

## **Beware of sub-prime housing policies in developing countries**

*The Third World poor could be the ultimate victims of the home-loans crisis*

Geoffrey Payne

Now that Britain's Northern Rock bank is no longer in a hard place, shares are recovering and a housing price crash has hopefully been averted, we can all relax. Or can we? Even more importantly, *should* we?

The extent of the housing crisis in the US and UK has yet to be determined, but is a cause of increasing concern to millions of home owners and those seeking a home of their own. These concerns are being felt far more in those countries, such as the US, UK and Spain where the proportion of the housing stock in owner-occupation is highest at, or above 70%, compared to about 40% in Germany and 35% in Switzerland.

Campaigns to extend home-ownership have been driven by political as well as social and economic considerations which assume that once people receive a valuable asset, especially one they have not had to pay the market price for, they are likely to vote for the political party which does most to protect it.

However, it is not just political dogma which has prompted the crisis. Sharp banking practices which produced short term growth rates, led to the authorities taking their eyes off the ball. Having provoked an international financial and economic crisis, the banks behaved like spoilt children who ran to governments for protection from the consequences of their actions. And like over-indulgent parents keen to protect other children, governments have had to bail them out. This poses the question of whether the best way to realize economic stability and meet diverse personal needs would be to encourage greater diversity of tenure options, rather than high levels of home ownership.

However, the problem is potentially even more far-reaching in developing countries than for savers and home-owners in the US and UK. As long ago as the 1980s, USAID and the World Bank were busy trying to promote the development of American style housing finance systems to promote low/middle income owner-occupation and house investment at scale in poor countries<sup>1</sup>, and a secondary mortgage market was sometimes promoted as a way of accessing additional capital so the housing finance institutions did not have to depend on government. Given the lack of depth in the financial systems in most of the countries they tried to promote it in, the approach had limited impact. However, the Peruvian economist Hernando de Soto provided a seductive theoretical foundation for policies to increase home ownership in his book 'The Mystery of Capital'<sup>2</sup>. Unsurprisingly, this was music to the ears of Thatcher, Milton Friedman and Jeanne Fitzpatrick, the former US Ambassador to the UN, all of whom endorsed it. Even Gordon Brown has signed up as a member of a commission co-chaired by de Soto which is now completing its work<sup>3</sup>.

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<sup>1</sup> Stanfield, D. and P. Bloch (2002), 'USAID investments in land markets and property rights: Interim assessment based on secondary sources', Land Tenure Center, University of Wisconsin.

<sup>2</sup> de Soto, Hernando (2000) 'The Mystery of Capital: Why capitalism triumphs in the West and fails everywhere else' Basic Books, New York

<sup>3</sup> The Commission for the Legal Empowerment of the Poor' co-chaired by de Soto and the US ex Secretary of State, Madeleine Albright.

According to de Soto's analysis, the major stumbling block that keeps the rest of the world from benefiting from Western capitalism is its inability to produce capital, and whilst the poor already possess the assets they need to make capitalism work for them, they hold these assets in defective forms. By this he means that they lack titles to their properties which they can use to invest in businesses, rendering their assets as 'dead' capital. He estimates the total value of such 'dead' capital is at least US\$9.3 trillion. They have houses but not titles.

By contrast, he claims that the substantial increase of capital in the West over the past two centuries is the consequence of gradually improving property systems, which allowed economic agents to discover the potential of their assets, and thus to be in a position to produce the non-inflationary money with which to finance and generate additional production. He proposes that if the governments of developing countries provide universal property ownership with clear titles and rights enforceable in law, then the poor will be able to use their assets to obtain credit and capitalism would enable countries to lever themselves, and their poor majorities, out of poverty and into capitalist affluence.

De Soto conveniently overlooks the contribution of colonialism and slavery, as well as technological innovation in the growth of Western affluence. In Peru, where his policies have been widely implemented, there has been virtually no increase in access by the poor to formal credit and poverty levels have not been significantly reduced. Despite the lack of empirical evidence to justify the promotion of home-ownership through land titling programmes, the US government and agencies such as the World Bank, continue to invest vast sums in promoting land titling programmes.

Initially, most land titling programmes were based in the rural areas of countries such as Thailand and benefited previously insecure farmers for whom titles enabled them to plan ahead with confidence. However, when such policies began to be applied in urban areas, they had very different consequences. First, by providing titles to residents in existing informal settlements, land prices escalated dramatically, particularly in inner city locations. This has occasionally generated conflict between competing claimants and led to the eviction of low-income tenants and to market driven displacement. Whilst some people suddenly became wealthy from the windfall gains acquired by selling to higher income groups or land developers, it enabled many developers to acquire land from the new owners for far less than it was really worth, in some cases leading to the concentration of landholdings in fewer hands.

