institutions responsible for the formulation and administration of urban development policies and programs.

In the housing sector, the Bank encourages governments to pursue policies to efficiently mobilize private and public resources to help households in solving their housing problems. Bank activities in housing will:

- Support policies and sustainable programs and projects to improve housing conditions for low-income households.

- Improve public sector effectiveness both as a facilitator of private sector initiatives and in the management of public resources allocated to the sector.
- Promote sector-wide allocative efficiency of housing and related markets such as land, financing and construction materials and services.

The Bank provides financing for programs and projects that directly improve the housing conditions of the low-income population by expanding the availability of efficient new housing solutions or by upgrading existing low-income settlements and housing. The Bank finances transparent, well-targeted and sustainable public subsidy schemes for housing when they are shown to be an efficient and equitable means of promoting improved housing conditions for the low-income population.

The Bank provides policy advice, technical cooperation and financing for the design and implementation of sector-wide reforms aimed at removing constraints to the efficient and equitable allocation of resources in housing including: the improvement of the regulatory framework for housing production, the promotion of efficient urban land markets, the establishment of efficient and sustainable housing finance mechanisms, the promotion of private investment in rental housing, and the development of an efficient and competitive building industry. Deficiencies in housing finance mechanisms are addressed within the framework of sound financial sector policies.

Housing Sector Reform

The mid-1980s witnessed the gradual consolidation of a novel approach to low-cost housing and housing sector financing and management. Demand-driven ideas replaced the supply-driven approaches of the past. The so-called “enabling approach” to housing markets relies on the private sector as the main supplier of houses and long-term mortgage-backed loans for households in all income brackets, with the government playing a role as regulator and facilitator of housing markets. A key feature of the approach is a focus on interventions to unleash the potential of individuals, communities, developers, investors and entrepreneurs to finance, build, sell and expand houses. Two major changes are proposed: (i) pulling the government out of the direct construction and financing of houses, and (ii) focusing government interventions on the development of primary and secondary mortgage markets, the facilitation of land subdivision and servicing for residential uses, and on improvements in the construction industry. Under this scheme, low-income households benefit from direct government subsidies for the purchase of market-transacted houses. Subsidies supplement household savings enabling them to complete the financing of a house with loans provided by private banks and whose repayment would take a pre-defined maximum of the household income. Originally advocated by the United Nations (HABITAT, 1988), the approach was adopted by the World Bank in the early 1990s (World Bank, 1993) and by the IDB shortly thereafter (IDB, 1995a).

This expanded approach to sector reform and the multiple linkages of housing to the financial and real sectors of the economy and its impacts on the quality of life of the population, make housing sector loans good instruments for the alleviation of health-related, employment-related and wealth-related poverty issues; for strengthening the financial sector; improving fiscal discipline; and the decentralization of government operations. Housing loans are no longer single-purpose investment loans, but instruments of housing sector reform. They support governments in adopting a facilitating and enabling role in the housing sector, relying on private sector, civil society, and community-based organizations for under-

taking the construction, finance, and management of housing production and distribution.

The concept of the public sector as a facilitator of housing sector operation (not as a producer or sole financier) has gained ground in many countries. There are several efforts currently underway in the region to strengthen the housing finance sector by developing commercial credit and mortgage markets, and by expanding the use of demand-based subsidies that eligible households can apply for to purchase a new home or finance home improvements. Emphasis on regulatory reforms and better targeting of public resources characterize present Bank housing reform projects. They support a wide range of housing options and foster the participation of the private sector and nonprofit and community development organizations as well as the use of transparent, direct, and up-front subsidies. They are far more complex than previous site and service programs and take much longer to mature, thus presenting a significant challenge for the Bank and its borrowing countries. However, Bank experience in the sector has demonstrated that governments adopting an “enabling strategy” are more likely to achieve their goals in the housing sector than those that use public funds to directly finance and construct housing units.

Settlement Upgrading

In most Latin American and Caribbean countries, the formal housing sector does not offer houses affordable to all segments of the population. Furthermore, formal urban land markets do not produce serviced lots affordable to the low-income population. This situation forces poor households to seek informal solutions to their housing problems, either doubling up with other households or occupying land in informal settlements. Operating outside formal urban development regulations, informal settlements house between 20 and 50 percent of the population of Latin America’s major cities. Living conditions in these settlements are deplorable, as they usually suffer the worst environmental conditions and lack basic infrastructure and urban services.

BOX 2**Ecuador: Housing Programs I and II**

The results obtained with two loans to Ecuador show the virtues of the housing policy adopted by the Bank in the mid-1990s. The first housing loan issued in 1999 concentrated on increasing efficiency in the use of central government resources devoted to subsidizing low-income housing, and incorporating the private sector into the production and financing of affordable houses. The housing sector achieved notable improvements as a result of the reforms introduced. Building on the institutional framework and streamlined system of subsidies, the Bank financed a second housing program in 2002, which included the institutional strengthening of the participating institutions, expansion of the subsidies program allowing their use for the rehabilitation of existing houses as well as new housing construction, and financing a neighborhood upgrading component.

Context and background. Rural migration caused the rapid growth of Ecuadorian cities in the 1990s, which posted annual population growth rates of over 3.5 percent. In 2000, 61 percent of the nation's 12 million inhabitants lived in cities. Urban housing conditions are generally poor. There is little available serviced land in for the formal sector to build affordable housing, thus, a great deal of the existing housing stock has been built informally. Between 1990 and 2000 441,000 informal houses were constructed. Most are of substandard construction and lack access to public services. Close to 50 percent of the urban population lives without basic residential services, lacking indoor water or sewerage or electricity. These problems affect the very poor who have no access to the formal housing sector. Approximately 850,000 households double up with other families and an additional 350,000 live in substandard houses. Every year 54,000 new houses are required in the urban areas to cater for new households. For decades the government assumed responsibility for low-income housing, acting as promoter, constructor and financial agent through

the Ecuadorian Housing Bank (BEV), activities that ultimately proved to be unsustainable. BEV suspended operations in 1996 and was turned in to a second tier bank in 1998.

Characteristics of the programs. A new housing program was launched in 1999 with a US\$62 million loan from the IDB and a US\$6.6 million counterpart contribution. In consonance with the Bank's housing policy, the program had the following goals: (i) promote greater participation of the private sector in the production and financing of new houses; (ii) improve access to housing by low-income households through savings and direct subsidies; (iii) use public resources in a more equitable and transparent way; and (iv) promote reforms to municipal land subdivision regulations to facilitate the formal creation of affordable residential land. The state transferred housing construction to the private sector and concentrated on facilitating the operations of the housing sector through a transparent system of subsidies, and the promotion of private institutions to provide support to families applying for housing subsidies.

Execution. The first housing program resulted in the construction of 65,000 houses. In addition, 110,000 households opened savings accounts, 48,000 of which are beneficiaries of subsidies. In 2002 the IDB approved a second loan to consolidate the reforms and expand the scope of the interventions to include subsidies for the improvement and rehabilitation of existing houses, financing for settlement upgrading projects and technical assistance to the institutions involved in the housing sector, including municipal governments. The consolidation of the direct subsidies scheme includes 12,000 *subsidies for new housing* of US\$1,800 each benefiting 54,000 people in households with a maximum monthly income of US\$360. This subsidy allows the eligible households to purchase houses costing, on av-

BOX 2**Ecuador: Housing Programs I and II**

erage, US\$4,500 with an average loan of US\$2,250, which is affordable for families with an average monthly income of US\$200. The direct subsidies scheme also includes 14,000 *subsidies for house upgrading* of US\$750 each that benefit 64,000 households, providing financing to establish connections to public utilities, build or renovate bathrooms and kitchens and build, repair and/or enlarge the roofs of houses with values not to exceed US\$4,000 (excluding the price of the land). Integrated settlement upgrading projects promote the physical and social integration of informal settlements to the formal city through improvements in urban infrastructure, the supply of social services and the regularization of land tenure. The program financed by the second loan

will benefit 3,600 families located in six municipalities with populations above 20,000 inhabitants. The average (per family) investment is US\$2,100 financed in equal parts by the central government and the municipalities. The third component of the program involves institutional strengthening, technical training and sector studies. The objective is to design and implement a system of planned savings accounts, support the municipalities in allocating land for public housing, identify and solve bottlenecks in the housing policy, introduce flexibility in urban land regulations to facilitate the provision of low-income housing and support the process of legalizing informal settlements and registering property.



Housing sector reforms supported by the Bank are encouraging the private sector to build and finance affordable housing.

BOX 3**Suriname: Low-Income Shelter**

The low-income shelter program in Suriname offers an innovative example of an integrated housing approach focusing on a combination of institutional strengthening and the re-orientation of an existing subsidy system. Housing deficiencies in Suriname are overwhelmingly qualitative thus the IDB loan set out to develop a program to address this condition. The program is focused on neighborhood interventions and allows for the rehabilitation and enlargement of existing houses as well as the constructing of new core units in serviced neighborhoods. This strategy maintains existing social networks and builds local capacity. Strengthening institutional, financial and organizational capacity to build houses with an emphasis on neighborhood participation will not only ensure beneficiaries in the short term, but also the sustainability and longevity of the initiative well into the future.

