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LIST OF ABBREVIATIONS

Ags	Aguascalientes
BANOBRAS	Banco Nacional de Obras y Servicios Públicos, S.N.C.
BC	Baja California
BCS	Baja California Sur
BOT	Build, Operate, and Transfer
Camp	Campeche
Chis	Chiapas
Chih	Chihuahua
Coah	Coahuila de Zaragoza
Col	Colima
COPLADE	Consejo de Planificación Estatal
CLOPADEMUN	Consejo de Planificación Municipal
DF	Distrito Federal
Dgo	Durango
FAIS	Fondo de Aportaciones para la Infraestructura Social
FISM	Fondo para la Infraestructura Social Municipal
FONAHPO	Fideicomiso Fondo Nacional de las Habitaciones Populares
FOVISSSTE	Fondo de la Vivienda del Instituto Seguridad y Servicios Sociales de los Trabajadores del Estado
Gto	Guanajuato
Gro	Guerrero
Hgo	Hidalgo
IDB	Interamerican Development Bank
IMSS	Instituto Mexicano del Seguro Social
INFONAVIT	Instituto del Fondo Nacional de la Vivienda para los Trabajadores
ISSSTE	Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado
Jal	Jalisco
Méx	México
Mich	Michoacan de Ocampo
Mor	Morelos
Nay	Nayarit
NAFTA	North American Free Trade Agreement
NL	Nuevo Leon
Oax	Oaxaca
PET	Programa de Empleo Temporal
PNDU	Programa Nacional de Desarrollo Urbano
PROBECAT	Programas de Becas de Capacitación para Desempleados
PROGRESA	Programa de Educacion, Salud y Alimentacion
PROSAVI	Programa Especial de Creditos y Subsidios para la Vivienda
Pue	Puebla
Qro	Queretaro de Aretaga

Q Roo	Quintana Roo
SEDESOL	Secretaría de Desarrollo Social
Sin	Sinaloa
SLP	San Luis Potosí
Son	Sonora
Tab	Tabasco
Tamps	Tamaulipas
Tlax	Tlaxcala
Ver	VeraCruz-Llave
VIVAH	Programa de Ahorro y Subsidio para la Vivienda Progresiva
Yuc	Yucatán
Zac	Zacatecas
Z.M	<i>Zona Metropolitana (Metropolitan area)</i>
Z.M	<i>Zona Metropolitana de la Ciudad de México</i>

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**MEXICO URBAN DEVELOPMENT:
A CONTRIBUTION TO A NATIONAL URBAN STRATEGY**

Table of Contents

Executive Summary	i
I. Introduction	1
II. A Still Evolving Urban System	3
A. The Roots of Mexico's Urban System	4
B. The Emergence of a more Balanced Urban System	5
C. The Urbanization of Poverty	7
D. Previous Government Programs for Urban Development	10
E. Implications for the Urban Strategy	10
III. Livable and Competitive Cities	12
A. What makes a City Competitive?	13
B. Land, Housing Markets and Urban Transport	16
C. Infrastructure and Basic Services	22
D. The Needs of the Urban Poor	25
E. Priorities for Reform	31
F. New Government Initiatives on Urban Development and Poverty Alleviation	34
IV. Manageable Cities	36
A. Limited Powers within an Ambiguous Institutional Framework	36
B. Limited Own Financial Resources and Unpredictable Transfer	40
C. An Incentive Structure that does not Promote Responsible Urban Management	42
D. Priorities for Reform	43
V. Conclusions and Policy Implications	48
Bibliography	52
Annex I: The fast-growing Large and Intermediate Cities of Mexico, 1995-2000	56
Annex II: State Business Conditions and Fast Growing Cities	57
Annex III: Map of Poverty and fast Growing Cities	58

Tables in Text

Table 1: Mexico has largely completed its urban transition	3
Table 2: Manufacturing employment is not longer concentrated in Mexico City	4
Table 3: Where do the poor live-by the city size	9
Table 4: Where do the nation's poor live-by region 2000	9
Table 5: Distance to market and cost of transport are hey determinants of investment location across sectors of Activities	13
Table 6: A third of population of country's 124 largest Cities lives in sub-optimal housing.	16
Table 7: States Typically grant few exclusive responsibilities to Municipalities for urban development	18
Table 8: Mexico City's center has been loosing population while its outer rings have grown very rapidly	22
Table 9: The two Mexico City: the get between the Federal District and conurbated municipalities in the State of Mexico	22
Table 10: Overall coverage is high, but still leaves many urban dwellers without Services	23
Table 11: The central city has much higher service coverage than the periphery	24
Table 12: Access to services among the urban poor is very low, Especially for sewerage, 1996	25
Table 13: Net enrollment rates of the poor vary across city size	27
Table 14: Leading indicators of social risk are high among poor Teenagers and young adults, (1996)	28
Table 15: Composition of Mexico's largest metropolitan areas	37

