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**GUIDELINES FOR THE DEVELOPMENT OF A SUPPORT STRATEGY FOR THE
INFORMAL SECTOR IN HOUSING, INFRASTRUCTURE AND SERVICES PROVISION**

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INTRODUCTION

This paper is concerned with formulating guidelines for the development of a support strategy for the informal sector in housing and infrastructure for USAID. It is based on the workshop discussion papers on land, finance, construction and employment, infrastructure provision and community participation, on a sample of documented experiences of various international agencies (including Foundations and NGOs) in dealing with the informal housing and small-scale enterprise sector and on my own work in this field.

All papers document the vitality and scope of the various parts of the informal sector related to housing and infrastructure and the positive contribution it makes to the overall economy, and to increasing housing and employment opportunities, particularly for poor urban households. This is in sharp contrast with many public sector housing projects. However, the limitations, constraints and the costs of operating outside of the formal regulatory system are indicated as well, for the individuals and firms involved in the informal sector and for society at large. These must be understood before a comprehensive strategy can be formulated to deal with the informal sector. Therefore, the questions to be addressed by this workshop cannot be narrowly focused on how informal mechanisms and processes in the housing sector could be incorporated into the Office's housing and urban development activities. In this paper, two complementary sets of questions are considered for each sector:

1. What are the constraints in the legal and regulatory framework related to land, housing finance, and the building materials and construction industry that forces such a large proportion of housing and infrastructure development activities to be conducted in the informal sector. What are the highest priorities for adjustments to improve the efficiency of the various sub-sectors and how could the Office of Housing and Urban Programs play a role in this process. The answers to these questions define the long-term sectoral goals. Even assuming that new regulations are accepted by the government and acted upon by the small-scale entrepreneur or broker, this process will take a long time and will mostly affect only new establishments. In the shorter term, therefore, these strategies should be complemented by measures that will operate more directly at the informal sector level.

2. How can informal sector activities related to housing and infrastructure provision be made more efficient in the sense of improving productivity, using appropriate materials and technology and reaching a larger number of poor households? How can the Office assist reaching those objectives? And how can informal sector deliverables, mechanisms and institutions be used for the improvement of housing services within lending and technical assistance programs of formal lending agencies?

These two sets of questions are not new and have formed the basis of most present intervention strategies. Already in 1974, after the extensive ILO studies of the informal sector, similar sets of questions were asked in the publication *Redistributionn* with

Growth (Chenery et. al., 1974). And, at a more practical level, several international development programs were designed such as USAID's Integrated Improvement Program for the Urban Poor (1981) and the Small Enterprise Project, the Ford Foundations's Programs on Livelihood, Employment and Income Generation. There are some very interesting success stories of development projects with the informal sector, both by international development agencies, foundations and non-governmental organizations. We should carefully study those cases and learn from them.

However, the very reason for the workshop indicates that these strategies have had only limited impact. Often, the reasons for this lack of success are political, and cannot be resolved by intervention strategies of international development agencies. However, evaluations of past performance indicate that assistance programs could have been better designed. They are often focused on narrow geographical or economic target groups and do not address the broader questions in each specific sector e.g. land, finance, construction, building materials production; another set of policy-level programs are mainly involve with macro-economic questions which do not directly relate to the small-scale and informal sector.

Moreover, project design and implementation methods for projects directed at specific urban target groups are often deficient, particularly in the ways of dealing with the informal sector. Lacking the capacity for grassroot work themselves, lending agencies have often used NGOs to deal with the informal and

community sector. While this sometimes has had good results, NGOs tend to have a strong social welfare orientation which has not emphasized the need for efficiency and organizational capacity of the small-scale sector, and their intervention often did not consider the effects of the overall market in each sector. Additionally, training, communication and information provision was often not systematically included.

What makes us think that we can be more successful this time?

We are in the middle of a dramatic change in the international development climate, which, however contradictory it may seem, could be more conducive to support the small-scale and informal sector. Because of strict macro-economic adjustment policies, which often hit the poorer sections of society hardest, politicians are more interested in special measures and programs which address the problems of the informal sector; many of the macro-economic adjustment policies which are prescribed by IMF and the World Bank emphasize changes in the regulatory framework which often will benefit the informal sector; import restrictions have a similar effect, in that the small-scale sector uses more locally available material and is more adjustable in its production process; sectoral development programs of the international agencies clearly stimulate a greater role for the private sector, including the small-scale and informal sector; the lack of success or lack of replicability of many government programs have made governments more open to collaborate with the private and non-governmental sector; and, with the present decentralization movement in many countries in Africa and Asia,

the role of urban local authorities and local communities will increase, which many facilitate the interfacing with the informal and small scale sector. So, it appears that there is a greater convergence of various interests concerning the informal and small-scale sector held by politicians, finance ministries, line-ministries, local governments and development agencies, although from quite different perspectives. Each proposed strategy needs to build on these various interests to make the approach successful.