Context and background. Suriname is a relatively small country with a population estimated at 436,000 (July, 2002) growing at only 0.55 percent annually. From the 1960s to the mid-1980s, its government directly constructed a large number of housing units and was largely able to keep up with demand. Civil disturbances in the interior occurred in the mid-1980s disrupting agricultural production and forcing many from the countryside and small towns into Greater Paramaribo, which currently concentrates more than half of the country's population. Additionally, since the 1980s, the decline in real incomes plus high mortgage interest rates (above 35 percent per annum), land market bottlenecks, and high building material costs have made housing unaffordable to all but the elite. Formal housing construction averages only half of household formation and, as a result, there is a large accumulated demand. Low-income housing was traditionally provided by the government, which hired large construction companies to build relatively large units (80m²) on large lots (400m² to 500m²). Al-

though this method resulted in very high costs and subsidies, the government has succeeded in building 20 percent of the current housing stock and distributing a considerable number of lots. While many low- and moderate-income Surinamese have either a small house or a lot, declining real incomes have prevented households from building on these lots or repairing the houses they have. In the late 1990s roughly 10,000 units in Greater Paramaribo were severely dilapidated and needed substantial rehabilitation. Additionally, Paramaribo contains roughly 10,000 vacant lots, the great majority of which have services or lie close to trunk infrastructure. If built upon, these lots could cover the city's new household formation at current rates for roughly two decades. Overall, the greatest need for shelter is for rehabilitation of the low- and moderate-income housing stock and for new in-fill construction on the serviced lots already distributed by the government. In collaboration with the IDB, the government has shifted its housing policy to address these current needs of the sector

Characteristics of the program. The program seeks to improve housing conditions of low- and moderate-income households by harnessing Suriname's most capable private finance institutions, nongovernmental organizations (NGOs), and community based organizations (CBOs) to assist underserved neighborhoods to improve or construct houses. At the same time, it aims to ensure that shelter policies and subsidies are allocated more efficiently, equitably and transparently. A three-pronged approach was used to achieve these goals. First, there are up-front subsidies to stimulate investment by low- and moderate-income households to rehabilitate their houses or construct new ones. Second, technical assistance is provided to financial institutions, NGOs and CBOs to strengthen their capacity to participate in the execution of the program remunerated via performance-based fees. Finally, by strengthening the public sector's capacity to

BOX 3**Suriname: Low-Income Shelter**

enable the private development of low- and moderate-income housing and to reform policy and regulatory framework to ensure the longevity of a re-oriented housing approach. The program's average subsidy of US\$2,100 is less than one-fourth of the amount that the government previously spent on providing new housing. Low-income households (who make up two-thirds of the beneficiaries) will generally access the subsidy only with an equity contribution of their own to finance rehabilitation or expansion of their own home. Hence, the program's investment component can operate without mortgage finance when interest rates rise to unaffordable levels, thus allowing the program to adapt to changing macroeconomic conditions. Moderate-income households will have access to this subsidy scheme with a mortgage loan at market rates as well as their own savings to finance construction of a core unit on their serviced lot. Technical assistance will help the government rationalize its land divestiture system and reduce other bottlenecks,

cut building material costs, and support financial institutions that serve low-income households.

Execution. The program makes use of existing, competent private and nongovernmental institutions to execute the main tasks. The government implementation unit sets policy, coordinates, and supervises these private organizations. This strategic partnership among lenders, NGOs, CBOs and contractors builds the long-term capacity and interest of these organizations to serve low- and moderate-income households. Eligible homeowners in the selected neighborhoods decide on the type and cost of their housing solution within the program standards and financial assistance brackets. This flexibility allows for tailoring each solution to fit precisely within the financial capacity of the household and the existing context of the neighborhood. The program provides strong incentives to maximize households' inputs in the form of land, cash, labor and building materials.

BOX 4***Favela Bairro I and II, Rio de Janeiro***

In Brazil, informal settlements usually take two forms, depending on their origin, location and ownership of the land. On the one hand are the *favelas*, which are the result of invasions of public or private land by squatters with no legal land title and are usually located close to downtown. On the other hand, are irregular land subdivisions, the result of the planned but illegal (because they lack required infrastructure) subdivision of private land, usually located in the periphery of the city, whose inhabitants generally have purchase documents but not legal title. Official estimates indicate that between 30 and 40 percent of the dwellings in Brazil are located in informal settlements, that is 8 to 11 million dwellings housing between 30 to 40 million people.

Context and background. Rio de Janeiro, with almost 6 million inhabitants, exemplifies the dual cities found in developing countries (worsened by the area's hilly characteristics). The formal city developed in the valleys and coastal areas. The informal city (created through land invasions and illegal subdivisions) grew in the slopes of the hills fueled by a steady flow of immigrants from the country's interior. In 1995, the first year of the Program for the Urbanization of Popular Settlements of Rio de Janeiro (PROAP), it was estimated that there were over 800 *favelas* housing approximately 1 million people, and nearly 600 illegal subdivisions housing 400 thousand people. In sum, nearly 25 percent of the city's population lived in informal settlements.

Characteristics of the programs. PROAP, better known as *Favela-Bairro*, originated from a self-help *favela* urbanization program financed by the municipality. The municipal policy toward informal settlements was embodied in a ten-year plan launched in 1990. The plan was the first official attempt to tackle the reality of informal urbanization in the city and proposed a strategy based

on the urbanization and integration of the settlements, abandoning previous policies geared to removing them. This approach led to investments in the infrastructure required by *favelas* and illegal subdivisions. The Bank began supporting this program in 1995. The *Favela-Bairro* Program works on the basis of interventions that are designed specifically for each *favela*. The composition and sequencing of the interventions are established with the ample participation of the beneficiaries and include investments in infrastructure (potable water, sewerage, roads, drainage, landslide prevention works, public lighting, parks and street landscaping); social services; employment generation programs; community development activities; environmental and sanitation education; and support for the regularization of land tenure. The PROAP also included a component to regularize illegal subdivisions that lacked the basic infrastructure required to become legal subdivisions. This component of the program provides financing to build the infrastructure as well as technical assistance (land title research, subdivision plans and support to individual owners in securing title) to regularize the settlements under more flexible norms issued by the municipality. Although tackling a less visible problem, the incorporation of the illegal settlements component into the program sent a signal about the municipality's commitment to tackling the problems of informal settlements in a comprehensive manner. The selection of *favelas* and subdivisions that will take part in PROAP is based on a point system that takes into consideration poverty indicators and the efficiency of investments (costs and impact of the required works and programs).

Execution. The first phase of the *Favela-Bairro* Program financed by the Bank started in 1995. In four years, the program benefited 55 *favelas* and 8 illegal subdivisions. The goal of the second phase of the program, which began in 2000, is to benefit 52

BOX 4***Favela Bairro I and II, Rio de Janeiro***

additional *favelas* and 23,000 households living on illegal subdivisions. The two phases of the *Favela-Bairro* Program resulted in an investment of over US\$600 million and benefited approximately 500,000 people. PROAP is considered an international best practice in dealing with informal settlements. A key factor in the program's success is that it is financed and executed entirely by the municipality (which simplifies execution). Under the leadership of the mayor, a technical committee makes decisions about the investments and a coordination committee ensures that all municipal departments are on board for the execution of the program. Another success factor is the use of modern management techniques, which are essential in a program that si-

multaneously executes between 40 to 50 interventions in neighborhoods located all over the city that are in different phases of execution. Project managers are responsible for keeping the projects on track. They are supported by an integrated information system that gives supervisors full knowledge about the progress and performance of the projects. Community involvement in decision making and in the operation of certain services (for instance community members are hired to collect garbage and undertake reforestation efforts) are factors that facilitate project ownership and construction of the works under the complex geographic and social circumstances of the *favelas* and illegal subdivisions.



Integrating informal settlements to the formal city enhances the inhabitant's prospects of improving their social and economic conditions.

After years of ignoring the existence of informal settlements or attempting their eradication, local governments in the region are adopting a new approach that seeks to incorporate them into the formal city and, whenever possible, solve *in situ* their environmental, social and housing problems. The IDB has been supporting the design and execution of neighborhood upgrading programs promoted either by local governments or central and regional governments in association with municipalities. These programs finance integrated improvements to the settlements including: sanitation services, access infrastructure, health and education infrastructure, recreational facilities and other urban services together with the regularization of the land tenure. This methodology of comprehensive interventions that simultaneously address the most urgent needs of households in informal settlements has proven to be an important social policy tool for poverty reduction. Settlement-upgrading programs are suitable social investments to deal with the backlog of substandard settlements only when they form part of a wider effort to reform the operation

of the housing sector in order to expand the construction of affordable houses for low-income households. Otherwise they will reinforce the informal mechanisms for solving the housing problem, exacerbating the urban problems created by informal settlements and forcing governments to incur in the heavy expenses involved in their regularization.