Boxes in Text

Box 1: Local economic development initiatives that worked: some examples	15
Box 2: the elements of good urban transport	20
Box 3: Comparing apples and oranges: measures of deprivation in urban and rural areas	29
Box 4: Slum upgrading – an essential and effective instrument to tackle urban poverty	32
Box 5: Rolling out Oportunidades in urban areas	35
Box 6: The institutional framework for Urban Water Supply And sanitation	39
Box 7: Improving accountability for public transfers – The example of FISM	45
Box 8: The “Metropolitan Problem”	47

FIGURES IN TEXT

Figure 1: Mexico's degree of primacy has declined steadily since the 1980s	3
Figure 2: The rapid growth of Mexico's intermediate cities, 1990-2000	5
Figure 3: Urban poverty incidence has improved somewhat but the number of urban poor has increased since the mid-eighties	8
Figure 4: The distribution of FISM favors rural states	30
Figure 5: FISM resources tend to favor smaller cities, 1997	30
Figure 6: Differences in property tax collection are only partly due to differences in income per capita and degree of urbanization	41
Map 1: Urban clusters defined by transportation flows	7

EXECUTIVE SUMMARY

1. The goal of a national urban strategy should be to maximize cities' contribution to the country's sustainable development. In Mexico, the stakes are high. Three quarters of Mexico's population live in cities. Eighty five percent of the country's GDP is produced in urban areas, where nine-tenths of GDP growth was generated over the last decade. But cities are also where two thirds of the country's poor live, where the majority of crimes are committed, and where much of the country's pollution comes from. Cities are also at the front line of action for Mexico's National Development Plan and its goals of a competitive economy, regional development and inclusion.

2. The challenge this goal entails is to make cities more competitive, as well as more livable – in the urban economist's terms, maximize agglomeration economies while minimizing congestions costs. By agglomeration economies, we mean the gains in efficiency generated by the larger markets for inputs and outputs found in cities and by the rapid diffusion of ideas and knowledge allowed by proximity. Congestion costs include traffic and pollution, as well as other ills associated with crowding and the concentration of poverty (crime, violence, contagious diseases, loss of social capital, etc.)

3. Mexico is in a good position to take on this challenge. It has a relatively mature urban system, which implies overall urban population growth is at a manageable level (around 2% per annum, and projected to slow further as the urbanization rate slowly converges to 80-85% over the next decades.) The country also has a reasonably balanced system of cities. Urban population is no longer disproportionately concentrated in Mexico City, although traditional urban centers (Mexico City, Monterrey, Guadalajara) still account for about 25% of the country's population. A more balanced urban system is coming about through the rapid growth of a number of medium size cities, largely fueled by their locational advantage: distance to market (central region and border towns) or specific circumstances (tourism towns, state capital.) This is a positive development as it implies the emergence of a number of cities large enough to experience agglomeration economies, without generating unmanageable congestion costs.

MAIN ISSUES

4. Key issues affecting the competitiveness and livability of Mexico's cities today can be summarized in three broad categories:

Dysfunctional nexus of land management, housing markets and urban transport

5. This hampers people's ability to locate and move about efficiently (thereby minimizing agglomeration economies, while worsening congestion costs.) Particular issues are the following:

- Urban land management is generally ineffective – municipalities have limited control of zoning, urban development, land use, or land regularization which are responsibilities shared among all three tiers of government. Planning capacity is generally weak.
- There are no good formal means of developing land for the low/moderate income population – and fewer informal solutions since the law was modified in 1992 to allow for privatization of *ejido* (rural communal) land. About a third of the land in the periphery of medium and large towns is in the hands of high-end private-sector developers majority. The rest is *ejido* land, which can be privatized but under excessively high development standards.
- The housing market is very illiquid and biased towards expansion at the periphery of cities. This is due to a small housing finance system, which only funds new, single home construction (thereby contributing to the inner city decline in most urban centers.) The housing finance system effectively excludes the poorer half of the population, who is then pushed into self-help housing, typically on informal settlement on the outskirts of cities. The rental market is very underdeveloped – the legacy of years of rent control combined with non-functioning eviction procedures and the general unavailability of financing for rental housing development.
- Urban transport is characterized by long commutes in individual cars and generally inefficient public transportation. Poor land use policies and the housing system that encourages urban sprawl are partly responsible for this, but so are the inefficient sharing of responsibilities between municipalities and states, the absence of metropolitan transport authorities, and the overall lack of resources – especially for poor communities on city peripheries.