As informal settlements became increasingly integrated into the formal land and housing markets, so the money to be made has attracted massive speculation, which has in turn resulted in cases of government officials working hand-in-glove with local and even foreign investors. It has also closed previously affordable and accessible urban areas to later generations of low income groups, forcing them into peripheral locations far from livelihood opportunities and services.

At the same time, new government or private sector developments designed to provide land to lower income groups are increasingly forced to the urban periphery, or even beyond, where land prices are lower. Whilst this enables households to receive a plot of land with secure title, it isolates them from the main areas where they can earn a livelihood and access basic services. The time and cost of transport increases the burdens imposed on such households and in some countries, such as South Africa, has led to distress sales as households seek to return to better locations, even at the price of less security.

The fundamental failure of mortgage banks involved in 'sub-prime' loans and of de Soto and his supporters in development agencies and national governments is that they fail to ask the first

question of potential borrowers – “can you afford to repay the loan?” Collateral only becomes relevant if the answer to this is positive. By lending to those unable to meet repayments, banks have brought the entire global financial system near collapse.

The result is that rather than removing poverty, there is a risk that these policies may actually be driving the poor from expanding cities throughout Africa, Asia and Latin America and forcing them to the margins of society. This is at a time when the world population has just become more urban than rural and when about one billion people globally is presently living in slums or squatter settlements. The UN's projection (2003:XXV) is that this figure will double to 2 billion people by 2030 unless concrete action is taken<sup>4</sup>. Many of these households are tenants who risk being evicted as a result of titling programmes<sup>5</sup>, or squatters vulnerable to market-driven displacement<sup>6</sup>. With populations of some developing country cities already far larger than London, the risk to social and economic stability is potentially even more serious than the problems facing the West.

Sadly, leading international and bi-lateral development agencies, such as the World Bank, UK's Department for International Development (DFID) and Sweden's International Development Cooperation Agency (SIDA), are reducing their support to urban issues in developing countries at a time when it has never been more urgently needed. Some are presumably hoping that by maintaining their focus on rural development, the flow of migrants into urban areas can be stemmed. However, experience suggests that this approach is doomed to failure as a combination of pressure on land in rural areas, the effects of climate change and internal conflicts, force more people off the land and into the cities, where opportunities for alternative sources of livelihood are greater, despite the squalor.

The real challenge for developing countries is to focus on the social and economic practices that work for the poor and modify official systems of regulations, standards and procedures to incorporate these, rather than expecting the poor to adapt to the middle class perspectives of bureaucrats and professionals. This involves governments and the international community examining, and building on, systems of local finance and livelihood strategies the poor themselves have developed out of necessity to improve their lives. This will help to build the necessary levels of confidence and security needed for the poor to invest incrementally in improved housing and infrastructure. Titles and home ownership are only one of many means of achieving these objectives.

The present crisis could therefore easily prove to be a foretaste of what is in store unless policy makers, whether environmental professionals, such as planners, or senior administrators in land administration, stop placing so much emphasis on land titling and home ownership and instead encourage a wide range of tenure options in which all social groups, in both affluent and developing countries, can meet their needs within their budgets. These should build on and adapt what people in different countries are familiar with and which already enjoy social legitimacy, such as customary tenure, community ownership or land trusts, private rental and co-operatives. Serious consideration should also be given to adopting and adapting a range of intermediate tenure forms, such as Botswana's 'Certificates of Rights', Bolivia's 'Anticretico'

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<sup>4</sup> United Nations (2003) 'The Challenge of Slums: Global Report of Human Settlements 2003' United Nations Human Settlements Programme, Nairobi.

<sup>5</sup> UN-HABITAT (2006) 'State of the world's cities 2006/7' Earthscan, London. (See page 95)

<sup>6</sup> Durand-Lasserve, A. (2006) 'Market-driven evictions and displacements: Implications for the perpetuation of informal settlements in developing cities'. In: Huchzermeyer, M., and Karam, A. (Editors). 'Informal settlements. A perpetual challenge?' University of Cape Town Press.

tenure, Trinidad and Tobago's 'Certificate of Comfort' and Kenya's Temporary Occupation Permits'. Information on these innovative forms of land tenure is widely available, and offers a range of examples to suit different contexts.<sup>7</sup> Meanwhile, national and international policy makers and urban planners should beware of 'sub-prime' policies which promise simplistic solutions to complex problems.

(1660 words)

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<sup>7</sup> See Payne, G (2002)'Land, Rights and Innovation: Improving tenure security for the urban poor' ITDG Publishing, London. Also: State Land (Regularisation of Tenure) Act, 1998 (No. 25 of 1998) Trinidad and Tobago.