The Bank stepped up its support to settlement upgrading programs in the early 1980s. Projects have been financed either as stand-alone operations or as components of social development or housing operations. The scope, components and implementation mechanisms of settlement upgrading programs have gained in complexity over time as lessons from programs suggested the need for new components to address the host of interrelated problems that affect these areas. The initial objective of these programs was to provide households in informal settlements with secure land tenure and minimum public services (water supply, sewerage, drainage and protection from land slides and flooding). Over time they expanded to include social services, such as

Bank municipal loans finance schools, health centers, roads and many other services for the population.



recreation and early childhood care, and income generation initiatives, such as training and workspace. A significant characteristic of these interventions is the emphasis they place on the development of the social capital of the communities. Local government capacity building has proven essential because the success of these operations rests on the full engagement of the community and the municipal government from design to post-implementation activities.



Municipal and Other Subnational Lending

In response to the decentralization of government functions that gained momentum in the early 1980s, the Bank has expanded lending for the development of municipalities and other subnational governments, such as departments, provinces, states or regions.

	Approach				
	Equilibrium tariffs		Public utilities policy		Subnational development strategy
	Decade				
	1960	1970s	1980s	1990s	2000s
Component	Reform to intergovernmental relations				■
	Hard market borrowing discipline				■
	Development of local governance				■
	Second tier municipal finance institutions				■
	Government owned financial intermediaries			■	■
	Fiscal management development			■	■
	Local government institutional development				■
	Expansion of municipal community services			■	■
	Expansion of other municipal infrastructure		■	■	■
	Water and sewerage infrastructure	■	■	■	■
	Project evaluation methodologies	■	■	■	■
		Expansion of sanitary infrastructure	Municipal infrastructure loans	Municipal development loans	Subnational institutional strengthening and local service and development infrastructure loans
Type of Project					

FIGURE 8
Municipal Lending Timeline

BOX 5**Mexico: State and Municipal Strengthening Program**

Mexico has committed to decentralization and transferred responsibilities and resources to the subnational governments (states and municipalities) in order to provide more efficient services to its citizens. The process began in the early 1990s and has received Bank support since 1994. The Bank's involvement in Mexico's decentralization process is expected to continue for another decade as all three phases of a project approved in 2001 are implemented.

Context and background. The process of decentralization in Mexico is intimately linked to the evolving political situation. The stiff electoral competition that has characterized the voting process in recent years, the alternation of local government among different parties, and the growing strength of civic organizations, professional associations and regional newspapers, have placed local management under close scrutiny. As a result, state governors and municipal presidents have been pressed to become more sensitive to voters' demands and the federal government has been made aware of the need to transfer greater responsibilities and resources to the local level. In 1994, the Bank approved a US\$500 million loan to finance 50 percent of the US\$1 billion municipal development program to strengthen the ability of municipalities in a group of participating states to expand their capacity to deliver basic services, with particular attention to the needs of the low-income population. The program provided financing for institutional development activities and community-based small infrastructure projects so small- and medium-size municipalities could improve their financial status and make public service delivery more efficient. The program also financed institutional strengthening to medium sized municipalities; provided support for a national training program in project preparation and a study of legal and institutional decentralization framework. During the 1998-1999 period a number of major initiatives to increase the autonomy of subnational governments were approved and implemented. The

Budget Acts of 1998 and 1999 introduced and refined a new instrument (*Ramo 33*), which significantly increased the volume of resources at the disposal of local governments, particularly the municipalities. The Ministry of Finance and Banking reformed the banking system introducing incentives for the banks to base their lending decisions on market considerations. Under these reforms the National Bank of Works and Public Services (BANOBRAS), which is a public bank serving local governments, gained in efficiency and capacity to serve the needs of its clients. Subnational governments expanded their capacity to take on responsibilities that had been assigned to them as part of the decentralization process. In 1999, the IDB approved the Program to Strengthen the States and Municipalities (FORTEM) to support these reforms

Characteristics of the program. The specific objectives of FORTEM were: (i) to increase the autonomy of subnational governments in the allocation of resources; (ii) to improve the performance of credit markets at the subnational level; and (iii) to strengthen the capacity of the subnational governments to manage public funds. The program consisted of a fast-disbursing component and a line of credit, in the amount of US\$400 million each. The Mexican government has requested a new Bank program that incorporates the lessons learned from FORTEM to support the changes required by subnational lending and, thus, adapt to recent financial market changes. This operation (approved in 2001 and totaling US\$1 billion) has been structured in three phases and seeks to introduce best practices in the management of public funds by subnational governments, strengthen their financial situation, finance investment projects with high social returns and provide technical assistance to expand the subnational capacity to deliver services. The program also supports the administrative and financial modernization of subnational governments so they can improve their capacity to access credit. With that in mind, the program has been

BOX 5**Mexico: State and Municipal Strengthening Program**

structured as a credit line that will be administered by BANOBRAS. Access to the resources will be linked to subnational governments' adoption of best practices for institutional and financial management. As they attain agreed targets, subnational governments will gain access to program resources and finance a portion of their investment plans. This new structure will allow greater flexibility in adapting program actions to the needs of each subnational government

Execution. Preliminary evaluations of the FORTEM project suggest that it has been a successful instrument to provide incentives to subnational governments to implement institutional and financial strengthening measures. BANOBRAS has played a fundamental role in promoting FORTEM, reaching agreements with the subnational governments on institutional strengthening measures to meet eligibility criteria and monitoring compliance with the agreed actions



Municipalities are taking on expanded responsibilities in the provision of primary health care, an essential service for low income families.

BOX 6**Local Development and Fiscal Responsibility Program of Bolivia**

The Local Development and Fiscal Responsibility Program is representative of the Bank's effort to support a sector-wide subnational policy development and reform that turned a complex and inefficient structure of subnational financing into a coherent set of intergovernmental relations and funding mechanisms that promote efficiency and accountability in local service delivery.

Background and context. The program assists Bolivia's efforts to deepen the decentralization process, whose foundation was laid out by the 1994 "Popular Participation Law." This law divided the country into 312 municipalities (before the legislation, municipal governments existed only in the largest urban centers) and created a transfer system that earmarked 20 percent of the fiscal revenue of central governments for municipalities that were to take over new functions. The transfer of resources and responsibilities revealed the limitations of many municipalities in their technical capacity to provide adequate services and to responsibly manage their finances. The Compensation Policy adopted after Bolivia qualified for the Highly Indebted Countries Initiative (HIPC) that reduced foreign debt, expanded these reforms. The Policy stated that the funds originally intended for debt payment would be directed to eight key sectors (education, health, basic sanitation, productive rural infrastructure, rural roads and electrification, environment and institutional strengthening) and that local governments would invest this money. The Compensation Policy also redirected fiscal resources to those localities with greatest unsatisfied basic needs and to implement institutional reforms to make more transparent and efficient use of these funds. HIPC funds

and grant money provided by foreign donors were allocated to municipalities through a formula based on unmet basic need.

Characteristics of the program. The Bank's two-phase program, for a total of US\$87.3 million, supports the implementation of this policy as well as changes in the legal and institutional framework for decentralization. It finances municipal projects through grants provided by the Productive and Social Investment Fund and through loans provided by the National Fund for Regional Development (FNDR). Grant funds are included in the Compensation Policy's annual budget and given out to municipalities according to the general distribution formula. Loans for a variety of typical municipal public works and services are provided on the basis of strict creditworthiness criteria. The program requires municipalities to draw up fiscal adjustment and investment plans that identify key financial and managerial weaknesses. It also recommends institutional and fiscal strengthening measures to reach specific financial targets, such as ratios of recurrent to total expenditures, personnel to total revenues, income targets for each municipal tax, and others. These targets are used to monitor annual progress by municipal governments. The Fiscal Responsibility and Local Development Program also finances a sector development component that is promoting changes in the legal framework for intergovernmental relations. These would affect issues such as the assignment of resources and responsibilities; revisions in the transfer system, strengthening of the FNDR with the possible inclusion of a private partner and funding through bonds, and a credit rating exercise for the main municipalities done by a private agency.

Bank lending in support of decentralization and subnational development has undergone a significant evolution. Early support to municipalities was a sporadic activity mostly concerned with expanding urban services, while the work done in the last two decades has been systematic and covers an ever-increasing range of subnational development issues. The Bank's initial approach to subnational lending focused on expanding the capacity of local governments in order to provide services to a growing urban population. A key concern of projects belonging to this generation was the efficient allocation of investment resources and the proper operation and maintenance of infrastructure. Bank loans thus emphasized project preparation and appraisal, devoting the bulk of the institutional development resources in improving the execution of project-related activities (cost-benefit analysis, transparent and competitive bidding procedures for contracting civil works) and to ensure proper operation and maintenance of infrastructures and municipal facilities. Another concern was to encourage recouping from the beneficiaries the cost of operating the services and maintaining the infrastructure as well as the capital investment. Also during this phase the Bank promoted national intermediary institutions to lend resources to several small subnational governments. With central government guarantees, the Bank supported municipal development banks, specialized public financial institutions and state or provincial municipal development funds to lend or transfer Bank funds to states or municipalities.