Unsatisfied demand for quality basic services (water, sanitation, waste management)

6. Overall access numbers are quite good, masking fairly serious problems of quality and reliability and a large absolute number of people without access – all of which has serious impacts on the environment and public health (“congestions costs.”)
 - Quality can be very poor and service partial: less than 30% of piped water undergoes potabilization, only a fraction of used water is treated, and less than half the households with piped water are serviced everyday, 24 hours a day. Only about three quarters of solid waste is collected, with about 35% disposed of under sanitary conditions. More than a quarter of the toxic waste generated by maquiladoras is unaccounted for.
 - Access is by no means universal: 5.7 million city dwellers are without running water, 8.7 million without sanitary drainage.
7. Sectorally, the most urgent improvements needed are those with the highest impact on the environment and public health (solid waste, toxic waste, wastewater treatment, etc.) Geographically, they are particularly pressing in informal settlements –*colonias*- where most of the un-served population is concentrated.

The lack of instruments to address the growing urbanization of poverty

8. As the population urbanizes, so do the poor. Today, 44% of the country's extreme poor live in urban areas, representing 12 million individuals and 38% of the extreme poverty gap. These numbers are even greater when overall poverty measures are used – 35 million poor individuals live in cities, accounting for 64% of the country's poor and 56% of the overall poverty gap.

9. The productive capacity of cities can and should be harness to help reduce poverty. Integrating the poor into the work force and improving their earning abilities and quality of life is an essential element of making cities more competitive and livable for all. Yet knowledge about urban poverty is sketchy and few resources and programs are available to address it:

- Urban poverty seems to be concentrated in large cities (up to 50% of the urban poor may be in cities of more than ½ million) and in the central region and greater Mexico City (which account for more than half the country's poor, urban and rural.) Within cities, the poor tend to be concentrated in informal settlements (*colonias*) on the outer rings of growing agglomerations.
- Urban areas have relatively lower social capital. Four fifth of female headed households live in cities– in half the cases, these women are the only adult in the house – and so do 2/3 of households formed of only people 65 years and older. Crime and violence are particularly acute issues, with a high proportion of poor youths at risk.
- The urban poor have relatively higher human capital: they tend to be better educated, with higher literacy rates and higher enrollment rates than the rural poor. More of them work outside the home in paid employment, 55% in the informal sector which offers neither pension nor health insurance.
- Health outcomes, such as the incidence of diarrhea among children, are about the same among the urban poor as among their rural counterparts, despite the urban poor having much higher access to basic services (water and sanitation.) This is due to poor quality and incomplete coverage of services, which in urban areas cause severe public health problems.
- Only one quarter of public spending for the extreme poor goes to urban areas. Part of this is due to the fact that extreme poverty is more prevalent in rural areas particularly when measured though the poverty gap, but also to the fact that targeting is based on indicators that take systematically higher values in cities (access to electricity) or measure different things in urban and rural areas (drainage.)
- There are very few programs to address the needs of poor urban children -- more than a million of which suffer from chronic malnutrition and stunting -- of the type developed in rural areas.

THE ELEMENTS OF A STRATEGY

10. The urban strategy for Mexico should be three-pronged. One prong should address the **institutional and regulatory problems** that hamper good urban management. This will help all municipalities and is largely a federal responsibility. A second prong should focus on **urban poverty**. This needs to be federally driven, though municipal and state government should be actively involved in design and implementation of programs. The third prong needs to tackle the individual problems of **cities that are of prime importance** within the country's urban system. These are the fast growing cities – medium size towns where jobs are being created, and which are encountering problems of congestion, pollution, increased concentration of poverty and irregular settlements – but also the country's historical population centers (Mexico City, Guadalajara and Monterrey) where a quarter of the country's population is still concentrated.