GUIDELINES FOR SUPPORT STRATEGIES BY SECTOR

The heterogeneity and extensiveness of the informal sector makes it extremely difficult and complex, to design general guidelines for a support strategy which are meaningful for such diverse areas as the small scale building industry, land and finance. This is particularly the case if one wants to approach the problems integrally and not just on the basis of small scale location oriented projects.

The papers prepared for the workshop put more emphasis on documentation of informal activities and need for research and demonstration projects than on the formulation of strategies. Yet certain facts are known on the basis of which we could formulate a preliminary outline for a strategy. I will do this sector by sector, lifting out the factual material presented in the papers and supplementing it with other information from evaluation reports and my own understanding based on personal experiences and extensive discussions with informal sector

program staff.

A. Housing Finance

Main issues:

Housing finance institutions in developing countries are typically small and provide a very small proportion of total housing finance. Most housing finance comes through informal sources of credit. This is a result of national financial and fiscal policies such as constrained interest levels (often negative real interest rates) which limit domestic savings and the development of domestic financial instruments; restricted investment selection directed to other sectors than housing; and a limited access of households to credit including housing credit. Housing finance is often segregated from the rest of the financial sector and is available only to selected income or employment groups. Particularly households at the lower end of the income distribution depend nearly completely on informal credit sources, which are expensive and mostly short-term. They lack the collateral, the guarantee of a regular and recorded household income, the ability to save and have limited access to formal financial institutions.

Strategies:

1. Improve the formal, public, and private housing finance sector so that it can respond more effectively to the demand for credit by lower-income households:
 - o Decrease financial market segmentation and increase savings into the housing sector by introducing more realistic

interest rate policies, both for deposits and for mortgage lending

- o Adjust the regulatory system so that new mortgage lenders can be attracted into the market, particularly those with a great propensity to serve the lower-income market, e.g. thrift societies, cooperative banks
 - o Develop adequate mortgage instruments, including instruments which are adequate for the provision of credit to investors in rental housing
 - o Make housing finance regulations more responsive to the specific needs of low-income households, e.g. adjusting the required guarantees for the recovery of principal and interest to deal with the fluctuating income situation and lack of traditionally acceptable collateral.
 - o Make mortgage banking procedures more "people-friendly".
2. Improve the performance of the informal financial sector, in order to provide better service to those who cannot be reached by formal finance institutions:
- o Develop bridging finance organizations that can form a link with the formal housing finance institutions to overcome problems of collateral and credit risks for long-term lending. These bridging organizations can also assist in the administrative process of origination and servicing of a great number of small loans. Examples are the proposed credit insurance community organizations in Peru, the thrift and cooperative societies in Sri Lanka. This is not an easy task, particularly in situations where

foreclosure in cases of default is politically blocked because of the highly politicized nature of the informal housing areas. Under such circumstances the formal housing finance institutions may be reluctant to enter in a collaborative arrangement with intermediary informal institutions.

- o Stimulate the formation of more efficient informal credit institutions where a link with the formal finance sector is not feasible, e.g. by improving savings and investment mechanisms, and by improving lending capacities of community-based fixed fund credit associations. However, these informal finance systems seldom resolve the problem of the need for long term credit and are therefore less appropriate for the financing of housing.

How can USAID help?

The Office has already experimented with a variety of strategies to make the formal housing finance sector more accessible to middle and lower income households. A beginning is made (e.g., in Sri Lanka) to create or improve the capacity of bridging institutions between formal and informal sector. However, in many cases there is no sector-wide strategy which covers both the formal and the informal sectors, to reach a more equitable and efficient housing finance system.

Housing Guarantee loans can form the basis for strategies to work with reliable bridging institutions, which are "guaranteed" by formal sector institutions. Financial assistance directly to the informal sector will have to be channelled through intermediary

NGOs. It is important that NGOs are selected which have a solid track-record in financial management and banking activities and an understanding of the informal finance systems.

At all levels, it is critical to develop a cadre of highly qualified people who will have insight in how the overall housing finance system affects access of low-income households to credit. Specialized training at the national policy-making level, at the financial institutional level, at the managerial- and the community-organizational level, will have to form an important part of any strategy. Roundtable meetings for a select group of decision-makers from different levels of the housing finance system can be powerful instruments in facilitating the development of appropriate procedures, regulations and institutions. The Office is in an advantageous situation to provide this type of training and further technical assistance to selected financial institutions. It can also facilitate the exchange of information on successful experiences among developing countries or between the US and developing countries.