The evolution of Bank thinking and investment in support of decentralization in the 1980s and 1990s parallels the evolution of the role played by subnational governments in service delivery and the promotion of socioeconomic development. Decentralization has increased the complexity of the development problem posed by subnational governments. In the 1990s, subnational governments took over expanded responsibilities for the provision of key services (such as health and education) to low-income population and the regulation and oversight of privatized services. Moreover, subnational governments are assuming more active roles in creating favorable conditions for business and in promoting local economic growth. The Bank's response was to expand the range

of services eligible for financing with municipal and subnational development loans; assist in mobilizing private sector financing for subnational governments; and place greater emphasis on strengthening institutional capacity at the local level. Bank interventions included support for second-tier financial institutions that rediscount loans from private banks and the refinement of government-sponsored municipal funds to prepare them for issuing debt instruments in local capital markets. Through the Private Sector lending window the Bank provided syndicated loans and guarantees for private companies investing in municipal infrastructure, most frequently in sanitation, transportation and energy distribution.



Integrated Urban Development Programs

Conservative estimates indicate that Latin America and the Caribbean may have over 5 million hectares of urbanized land. A significant proportion of this land, particularly in the urban fringes, is inadequately served. Other parts, mostly in the historic centers or first urban growth ring, are underutilized or contain seriously deteriorated infrastructure, facilities and buildings. In response to demands made by municipalities and higher tier governments, the Bank financed integrated urban development projects to consolidate peripheral urban areas and rehabilitate inner city areas. In the 1970s and 1980s projects focused on the poorly structured growth areas in the urban fringes; in the 1990s the focus shifted to central areas, fueled by the growing interest by local and national governments to preserve historic centers.

Urban Rehabilitation

The Bank has financed a variety of urban rehabilitation projects ranging from investments designed to address the needs of spe-

The rehabilitation of urban central areas and historic centers requires integrated interventions to renovate infrastructure and buildings in order to promote the social and economic rehabilitation of the communities.



cific neighborhoods (like the Belgrano area of Buenos Aires, or the newly urbanized area of southern Bogota) to an area affected by an earthquake in Peru. These operations focused on coordinating investments in a given territory in order to increase access to sanitation, housing, employment, health, and education, particularly for low-income residents. These integrated projects have proven effective in achieving their objectives, but their execution poses significant institutional challenges (including difficulties in coordinating the many agencies involved) and cost overruns due to extended execution schedules (IDB, 1997b). To address these challenges the Bank promoted a variety of new institutional execution arrangements. These include public urban development corporations operating as private companies (as is the case of the Urban Rehabilitation

Program in Uruguay), formal consortia of municipalities to execute mutually agreed investments (the execution mechanisms for the Urban Agglomerations Program benefiting several provinces in Argentina) and mixed capital corporations (like in the case of Quito's historic center). Experience indicates that adequate institutional arrangements go a long way toward solving the coordination problems posed by these projects, making it possible to reap the significant benefits they can bring. A key feature of successful implementation mechanisms is their ability to efficiently distribute benefits and risks among public and private actors. It has been found that the execution of urban rehabilitation projects is facilitated by the existence of sound urban land use and housing policies, and by the availability of local financing for infrastructure.

Urban Heritage Conservation and Development

Urban heritage conservation and development is a new area for the Bank, although it did finance some conservation works as components of tourism development projects in the 1970s. In recent decades there has been a growing interest in urban heritage in Latin America and the Caribbean. Many national and local governments have undertaken ambitious programs for restoration and preservation of their heritage assets and some have sought technical and financial assistance from the Bank. An active program of loans and technical assistance has been developed to meet this demand and significant innovations on institutional arrangements for the execution of the conservation efforts were introduced. Their main objective is to make the process sustainable in the long term, involving all social actors and putting urban heritage assets to meet social needs or real estate market demand. When the conservation of urban heritage becomes a concern and responsibility of a wide variety of social actors, it gathers momentum and dynamism from the interplay of different interest groups and the real estate market. Private philanthropy, civil society organizations and local communities become involved in the process together with government organizations at the local, regional and national level, each with clear and complementary roles.

The experience gained by the Bank in these projects suggests that urban heritage preservation in historic centers is part of the general issue of rehabilitating deteriorated inner city areas. Thus, there is a growing convergence of technical approaches, institutional arrangements and coordinated public and private interventions in urban rehabilitation and urban heritage preservation projects financed by the Bank. The integrated interventions required in urban rehabilitation projects are facilitated by good policies in related sectors of government activity. The Quito project succeeded in retaining moderate-income households in a historic center that was undergoing a rapid process of rehabilitation and development. This was made possible thanks to the existence of an effective national housing policy that provides low-income households with direct subsidies for homes purchase. Many used these subsidies

to move into the low-cost apartments rehabilitated by the Quito Historic Center Company (a mixed capital corporation in charge of the rehabilitation program). Attracting private sector financing is key to the long-term sustainability of the urban heritage preservation and development effort. The Bank sponsored projects support a variety of instruments to facilitate this process. They include the establishment of municipal conservation funds open to public and private philanthropic donations; direct subsidies to assist owners and developers to shoulder the extra costs of rehabilitating heritage; and the promotion of joint public-private investments to preserve and develop urban heritage assets with commercial potential or high social demand



Urban Transportation

Most cities confront a difficult choice between the need to expand their road- and car-based transportation systems or to increase efficiency in their public transportation systems. Road expansion encourages private car usage, promotes urban sprawl and, in the long run, may not reduce traffic congestion. Investment in public transportation makes better use of resources, reduces pollution and better serves the low-income population, which tend to be its most frequent user. Yet, public transportation is usually poorly maintained, unsafe, highly polluting, often uncomfortable and with limited coverage.

One of the objectives of the Bank's assistance to cities has been to support the planning and financing of urban transportation systems and infrastructure, seeking to expand service coverage and effectiveness and to make it more accessible for the low-income population. Emphasis is placed on the appropriate operation and maintenance of existing systems and on encouraging the participation of the private sector in the financing and operation of the systems. For that purpose, the Bank finances a wide variety of interventions, including the rationalization, restructuring, and rehabilitation of existing urban transportation systems, the expansion of

BOX 7**The IDB's Approach to Urban Heritage Conservation**

Latin America has a rich and varied urban heritage contained not only in distinctive historic centers that are fine examples of the urbanism and architecture of the Colonial and Republican eras, but also in individual monuments and archeological sites of great significance. This heritage is a testimony of the different phases in the evolution of national culture and has received international recognition, as many places are UNESCO World Heritage Sites. The conservation and development of this heritage is gaining priority in the political agenda of central and local governments, given the role that it can play in promoting a sustainable development process based on local traditions and community resources in a globalizing world. The Bank has pioneered the participation of multilateral development banks in assisting borrowing member countries in the protection and development of this heritage.

Because the connection between heritage conservation and economic development is not fully understood yet, the Inter-American Development Bank has moved cautiously in funding urban heritage conservation projects. Basically, it has concentrated on projects that fall squarely within its mandate to accelerate economic and social development and that also meet its technical, economic, institutional, financial and environmental review criteria. To determine the eligibility of projects, the Bank applies criteria based on successful international experience and its own policies and operational guidelines. The Bank finances projects that comply with the following requirements

- Set up conservation models capable of flourishing in the long term and becoming self-sustaining.
- Are fully supported by the beneficiary communities and the owners of the heritage properties.
- Open channels for participation by private philanthropies as an alternative to public financing through subsidies.

- Encourage public-private cooperation in the execution and financing of conservation.
- Improve the regulatory environment and public functions involving conservation.
- Prevent irreversible loss of heritage properties.

The Bank does not support projects that finance activities that can be more effectively financed through market mechanisms, or those projects that propose isolated activities or distribute conservation cost and benefits unevenly among those involved.

Bank financed projects in the 1990s include the Quito Historic Center Rehabilitation Program, a US\$41 million loan to the municipality of Quito, Ecuador, approved in 1994 to promote the rehabilitation of 74 blocks of the city's downtown; the National Urban Rehabilitation Program of Uruguay, a US\$28 million loan to the central government approved in 1998 to preserve and develop a national heritage building and historic area; the Historic and Cultural Sites Preservation Program, a US\$50 million loan to the Ministry of Culture of Brazil approved in 1999 to finance a conservation and development program for 24 historic centers; the Pilot Program for the Integrated Rehabilitation of the Historic Center of Tegucigalpa, a US\$10 million loan to the Government of Honduras approved in 2000. Tourism development projects in Belize, Bolivia, Brazil, Panama, and Peru have included funds for the conservation and development of historic centers. Additionally, the Bank has an active technical cooperation program supporting institutional development and project preparation activities for heritage conservation and development programs financed through its own resources and bilateral trust funds managed by the Bank.



The Bank promotes the improvement and development of urban public transportation systems that serve the majority of the population and reduce congestion and pollution.

streets and urban transportation systems, and passengers and freight terminals and complementary equipment.

The Bank has financed urban transportation projects that range from the expansion and improvement of commuter trains in São Paulo and Buenos Aires to a national urban transportation program in Venezuela, as well as a traffic management project in Bridgetown, Barbados. Bank financing is prominent in the expansion of a bus-based system in Curitiba, Brazil, that includes significant private participation. The improvement and expansion of

highways and roads also form part of Bank sponsored urban transportation projects. Through its private sector window, the IDB provided a loan to the consortium that constructed and is operating the *Via Amarella* toll road in Rio de Janeiro and a guarantee to debt issued by the consortium that is building and operating the *Costanera Norte* toll road in Santiago, Chile. Other urban projects, particularly municipal development loans, often support investments in roads, streets and sidewalks and in transportation terminals and modal interchange facilities.