Institutional and regulatory reform for improved urban management

11. Underlying many of the issues confronting Mexican cities are the limited powers, resources and often capacity of municipalities. The decentralization framework is characterized by concurrent responsibilities between all three tiers of government, limited responsibilities of the municipal level, weak accountability and an incentive framework that does not promote good local governance. Addressing these issues, clarifying the framework for private participation in infrastructure and urban land management, and reforming the housing finance system should therefore be the core of the national urban strategy. Federally driven institutional and regulatory reform should focus on the following areas:

- Revisit the decentralization framework to :
 - o Grant municipalities exclusive competence for municipal management and more generally eliminate the ambiguity and overlap in responsibility among the three levels of government. Concrete examples include making land use and the allocation of public transit routes municipal responsibilities. This should still allow for some standards, such as environmental ones, to be set at state or national level or for the shifting of powers from municipalities to metropolitan authorities.
 - o Improve upward accountability by making grants and transfers conditional upon the receipt of budgets and audited accounts. This implies a change in the law, and so will require time. In the meantime, incentives for better accountability could be created by granting more responsibilities and/or resources to municipalities that respect minimum reporting standards. This will have the additional advantage of tailoring resources and responsibilities to a municipalities' capacity. Additional measures to improve financial management and transparency include technical assistance, especially to smaller municipalities, and encouraging the one third of the states that still need to pass laws governing budgetary procedures and financial management to be able to meet the minimum requirements.

- o Improve downward accountability. This is a long term goal since it requires electoral reform to eliminate the restriction on consecutive terms for mayors, and/or allow for direct elections of council members rather than the current system of party list.
 - o Build into the transfer system incentives for municipalities to improve their own revenue raising efforts – through matching grants or through a system of premia based on measured tax effort. Demand driven technical assistance for improved revenue collection may help the generally low property tax collection performance, as could alternative to complex and cumbersome cadastres (such as fiscal cadastres or self-assessment.)
 - o Develop instruments to address metropolitan issues. A number of options are possible, from single purpose authorities such as a metropolitan transport authority, to multipurpose metropolitan government structures. Multipurpose metropolitan governments are more desirable in that they can coordinate across related management areas (such as land use and urban transport) but they are complex to establish. The recommendation is therefore to create the most urgently needed single purpose authorities (typically transport) which can later be merged into a metropolitan government structure. Alternatively, *Institutos de transporte*, such as the ones in Leon and Ciudad Juarez which have professionalized transport and provided an institutional memory, may be the more feasible starting point.
- Improve states' regulatory environment for private participation in infrastructure to minimize uncertainty around concessions – this requires adopting regulations governing private sector participation (in place in very few states) and establishing distinct regulatory authorities to oversee service provision. In addition, these state level regulatory authorities could provide municipalities with much needed assistance in identifying, negotiating and managing concessions. These measures, however, can only supplement sector reforms, particularly in the water sector.
 - Reform the land and housing system to increase the liquidity of the housing market and the range of formal housing products available. This requires developing lending for used housing (a policy which will do much to revitalize decaying city centers), improve foreclosure capacity, and revitalize the rental market. Additional measures are needed to expand low income housing, notably through lower subdivision standards, a streamlined land development process and a number of complementary measures aiming at mimicking the gradual way in which the poor typically acquire housing and at developing an industry of low/moderate income land developers. Finally, state housing agencies need to be strengthened so they can convert agricultural to urban land and provide the macro infrastructure (trunk water and sewer lines), but also so that they are better able to facilitate partnerships (allowed by the 1992 law) between ejidarios and developers for land development. Since the best mix of housing solutions varies substantially by region, states and municipalities should be allowed to develop their own programs, although the federal housing program should set key

parameters. The Mexican Government and the Bank are currently collaborating on a low income housing strategy, which is developing many of these themes.

Develop urban poverty programs

12. Additional, urgent work is needed to develop well targeted programs for the urban poor. Better knowledge of the urban poor is needed, however, if targeting is to be efficient. Mini censuses can be conducted in neighborhoods that are well known for being poor, while low income families residing in other areas could register voluntarily. Overall, however, Mexico needs a national targeting system such as the *ficha* CAS in Chile, or SISBEN in Colombia.¹ The following are some suggestions for priority interventions, which may be of use to the Government as it begins developing an urban poverty program:

- Actions are needed to help the poor develop their **assets** – which in urban areas are basically housing and human capital. This requires developing the low income housing policies mentioned above, but also slum upgrading programs. In addition, OPORTUNIDADES, which provides integrated support for education, health and nutrition for the very poor mostly in rural areas, could be expanded further in urban areas.²
- Urban specific interventions to help the poor improve their **income earning capacity** include public transport (discussed above), training and child care. PROBECAAT (a training program) needs to be thoroughly redesigned and should be supplemented with schemes to facilitate entry into labor markets for school leavers and graduates (vocational training, apprenticeships.) Subsidized community child care may need to be developed since the current formal system is too expensive and limited to women employed in the formal sector.
- Interventions to improve **security** need to address income insecurity, violence and social capital. The reforms under way to open social insurance programs (IMSS and ISSSTE) to informal sector workers are essential and should be continued. In the longer term, it may be helpful to encourage formalization of the informal sector. Workfare programs, which exist in rural areas, could be developed in urban areas and gradually replace the costly and overlapping targeted food subsidy programs that still exist. Programs to address violence are complex but are very much needed in Mexico. International experience, such as Brazil's may offer some useful ideas on how to proceed.³ Finally, although social capital is difficult to foster

¹ The *ficha* CAS is a two page form that Chilean households must fill to apply for benefits (income transfers, water subsidies, social housing, childcare centers.) It is cost effective and performs reasonably well, although it is prone to errors of exclusions. This is due to insufficient awareness of it among the poor, and to its inability to capture vulnerability associated with shocks such as unemployment and illness. For a discussion of the *ficha* CAS targeting system see Clert and Wodon, 2001.

² OPORTUNIDADES was developed in and for rural areas. It has recently started functioning in some urban areas, where it includes about 500,000 urban poor families. Estimates are that an additional 700,000 urban families need to be integrated into the program. A key question is whether some adjustments need to be made to the program's design to adapt it to urban settings.

³ Documentation on Brazil's very rich experience with urban poverty alleviation programs (which includes programs to address urban violence) is available at : <http://lnweb18.worldbank.org/External/lac/lac.nsf/4c794feb793085a5852567d6006ad764/a0aa75a4359674aa85256a760069d0bd?OpenDocument>

directly, the provision of community space in poor urban areas helps as do community based approaches to service delivery.

13. Another suggestion for reform concerns the need to replace the indicators used in the allocation of targeted spending under Ramo 33 with location neutral ones (that capture the living conditions of a population group regardless of whether they are in urban or rural areas.) Thus, instead of access to electricity and drainage, better and equally available indicators are access to safe water or quality of housing (durability of roof or wall material.)

Develop joint programs for cities of national importance

14. Interventions to help specific cities should result from joint local and federal efforts, and probably include states. Current knowledge suggests interventions would need to address the following problems:

- In the *older mature cities*, which are not growing fast but are very important in terms of population and output (Mexico City, Monterrey and Guadalajara), there is a need to revitalize decaying city centers, manage traffic and pollution and generally cope with congestion and poverty – the negative externalities associated with size. This will require developing a metropolitan management system since in Mexico City and Guadalajara, congestion issues spans several municipalities. Lending for used housing and efforts to develop rental markets could help reverse the outflow of population away from central districts and do much to alleviate problems of traffic and pollution. In addition, these cities are in a transition phase, concerning their economic and productive roles. Their fate (in line with the natural evolution of large urban centers) is to lose their manufacturing bases, so their future growth is predicated upon positioning themselves as centers for services and innovative industries. They also have an important role to play in linking the country with the rest of the world. In all three cases, there is scope for innovative local economic development strategies and improving the business environment – the business climate of Jalisco, Nuevo Leon and Federal District are ranked as 8th, 24th and 32nd (or absolute worst) among Mexico's constituent entities.
- In the *fast growing large and medium manufacturing towns of the north and the center*, investments are needed to handle rapid population growth and tackle emerging congestion, environmental and social problems that could preclude further growth. A recent survey in Chihuahua shows that for small and medium scale enterprises the binding constraint currently is infrastructure. Similarly, recent press coverage in the US emphasized water issues and lack of appropriate housing in the fast growing border towns. In addition, private sector development analysts expressed the fear that the maquiladoras of the North may be going the Puerto Rico route (low skill, low wage activities in an enclave model) and develop in isolation from the rest of the economy. This suggest the need for local economic development strategies to foster local linkages.