Land

Main Issues

Most developing countries have gross inefficiencies in the functioning of the land market, resulting from cumbersome legal and administrative government regulations and procedures, unresponsive to the need for urban land development particularly for low- and middle-income housing. Individual and group invasions of land and informal land development and subdivisions

by micro-brokers play an important role to overcome these inefficiencies of the market. However, the costs of invasions and informal subdivisions is high to the occupants. Moreover, informal ownership certificates do not allow the land to be used as collateral for credit. Also, potential societal costs related to inefficient land-development patterns and possible inequitable landownership trends are high. The public sector lacks micro-level information on which to base an effective linking mechanism with the informal land-developers. Often, linking mechanisms that have been tried, have resulted in land becoming unaffordable for low-income households and in a concentration of landownership.

Strategies

1. Improve the efficiency of urban land markets particularly to facilitate access to land by moderate and low-income households:
 - o Simplify cadasters and registration systems (see present experiments in Cote d'Ivoire)
 - o Simplify technical regulations and standards for land-development
 - o Increase and guide the supply of land by symplifying acquisition procedures of state-owned land and by construction of basic infra-structure.

2. Based on detailed studies of the operation of micro-brokers and on studies of landownership status and concentration patterns in the informal land market:
 - o Develop legal forms of landownership and occupancy licences

which will stimulate housing and infrastructure investments and/or be acceptable as collateral by financial institutions, yet will not jeopardize the accessibility of the land by the lower-income groups. Cooperative landownership is one way of achieving this.

- o Develop mechanisms through which government agencies can collaborate with quasi-formal landowning groups or micro-brokers in land-development and in co-financing of infrastructure and services.

How can USAID help?

Ways in which USAID can assist are similar to those mentioned in the finance section. They have to begin with the training of crucial decision-makers in this field and the initiation of discussions between central and local government land officials, who both have a stake in reorganizing land policies and regulations. There is little experience yet with linking-mechanisms between formal and informal sector and further studies and brainstorming with local experts is needed, as well as the sharing of information between countries. This appears to be the area, however, in which USAID's contributions, both through technical assistance and capital investment, can be significant.

Small Construction Enterprises

Main Issues

Most residential construction is carried out by small-scale

construction firms. The majority of these firms operate informally because the residential construction in which they are involved does not comply with building and planning standards. Compliance would make the construction unaffordable, so no official building permits are obtained. Also, the costs for the firm to submit to regulation is very high and time consuming. The other side of the coin is that unregistered and informal firms have difficulty obtaining credit and larger-scale contracts. This limitation and the lack of training and assistance in procuring materials or equipment impedes their growth.

Strategies

1. Promote changes in the formal regulatory framework related to residential construction:
 - o Allow more realistic planning and building standards, including for rental housing
 - o Simplify the administrative procedures to obtain permits, licences and deeds
 - o Revise regulations on preferential pricing and building materials concessions for the formal sector.

2. Support activities for small-scale construction enterprises:
 - o Develop mechanisms or institutions to make credit available or to guarantee loans for small-scale contractors. The special nature of construction credit causes has to be taken into account in credit provision for this sector. Intermediary institutions which link the small-scale sector with formal finance institutions have to be carefully

selected on the basis of their understanding of this sector and their willingness reach out to small firms.

- o Make cooperative arrangements for smaller firms to acquire construction equipment.
- o Provide training and advisory assistance on tendering, planning, programming etcetera. Ideally, this type of service should in the long run have no need for subsidy as client firms pay for services rendered. Several pilot projects have been initiated, many of which were not successful. These should be studied carefully in order to understand whether their lack of success was due to structural problems in the sector or to the inefficiency of the assistance program perse.

How can USAID assist?

For many years the Office has worked with governments on the development of realistic building and planning standards in the context of Housing Guarantee projects. Successful experiences should be documented. How have central government agencies and local authorities adopted more relaxed standards; what were the results in the quality of houses built and the income-groups reached; how was the planning, implementation and maintenance process affected. This material could then be used as information material in working with other central or local authorities, particularly within the same region. The Office could expand its project work to include the wider regulatory context in which small-scale residential construction takes place, including rental housing.