BOX 8**Curitiba: Urban Transportation Program**

Curitiba's innovative urban transportation system has been replicated by other cities throughout Latin America (such as Quito and Bogota) and studied by others throughout the globe. It provides clean and efficient transportation services through a publicly regulated and privately operated system that is fully coordinated with the city's Master Plan. Though the basic network was already in place before the first IDB loan, the Bank contributed to prepare the road infrastructure to the needs of the new high capacity buses, expand the service to low-income neighborhoods in the urban periphery, built local service centers in the bus terminals, install street lighting and sidewalks in under serviced areas, and construct bicycle paths as an alternative means of commuting.

Context and background. Curitiba, the capital of the southern Brazilian state of Paraná with an estimated population of 1.6 million, is the core of a metropolitan area whose population increased by 32 percent in the 1990s (from just over 2 million in 1991 to more than 2.7 million in 2000). The growth in the metropolitan population placed added strains on the transportation system as ridership increased between the urban core and the periphery. The city has a history of integrated land use and transportation planning that dates back to 1970 when, under the *Instituto de Pesquisas e Planejamento Urbano de Curitiba*, it replaced a mono-centric urban growth model with a linear structure that could accommodate future growth. With the new model, two central road corridors running north-south and east-west were built with the middle lane reserved exclusively for buses. Planning regulations allowed for greater densities in housing and commercial uses along the corridors, generating a growing demand for public transportation. The increased flow of passengers led to the expansion of the system, maintaining reasonable fares and high frequency service. The Integrated Transport Network was introduced in 1980. It allows passengers to travel along all points of the system, includ-

ing feeder routes, on a single fare. To keep up with current and projected ridership along the system, in the early 1990s Curitiba introduced semi-articulated buses with capacity for 270 passengers. The system was capable of handling 18,000 passengers/hour/direction with buses running at one-minute intervals. The efficiency of the bus service increased with an innovative station design that offers same-level access to the buses and the ability to have passengers pay the fare before boarding cutting down on waiting time. While the new system worked well within the city limits, it offered little for the increasing numbers of low-income residents that settled in the urban periphery. Many of the outlying areas did not have paved roads, street lighting or sidewalks, and did not have easy access to bus routes and other services. The absence of public services in the periphery forced residents to travel downtown to obtain them. The solution to these problems required the expansion of the system of high-capacity articulated buses, expanding the feeder system, improving road conditions in the newly served areas, providing public services in the new bus transfer terminals, and saving low-income households from traveling downtown.

Characteristics of the program. The general objectives of the Curitiba Urban Transport Program are to expand and improve the public transportation system that connects outlying residential communities with the different sections of the metropolitan area without increasing fares. The program is divided into six components that seek to: (i) alleviate overcrowding on buses along the north-south corridor, the busiest in the city; (ii) speed up the boarding and off-loading of passengers to shorten total travel time by bus; (iii) afford greater convenience and safety to users in low-income areas through paving and street lighting along bus routes, and the construction of sidewalks and bicycle paths; (iv) reduce traffic accidents, particularly involving pedestrians; (v) eliminate the need

BOX 8**Curitiba: Urban Transportation Program**

for long journeys in order to reach public services and commercial areas building facilities offering these services in the vicinity of the bus terminals; and (vi) make the main system accessible to the disabled.

Execution. The achievements of the Curitiba project serve as a model for other cities. The city now has one of the most heavily used, yet low-cost, transportation systems in the world. The capacity of main trunk lines was increased through the implementation of a bi-articulated system of buses with a capacity for 270 passengers per unit. Four high capacity corridors have been developed with buses provided and operated by private firms. Buses circulate on exclusive lanes and passengers embark and disembark, as do those on the most modern metro systems in the world. A significant number of corridors and intersections

used by the buses were improved and traffic signals were modernized. Stairs and turnstiles were eliminated from the vehicles and ticket booths were located at the entrances of each station. These conditions have exponentially increased the efficiency of a system that costs between 5 and 17 percent of light rail systems and drove 25 percent of car owners into using the public transportation system, resulting in a quantifiable reduction in air pollution. In addition, the program provided community amenities serving low- and moderate-income neighborhoods outside the urban core in centers called “streets of the citizenry.” They were located adjacent to seven terminals at bus transfer stations eliminating the need for those seeking such services to travel long distances to the city center. Also, the network of bicycle routes was extended for those choosing an alternate means of commuting.



Combining centralized management of the public transportation system and private provision of the service, Curitiba provides high quality and low cost transportation to the population.



Water, Sanitation and Urban Environmental Management

The Bank's operations in the water and sanitation sector have traditionally centered on investments to improve and expand water and sewerage network infrastructure, emphasizing actions to improve the management efficiency of service providers. The Bank had approved loans for urban water and sanitation projects benefiting cities of all sizes, including the region's major metropolis. Public sector reform, institutional restructuring, regulation, and privatization issues increasingly figure into the design of water and sanitation projects, many of which support structural reforms of the sector at the national level to develop sound regulations, water quality control, water and sewerage tariffs adjustments and boost private sector participation. Building a culture of sound management, operation and maintenance of completed works is

crucial to long-term sustainability. Bank projects place emphasis on rehabilitating existing water supply distribution networks; setting adequate rates; planning capital investment; establishing micro metering systems, efficient collection and accounting of tariffs; and strengthening the managerial capacity of companies. Given that water supply expansion is only possible to the degree that aquifers are protected and managed, these environmental components are gaining importance in the Bank's projects. Privatization of public utilities has expanded capacity and improved service in many cities. The Bank is supporting these efforts with loans for the utilities through its private sector window and technical assistance financed by the Multilateral Investment Fund to develop efficient regulatory and supervisory frameworks.

In the last decade, the Bank has moved into urban environmental management, protection, and remediation issues. Flood control, disaster mitigation, resettlement of vulnerable populations, and reforestation, waste water treatment, industrial efflu-

Since its inception, the Bank has supported the expansion of potable water and sanitation services by providing assistance to expand coverage and improve the quality of services and the sustainability of the public utilities.



ent reduction, and strengthened urban environmental management are often components of Bank operations. The current portfolio of loans has projects to clean up bays, rivers, and lakes near cities or to protect green areas and forests surrounding cities. They tackle the issues of large watersheds (like the Tietê river in São Paulo and the Reconquista and Riachuelo rivers in Buenos Aires), large harbors (like the Guanabara and Todos os Santos bays in Brazil) and other critical urban environmental issues. These are all complex programs that require coordination among multiple public agencies and private water and sanitation companies, the drafting and passage of environmental legislation and land use plans, enforcement of pollution control measures, incentives, campaigns or other methods to engage industries and communities in supporting cleanup efforts.



Technical Cooperation, Research and Publications

The Bank has an active technical cooperation program to facilitate the preparation of urban development loans and support institutional development and innovation in borrowing member countries. Funds for these operations come from the net income of the Fund for Special Operations and from trust funds established by nonborrowing member countries and administered by the Bank. More than 100 operations amounting to over US\$16 million in support of urban development in the region were executed between 1994 and 2001. They range from operations providing resources to prepare

national or subnational investment programs that will later be submitted to the Bank for financing, to contributions to training programs benefiting several countries.

Likewise, the IDB has a program of applied research and publications that provides technical support to innovative operations, assists the borrowing member countries in tackling emerging issues, and disseminates the results of Bank operations. Best practice studies and technical documents cover all areas of Bank activity in urban development. Prominent among them are studies supporting new areas of lending or those undergoing significant change. Housing sector reform is supported with studies on the role of subsidies and good practice analysis of successful reforms and lessons from progressive housing programs. Subnational development is supported by research and best practice analysis coming from different areas of the Bank, including studies of the macroeconomic implications of decentralization, efficient ways to structure inter-governmental relations for sound subnational management, and successful approaches to improve fiscal management at the subnational level. Best practices analyses in municipal planning and budgeting, and in improving metropolitan governance have also been prepared. Integrated urban development programs are guided by best practice studies on successful urban rehabilitation strategies, efficient institutional and financial arrangements. Research on urban sanitation centered on instruments for the effective management of water and waste disposal services, incentive-based environmental management tools in urban areas and regulatory issues concerning the involvement of the private sector in the provision of services. The Bank regularly organizes international seminars to discuss these issues and increase awareness of the issues involved and efficient solutions.

BOX 9**State of Bahia. Environmental Sanitation Program for Salvador and the Municipalities of *Todos os Santos* Bay**

The decline in the quality of water bodies located near rapidly expanding urban centers (the result of historic underinvestment in wastewater treatment and unmet demands in sanitation infrastructure) is one of Brazil's most serious environmental problems. The program to improve the water quality in the *Todos os Santos* bay in Bahia forms part of a concerted effort to solve this problem. Similar programs benefit other major metropolitan areas, like Guanabara bay, which receives wastewaters of the Rio de Janeiro metropolitan area and the Tietê river in São Paulo.

Context and background. The *Todos os Santos* bay occupies an area of 500 square kilometers and has 400 kilometers of coastline. Twelve municipalities border the bay with a total population of 3 million people. Since the 1960s, the bay area's population and economic activities have grown significantly. Population tripled, tourism expanded and heavy industry grew very fast in locations whose waters and wastes are discharged into the bay. The area has over 50 heavy industries, a major port and one of the country's largest oil refineries. Municipal resources and state institutions could not keep pace with population and economic growth. It was imperative to make the necessary investments in water and waste management infrastructure and services as well as enforce anti-pollution legislation. By the mid 1990s the area generated 30,000 kilograms per day of biological oxygen demand from domestic sewerage and 23,000 kilograms of chemical oxygen demand from industrial organic materials. Every day 7,000 kilograms of petroleum by-products were also dumped into the

bay. Domestic and industrial contamination is having a negative impact on the ecosystem of the Salvador metropolitan area, leading to the closure of 19 beaches because of unhealthy levels of coliforms and a growing incidence of water-borne diseases.

Characteristics of the program. The program has two interrelated objectives: (i) improve the quality of life of 2.7 million residents of the metropolitan area by expanding collection and proper disposal of sewage and solid waste, increasing potable water coverage and reducing industrial pollution, and (ii) strengthen local government institutions with responsibility for environmental issues in the area. The program devoted US\$130 million to expand sewage collection and treatment in Salvador and 12 surrounding municipalities; US\$20 million to expand potable water services; US\$9 million to improve solid waste collection and disposal; and US\$57 million to strengthen institutions in charge of pollution control and the provision of sanitation services, carry out an environmental education campaign and introduce modern environmental management techniques.

Execution. The program was executed by coordinating the activities of all the state and municipal institutions involved. It expanded coverage of potable water services to 90 percent of the population and sewerage to 70 percent (up from 60 percent and 20 percent respectively). Pollution abatement targets included reductions of 90 percent in the volume of industrial discharges into the bay and establishing institutional capacity to monitor the bay's water quality and enforce environmental legislation.



**Future Directions:
Facing the Challenges
of Competitiveness and
Social Inclusion**

Bank mandates have expanded according to the needs of the region, assisting the borrowing member countries to undertake the profound economic and social reforms required to take full advantage of development opportunities open to the region in the coming decades. These include expanded international trade brought about by globalization, and increased productivity of capital and labor resulting from urbanization and the fast dissemination of technological innovation. Declining birth rates will provide a demographic window of opportunity during the next two decades. It is anticipated that population growth will stabilize at around 1.6 percent by 2025 and that, as a result, there will be only 1 dependent person for every 2 workers, a complete reversal of the situation in 1950. This will lead to reduced dependency ratios in the region and to a larger number of workers per household. As a result, the people of Latin America and the Caribbean will have an opportunity to increase their income-earning capacity and improve their human capital and expand their physical assets, both conditions to overcome poverty (HABITAT, 2001). To take full advantage of these opportunities, countries must actively pursue economic integration, increase their competitiveness and solve social problems that are excluding significant portions of the population from the benefits of development. Long-term sustainability of the development process, in turn, requires: ensuring macroeconomic stability, promoting democratic decision-making and oversight so that the government can operate as an effective development agent, and solving the complex environmental issues existing in the region as well as and (IDB, 1999).

Experience indicates that markets alone cannot solve all urban problems. A combination of private and public interventions is necessary. Cities need to put in place sound regulations for the most critical urban markets, and set up taxes and user charges capable of sending the correct signals to the markets concerning the social costs of the private actors' decisions in the city, and to induce them to contribute to the attainment of the democratically defined social goals for urban development. Cities must also muster the resources required to expand public services and social programs in line with the needs to achieve the Millennium Development Goals set under the aegis of the United Nations (UN, 2000).

Urban sector operations are an efficient Bank tool to attain these objectives. Cities provide the service platform supporting the most dynamic economic activities and the efficiency of urban production significantly affects overall economic competitiveness. As there is a "country cost" that has an impact over competitiveness, there is also a "city cost" that impacts the productivity of firms and individuals producing in cities. Furthermore, cities contain the largest concentrations of labor and offer the best opportunity to reach them with programs to improve productivity. In the social arena, the concentration of population and services in cities facilitates the development of human and social capital and the promotion of a more egalitarian distribution of the benefits of development. The high density of population and economic activities in cities also facilitates taking advantage of the synergy between economic and social programs. Tapping these development opportunities places a heavy burden on urban governments and highlights the need to increase the efficacy of urban governance mechanisms. Expanding the use of the new technologies for citizen participation and information and the efficient management of city affairs, facilitates the process.



Facing the Urban Challenges at the Turn of the Century

As discussed, the evolution of the Bank's urban portfolio shows a sustained increase in lending volume with a wider scope and growing complexity of the loans benefiting cities. This trend is expected to continue in the coming years. Demand for investment resources will increase due to the combined effect of pent-up demand for housing and urban infrastructure and services, the need to cater to population and economic growth and to satisfy the more sophisticated demands of the urban population as household income grows. The scope of urban interventions will expand as governments, civil society organizations, and firms, converge on the conviction that the solution of the social and environmental issues faced by cities

is a precondition for economic development. Complexity of urban operations will continue increasing as knowledge of the multiple and interrelated causes of urban ills expand. This trend will affect traditional areas of lending and will require the Bank to enter new areas of action in support of urban development. The remainder of this section deals with the Bank's approach to these challenges in the traditional areas of urban lending. The section that follows discusses emerging urban development areas for Bank participation.

Housing

Priority areas for Bank action in low-income housing are those consistent with the promotion of the enabling approach to housing reform and include:

- *Improving the performance of housing finance markets.* This requires attention to mortgage markets, helping to deepen and broaden the private supply of mortgage finance, as well as innovative approaches to micro credit for housing.
- *Strengthening urban land markets.* The availability of residential land at affordable prices with secure tenure is critical to the welfare of the low-income population. This often requires a judicious reform of land use and titling regulations as well as land taxation.
- *Designing programs that use public funds efficiently.* Many countries devote substantial public resources to the housing sector; improving the design and targeting of the programs that receive public funding can produce dramatic increases in the number of poor households that receive support.
- *Effective environmental planning.* Vulnerability to natural hazards can be significantly reduced by well-designed and enforceable land use regulation. In addition, standards for housing design and construction, if carefully designed and widely promoted, can help make low-income neighborhoods safer and healthier.

In pursuit of these objectives, the Bank disseminates information on good practices and engages governments in a policy dialogue to adapt these practices to the specific conditions of each member country. The Bank will continue supporting *settlement upgrading* programs to improve the quality of the stock of informal housing. To the extent possible these programs must be part of wider housing sector reform programs that expand the availability of housing solutions for the poor. This two-pronged approach is consistent with the best available practices to improve the quality of housing of the low-income population and better allows the countries to fulfill the Millennium Development Goal of improving the living conditions of slums dwellers (UN, 2000).

Subnational Government

The Bank will continue supporting subnational governments in their efforts to become efficient and democratic institutions that promote economic development and provide services to the population and economic activities in their territorial jurisdiction. This is a vast and complex undertaking that requires coordinated developments in the political, fiscal, institutional and financial arenas. The objective is to achieve a structure of *intergovernmental relationships* that provides subnational governments with incentives to efficiently allocate resources to the most socially profitable uses. The goal is to have subnational governments with clearly defined responsibilities, sufficient resources to discharge their allocated functions, and facing hard budget constraints that force decision makers to assume full responsibility for the trade-offs involved in collecting and allocating a limited pool of resources. Also required is a *governance* structure with well-functioning mechanisms of citizen representation and oversight so that elected subnational officials can effectively be held accountable of their decisions and the management of local affairs and subnational government operation is transparent. Another objective is to ensure that there are sufficient *institutional capacity* and resources to discharge responsibilities at socially acceptable levels of performance, including a well-developed organizational structure, administrative systems and human resource

policies that strengthen the civil service career. Proper *financing* is needed to ensure good subnational government performance. Autonomous sources of revenue should be the principal source of financing for subnational governments, using fee for services rendered where possible; otherwise, they should be financed from taxes borne by local residents. When subnational services are associated with national or regional priorities, higher tier government transfers are an efficient source of resources. Transfers can be used to alleviate vertical and horizontal imbalances; however, they must not substitute own revenues and should not distort local expenditure preferences. To bring fiscal discipline to subnational governments, subnational borrowing requires a regulatory framework for debt management as well as financial market-based mechanisms (private or publicly placed) that are well priced and liquid. These mechanisms must also foster risk differentiation across subnational governments and enforcement of capital markets rules (IDB, 2001c).

The *provision of public utilities* and services is a traditional field of activity of subnational governments and encompasses a variety of essential services for the population and urban economic activities (water, sewerage, solid waste collection and disposal services, roads, drainage, public lighting, markets, abattoirs, transportation terminals). Current approaches seek efficiency gains through the privatization of provision and its financing with direct charges to beneficiaries, whenever possible. This entitles a change in the role of subnational governments in the provision of many of these utilities and services: from being a direct provider of water and sewerage services to a regulator of privatized utilities, from administrator of municipal markets and abattoirs to overseer of private facilities. Bank activities, either through sector or subnational loans, will support sector reforms needed to put in place the correct system of incentives and the regulatory institutions required for the sustainable and efficient provision of these utilities and services (IDB, 1995b).