As mentioned before, the provision of credit, training and professional assistance to small construction enterprises through government or private sector institutions has been tried in many countries by nearly all international development agencies; typically, this approach has been unsuccessful in reaching the small-scale enterprises or in making a lasting impact on the efficiency of their operation. Within the NGO sector the results do not seem to be much better. There is a need to explore different types of intermediary organizations, which are more specialized in a single activity, such as credit, and which have highly qualified staff, well respected by formal credit institutions. The Ford Foundation's recent evaluations of assistance to small-scale enterprises point in this respect to the experience with the Grameen Bank in Bangladesh and to positive experiences with trade unions representing small-scale enterprises in one sector. However, these experiences do not include the construction sector. It is necessary to understand the reasons for success. If it is the structural characteristics of the construction sector which are the cause of all too many failures of assistance programs to the small-scale enterprises, these constraints have to be addressed first. It can be expected that powerful interest-groups will make this process a difficult one.

Small-scale Building Materials Producers

Main Issues

Small-scale firms producing building materials are often very viable in comparison with large-scale firms, because they can continuously adjust the type of products and the production process as needed. The growth of small firms is constrained, however, by lack of access to credit and in some cases by a lack of access to imported material.

Support Strategies

1. It is important to focus support for small building materials firms on those areas of production where economies of scale do not favor large formal sector firms. In those areas, strategies could be developed as follows:
 - o Eliminate constraints imposed by the regulatory framework which discourage the development of the small-scale sectors e.g., barriers to register, monopolistic trends in the large scale sector, access to materials.
 - o Facilitate the participation of small-scale firms in larger contracts by the definition of standards for building materials by public agencies which can assist to improve the quality and by specification of building materials for public sector contracts.
2. Support strategies for the small-scale building materials producer:
 - o Provide channels to give this sector access to credit. Initial small loans for short periods of time will allow

credit ratings to be established, and gradually larger loans could be issued.

- o Provide training and technical assistance within the context of the small firm to improve the quality of products. High quality goods produced for a wide section of the market give a much higher rate of return.

How can USAID help?

The Housing Guarantee projects can include subcontracting arrangements with viable small-scale building materials firms. Based on studies of this sector, USAID can work towards the elimination of restrictive regulations, through various information, training and communication activities.

Work with the small-scale sector itself needs the same careful consideration as mentioned under the small-scale construction enterprises. The selection of appropriate NGOs which can work with the sector is crucial.

Infrastructure

Main Issues

The provision of infrastructure and services such as water supply, solid and human waste disposal, roads and paths and electricity, has been the domain of government agencies, for obvious reasons. However, public agencies have not been able to provide infrastructure to a growing number of urban neighborhoods. Increasingly, individual households, community groups and informal enterprises have taken over this task, often

at high costs in real terms and in terms of consequences for the health of affected population groups. A redefinition of tasks has to be worked out between public agencies and informal providers.

Strategies

1. Public agencies could move towards a more managerial and controlling function through:

- o Redefine technical standards and procedures, including safe low-cost techniques, which will be published in accessible guides and manuals. Several successful examples for new land development are mentioned in Cambell's paper. Other examples exist for the upgrading of occupied unserviced neighborhoods. A careful evaluation of new technologies has to be done in relation to their social and cultural acceptability.
- o Develop strategic water and sanitation plans which will be continuously updated according to changing needs and which will be distributed to the communities involved.

2. Support activities for the small-scale sector:

- o Public agencies can provide licenses or contracts to informal bonafide enterprises or associations for specific tasks in services provision (e.g. in Cote d'Ivoire PRE/H training activities in urban management stimulated experiments by local authorities to contract with small-scale firms for solid waste disposal) or in the construction of infrastructure (e.g. in Sri Lanka the

National Housing Development Authority has worked out procedures to contract with community construction groups for the construction of wells, roads and footpaths. The NHDA planners play a supervisory role only). The organization of such public-private linkages requires training of both the public agencies and the informal groups or enterprises.

- o Use a participatory approach to project design and planning and improve the motivation and skills of communities to form construction and maintenance groups. Training of public agency staff is needed and frequently the assistance of NGOs is crucial.

How can USAID help?

As with many of the previous sectors, USAID has a long history in developing and stimulating governments to adopt more appropriate technologies for infrastructure provision, both in the urban projects and through the WASH project. It is a slow process in most countries and collaboration between various development agencies is crucial.

Since USAID has nearly always worked through public agencies for infrastructure and service provision, a track record of public-private partnership does not yet exist. However, in countries where USAID supports decentralization and urban management programs (mostly in Africa) the training and technical assistance inputs could be important facilitators for such approaches as they have proven to be in Cote d'Ivoire Coast. When more is

known about these ventures, the Housing Guarantee projects can provide more direct capital inputs into this area.

CONCLUDING REMARKS

A. The potential of the small-scale and informal sector can only be realized if a sector-wide support approach is adopted.