The development of an adequate regulatory framework for the private provision of infrastructure is an area of concern where subnational governments need to develop capacity. To fully tap the potential of privatization, subnational governments need to develop strategies to identify the most efficient privatization schemes un-

der local circumstances. Local governments need to develop the institutional capacity to outsource services, sell or lease assets, award concessions, supervise contracts or build infrastructures under innovative financial and operational arrangements. The provision of utilities and services that cannot be privatized is another challenge that requires institutional developments in governments to ensure the appropriate separation of functions and financing between services, and to put in place efficient cost recovery and financing schemes. Charges to beneficiaries are the preferred source of financing and local taxes or contributions should be used when charges are not appropriate. In principle, charges should be set at the competitive private level, with no tax or subsidy element included. If subsidies are the most efficient way of achieving the public policy goals of equalizing access among population groups, direct transfers to the poor (e.g., through some variant of vouchers) are to be preferred. Urban governments need to implement clearly defined and well-funded social programs that do not jeopardize the financial foundations of service provision. These policies should include an explicit statement and clear justification of the chosen social objective; a procedure ensuring a mechanism for financing, whether from general taxation or tariff revenues; and a transparent mechanism for allocating funds to the target group.

Integrated Urban Development

Integrated urban development projects are increasingly required to tackle the growing complexity of urban growth and rehabilitation. The Bank places great emphasis on providing efficient institutional arrangements for the timely and cost-efficient execution of these programs. Broad community involvement in all phases of program design and execution is a solid guarantee of incorporating community goals into the programs and providing support for their continuity when local administrations change. Public-private partnerships are encouraged whenever possible as a way to efficiently allocate program's risks and returns among stakeholders and other interested parties. Programs are to encourage private sector participation and financing. The availability of local long-term financing is

an asset for these complex undertakings that require long execution periods, for which reason Bank operations will leverage, whenever possible, local resources either from investors or beneficiaries.

Urban Environment

The Bank has identified areas of cross-sector support for improving the urban environment and preventing environmental problems. Priorities include strengthening government institutions in charge of regulating and supervising urban environmental issues, and assessing the environmental impact of development activities. The involvement of organizations of the civil society in urban environmental issues is also encouraged and will be supported to facilitate community participation in environmental decisions and oversight. The development of sound regulatory frameworks and efficient environmental management instruments plays a major role in achieving the environmental sustainability of urban areas while improving competitiveness and productivity. Such instruments should promote the full involvement of the private sector in environmental management and in the provision of environmental services and goods for improving environmental conditions and ensuring sustainability. Reducing the vulnerability of the urban population to natural hazards is a growing priority that has an impact on all aspects of urban development, from the location of new housing to the planning and execution of urban infrastructure. The Bank supports planning and execution of risk mitigation interventions including sound urban development planning and enforcement and disaster preparedness.



Emerging Issues

Cities are contributing to reducing poverty and can also make a significant contribution to reducing social inequality. Efficient urban government facilitates access to public services to all, and good

urban housing policies expand the assets of the poor. Sound urban development policies and programs contribute to the reduction of social and economic exclusion by promoting economic growth—particularly the growth of small- and medium-size enterprises (that generate the bulk of the urban employment)—and by supporting increases in the productivity of informal economic activities.

Traditional urban problems that are aggravated by rapid growth and poor urban management in the past, are also growing concerns that need to be addressed in the near future. Traffic congestion in large cities is affecting the productivity of capital and labor and undermining the competitiveness of the urban economy. Urban sprawl not only increases the costs of service provision but also consumes valuable agricultural lands while well-serviced inner city lands remains underutilized or idle.

The Bank supports the planning, improvement and expansion of urban transportation to provide sustainable service and reduce congestion and pollution. Cost effective and well-managed public transportation systems are a priority area of support, as are, in the case of private car-transportation, the development of user charges and other mechanisms to transfer most costs of improvements in road infrastructure to users. The Bank stresses the need to link urban transportation planning and management with land use planning, and the planning and financing of the expansion of other utilities. They are critical determinants of urban growth patterns and have an impact on the capacity of cities to become efficient platforms for economic development and provide equitable access to services to all segments of the population. Economic efficiency improves as the quality of urban transportation increases and labor gets greater access to the jobs available in the city. Better transportation also improves living conditions as the population has better access to urban services. Similarly, as housing sector policy is reformed to facilitate the entry of the private sector to the production and financing of housing, and public funds are liberated to be targeted to the poor, more affordable housing solutions will be produced with impacts on employment and the well-being of low-income households.

The Bank's urban development portfolio is proof of the continued concern of urban governments for addressing the most dire

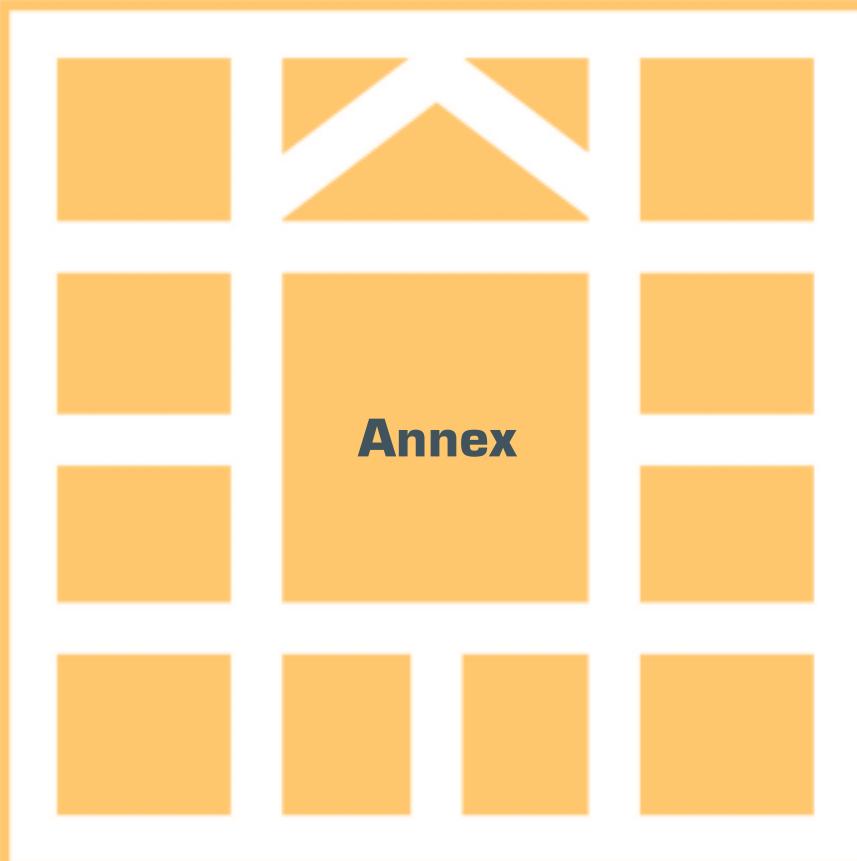
and pressing needs of their citizens. The fact that new projects in urban environmental management, inner-city rehabilitation, or urban violence mitigation are coming on line indicates that cities and metropolitan regions are expanding the scope of their interventions in response to emerging issues and social concerns. It also shows that they are looking to the future with resource conservation and quality of life in mind. Furthermore, the growing complexity of the municipal development portfolio shows the commitment of the countries to improve the capacity of local governments to deliver public services and to mobilize to this end the fiscal and human capital of the private sector and community-based organizations.

Tapping these development opportunities requires deepening the integrated approach to urban lending of recent Bank operations. Coordinated multi-sector interventions need to be conceived within a long-term view of urban development shared by all social actors.

The efficient application of the Bank tool-kit to the urban sector involves the coordinated use of sector and multi-phased loans in conjunction with more traditional investment loans and technical cooperation. With the full involvement of central governments, the Bank joins a policy and programmatic dialogue with its urban clients in order to develop an integrated assistance package that suits their needs and time frames. Further, the Bank is actively searching for efficient approaches and good practices to solve emerging problems like: the challenges of metropolitan governance, introduce innovative financial and execution arrangements to implement urban rehabilitation programs, and to expand the scope and reach of housing solutions for low-income households. Execution of proven solutions requires the cooperation among public and private actors and among different public entities, the Bank will continue supporting this efforts to expand the productivity of cities and the quality of life of the population.

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IDB Urban Lending 1961–2002

(In 1996 US\$ millions)

Year	Housing				Integrated				Municipal		Transport		Sanitation and Environment				Total urban		Total Bank		Year
	Housing		Barrio		Integrated		Heritage		Municipal		Transport		Environment		Sanitation						
	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	
1961	278.1	6													204.6	13	482.7	19	1308.9	73	1961
1962	402.8	13													327.6	9	730.4	22	1448.4	68	1962
1963	52.2	2	17.4	1											73.9	5	143.5	8	1123.6	56	1963
1964	541.5	6													98.5	10	640.1	16	1282.3	69	1964
1965	129.1	7													288.1	7	417.2	14	1570.8	66	1965
1966	141.9	3			49.9	1									254.7	6	446.5	10	1619.7	68	1966
1967	8.7	1	21.8	1	23.8	1									107.5	4	161.8	7	1968.9	60	1967
1968	95.4	3													94.3	3	189.8	6	1638.2	55	1968
1969	18.1	1							22.8	1					224.7	5	265.7	7	2289.0	67	1969
1970					120.4	1			42.7	1					75.7	4	238.8	6	2217.6	59	1970
1971	24.6	1													123.2	3	147.8	4	2135.5	59	1971
1972					138.3	1									164.1	4	302.3	5	2536.9	52	1972
1973									42.6	1					121.7	4	164.3	5	2630.9	57	1973
1974															222.0	6	222.0	6	3033.2	53	1974
1975			62.9	1							32.5	1			152.4	5	247.8	7	3434.5	70	1975
1976	82.7	2									52.0	1			172.3	5	307.1	8	3611.7	81	1976
1977	4.7	1			91.1	1									194.6	7	290.3	9	4017.6	81	1977
1978															229.5	4	229.5	4	3877.7	65	1978
1979															142.6	3	142.6	3	3925.4	79	1979
1980									70.1	2					298.0	1	368.1	3	4047.7	88	1980
1981									18.0	2					202.8	3	220.8	5	3997.5	81	1981
1982					272.4	2			135.4	2					273.6	2	681.5	6	4142.1	79	1982
1983									49.9	2					356.4	4	406.4	6	4421.0	74	1983
1984			24.2	1	161.0	1			231.0	2					112.4	3	528.6	7	4992.7	75	1984
1985			5.7	1					67.9	1					95.5	2	169.1	4	4154.1	78	1985
1986			35.5	1	29.3	1			162.0	1	53.8	1			459.8	4	740.4	8	4032.4	63	1986
1987			56.5	1					108.9	2					540.6	3	706.0	6	3043.4	43	1987
1988									15.1	1	56.9	1	62.5	1	377.6	4	512.1	7	2102.7	32	1988
1989			163.4	2					252.2	1					31.5	1	447.1	4	3144.5	36	1989
1990									209.8	3					502.8	3	712.6	6	4486.5	45	1990

IDB Urban Lending 1961–2002
(In 1996 US\$ millions)

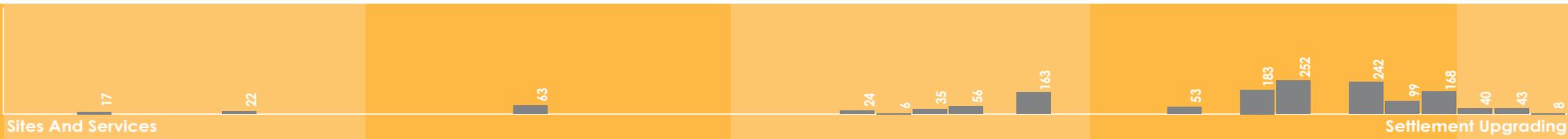
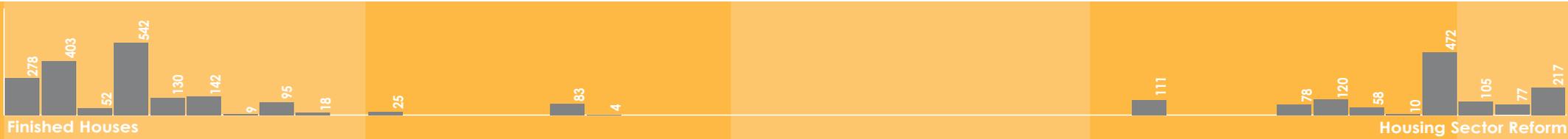
Year	Housing				Integrated				Municipal		Transport		Sanitation and Environment				Total urban		Total Bank		Year
	Housing		Barrio		Integrated		Heritage		Municipal	Transport	Environment		Sanitation		US\$	Nº	US\$	Nº	US\$	Nº	
	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	US\$	Nº	
1991									263.2	2					720.5	4	983.7	6	6043.4	77	1991
1992	111.1	2							87.6	2			490.0	1	506.5	4	1195.2	9	6557.3	90	1992
1993			53.2	1					17.2	1	19.7	1	733.9	4	82.4	2	906.3	9	6339.7	93	1993
1994							42.7	1	770.8	3	543.4	2			778.1	4	2134.9	10	5473.5	70	1994
1995			183.5	1					28.5	1	122.3	1			584.7	4	919.1	7	7445.1	82	1995
1996	78.4	2	252.0	2					249.0	1	14.0	1	89.6	4	253.3	3	936.3	13	6765.7	98	1996
1997	119.7	2			431.6	2			112.4	2			275.9	2	52.8	2	992.4	10	5902.4	105	1997
1998	58.1	1	242.2	1	19.4	1	27.1	1	585.1	7	72.7	1			59.1	4	1063.7	16	9655.5	105	1998
1999	9.9	1	99.3	2			59.7	1	718.7	4	12.6	1			557.4	8	1457.6	17	9359.1	95	1999
2000	472.3	1	168.3	1			7.6	1	285.9	2			14.0	1	122.5	2	1070.7	8	5700.7	91	2000
2001	105.1	3	39.7	1					774.2	7	42.6				103.4	2	1065.0	13	7417.1	87	2001
2002	77.0	4	42.5	1					435.3	7			15.4	1	92.1	3	662.3	16	4135.9	97	2002
2003	216.9	3	8.3	1	92.3	1			284.3	8	117.2	3			138.5	2	857.6	18	6281.7	78	2003
Total	3028.3	65	1476.4	20	1429.5	13	137.1	4	6040.8	69	1139.7	14	1681.3	14	10574.4	181	25507.5	380	175312.6	3100	

URBAN LENDING 1961–2003

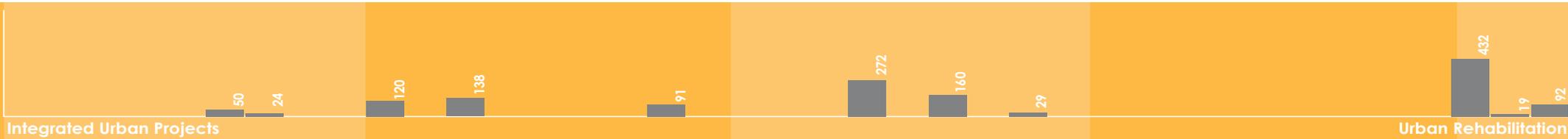
in 1996 US \$ millions

1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003

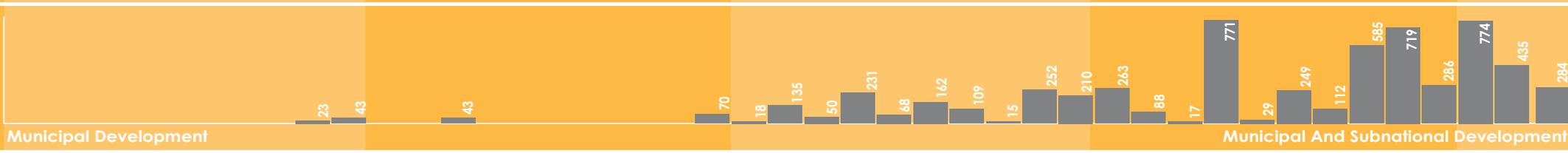
HOUSING



INTEGRATED URBAN DEVELOPMENT



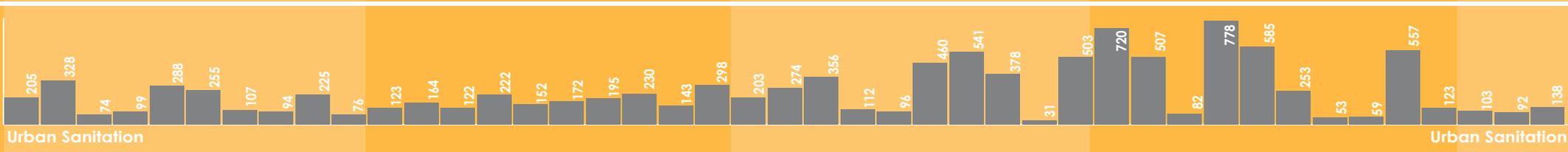
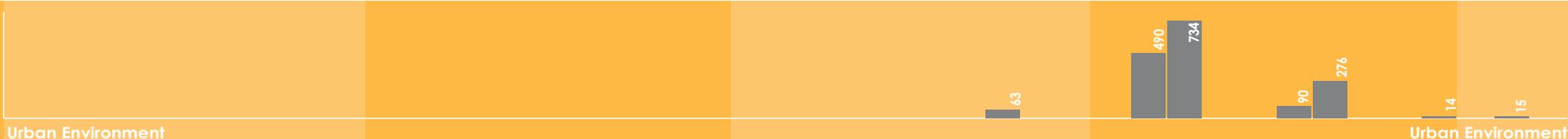
MUNICIPAL DEVELOPMENT



URBAN TRANSPORTATION



SANITATION AND ENVIRONMENT



1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003