Such an approach should be based on:

1. An understanding of unnecessary and harmful constraints imposed by the legal and regulatory framework on the small-scale and informal sector and of other reasons for market inefficiencies. This understanding should be translated into actions at the formal sector and informal sector level that are designed to reinforce each other. It should also be reflected in the research and training agenda of the Office.

2. An understanding of the different interest-groups or actors involved in the decision-making process related to the small-scale or informal part of each sector in order to develop a solid support-base for necessary changes. In the introduction, I explained the changing climate surrounding the informal and small-scale sector which needs to be understood and used creatively. Networking and training activities organized by the Office are important tools in this respect.

3. A close collaboration and coordination of activities between different sections of international development

agencies (PRE/H, Science and Technology, Regional Offices etc.) and between the various international agencies and foundations, both at the structural programmatic level and at the project level. Shared country-specific or regional support agendas could facilitate the learning process and the effectiveness of each of agency's actions.

4. A different process of project design, allocation of funds and monitoring and evaluation. A sectoral approach to work with the informal sector will necessarily have to be an incremental learning process, based on building up appropriate policies and interorganizational linkages through training and information sharing. Part of these activities can be connected to existing Housing Guarantee projects in selected countries (e.g. in the area of housing finance to lower-income households through formal and bridging institutions, credit to small-scale contractors and public-private partnership in service delivery). However, a more comprehensive sectoral approach will have to reconsider the relative role of Housing Guarantee-related capital assistance and technical assistance, both in scope and sequence. Technical assistance, including training, will have to precede large-scale financial inputs in most cases. This has consequences for the way in which funding for technical assistance and training for informal sector projects will have to be acquired.

B. Support strategies which focus directly on improving the

efficiency of the informal and small-scale sector are needed certainly in the short-term. These are difficult to design and careful consideration should be given to:

1. Selection of institutions or organizations that can organize or work with the informal sector. International development agencies like USAID seldom have the capacity to work directly with the informal sector. Public sector agencies often are also not in a position to act on behalf of the informal sector. The creation of self-reliant organizations outside of the governmental structure is impossible for government agencies and many of the programs for the informal sector are initiated because of a disillusionment with public sector performance. The nongovernmental sector has therefore been considered as the most appropriate. However, past performance of NGOs in this area has on the whole been quite disappointing. NGOs often prefer to work in a limited geographical area with small groups and often resist to expand their programs. They receive their funding from foreign development agencies and are totally independent and often in conflict with the government. Their programs can, therefore, often not be replicated. This is compounded by the fact that the cost per participating household or firm in NGO projects is often very high, creating a dependent relationship rather than one based on self-reliance. In selecting a counterpart organization to work with the informal sector, the Office has to be clear about the specific function

which the NGO is supposed to perform. With a sector-wide approach it is important that the NGO is interested in expansion and the building up of replicable organizational structures, where possible and necessary, in collaboration with the formal private or public sector. If its main role will be to work with the production sector, a general social welfare-oriented NGO may not be the appropriate choice. Trade unions and non-profit private banks are some of the alternatives which have been more successful as bridging organizations between informal and formal institutions in the production sector. For the organization of communities in low-income areas or landowning community groups the former may be the appropriate institution.

2. Consideration of the institutional or organizational structure most appropriate for the particular informal or small-scale sector. Often the informal sector needs to be organized directly or a support system for that sector needs to be established. The organizational form which either the direct organization or the support system for the informal sector assumes is crucial; much more study should be devoted to that issue. The organizational structure should be closely related to the main goals which are to be achieved by that section of the informal sector; e.g., is the purpose to obtain housing credit and should the organization overcome the problem of inadequate collateral and credit risk guarantees for low-income households; is the purpose to improve the operation of

small firms by gaining access to credit? While a cooperative structure may be the most appropriate in the first case, cooperative operations may be the kiss of death in the other.

3. The selection of productive activities to be supported (particularly in relation to the building materials production and construction sector). Selection should be based on an understanding of the overall market and the competitive advantage of the small-scale sector in relation to the large scale sector.
4. The selection of support activities that are to be stimulated. Often it does not seem fruitful to have too many support activities planned simultaneously for one informal sector organization. This tends to bog down the fragile organizational structures. Support efforts are best concentrated on a limited number of relatively simple activities which have a large potential spin-off effect and replicability, e.g., credit (which seems to be the critical support component for most informal sector activities considered in the workshop). At later stages support activities can be expanded.
5. The selection of appropriate project design and implementation methods. More than with any other sector, work with the small-scale and informal sector needs to be participatory in nature, and based on incremental learning and planning procedures.

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