- In the *tourism cities* such as Cancun, and Puerto Vallarta, the priority should be the infrastructure to protect their fragile ecological environment, and managed growth plans.
- As to the *southern capital cities*, it is unclear at this stage what is driving their growth and whether they could be emerging as growth centers for the poorer states. A local economic strategy for them would assess this potential.

15. These suggestions are in line with the programs developed by the Government in both its Programa Nacional de Desarrollo Social 2001-2006 and in its urban strategy *Programa Nacional de Desarrollo Urbano y Ordenación del Territorio 2001-2006*. Most importantly, the urban strategy sketched here is well aligned with the central criteria of the National Development Strategy, namely inclusion, sustainability, competitiveness and regional development.

I. INTRODUCTION

1.1 Three out of four Mexicans live in cities. Close to 85% of national value added is generated in urban areas. Increasingly, Mexico's economic activities are concentrated in cities where they benefit from ample markets for inputs, outputs and labor, and where ideas and knowledge are rapidly diffused. And thanks to these agglomeration economies,⁴ cities have generated more than 90% of Mexico's growth in the last decade.

1.2 Along with agglomeration economies come congestion costs such as traffic and pollution: in Mexico City, which accounts for 18% of the population and 23% of national output, unhealthy levels of ozone and particulates are the norm and the average resident spends hours every day in traffic. Mexico City also suffers other ills associated with crowding, such as crime, violence, contagious diseases and loss of social capital.

1.3 Fortunately, Mexico's urban system has become less concentrated following economic and political liberalization.⁵ The closed economy manufacturing belt around Mexico City has dispersed as its share of manufacturing employment fell from 47% in 1980 to 26% today. New industrial centers have formed in Northern Mexico and elsewhere in the Central Region. This has resulted in a decentralization of employment and a reduction in regional specialization as multiple manufacturing activities expand in the new industrial sites. Other clusters are developing around tourism in the South, creating another growth pole.

1.4 While this deconcentration is making Mexico City's problems more manageable, it is also creating new challenges. The rapid growth of other metropolitan areas and secondary towns has caused serious urban management problems. Urban sprawl and inner city decay plague larger cities – new and old. Municipalities, large and small, have difficulties keeping up with necessary services: 5.7 million urban Mexicans do not have running water; 8.7 million have no sewerage services, and 24% live in irregular settlements. And few municipalities have the means – financial or institutional – to cope with the 35 million poor who live in urban areas.

1.5 These facts suggest the need to assist emerging growth centers through interventions that improve their internal efficiency, help them cope with rapid population growth and take advantage of the opportunities offered by NAFTA. But this should not be at the expense of older, traditional urban centers. These -- Mexico City, Guadalajara and Monterrey -- remain extremely important and face problems of inner city decay, urban sprawl and growing slums at their periphery. For both traditional centers and the emerging growth centers, interventions should aim at making them more dynamic as well as more livable.

⁴ Agglomeration economies are of two types: economies of scale due to larger and thicker markets, and economies of scope associated with the wider diversity in supply and specialization of firms.

⁵ This paragraph is based on Hanson, 1998.

1.6 Such a strategy requires the cooperation of all three tiers of government. At the federal level, the Government, through the Ministry of the Economy has expressed its willingness to strengthen the *cadenas productivas* that form the backbone of Mexico's metropolitan areas. Its support will also be needed to help develop the institutional structure necessary for city level governments to cope with their responsibilities. And both states and municipalities must cooperate to manage metropolitan issues and small town problems.

1.7 The present report was written as an input into policy dialogue with stakeholders from all three tiers of government, the business and academic communities and civil society. A national advisory committee and regional groups of city representatives considered core ideas which were subsequently presented in a seminar and then to the Federal Government for discussion. The World Bank, along with the IDB and CAF, supported this process.

1.8 The present report is structured as follows. Volume I presents the elements of an urban strategy. It offers a quick description of Mexico's urban system, analyzing how it has changed following economic and political liberalization. Policy recommendations are then organized along the themes of *livable/competitive cities* (highlighting the dysfunctional nexus of land use/housing markets/urban transport; the backlog of infrastructure investment; and the concentration of poverty in peri-urban areas), and *manageable cities* (how to develop the institutions to manage and implement these policies.) These themes are developed further in Volume II, which includes four background essays commissioned from Mexican academic centers:

Economía Urbana: ¿Cuál es la clave de la competitividad? analyzes factors that explain public and private sector investment decisions across cities and sectors and analyzes emerging geo-economic urban clusters in Mexico.

Reconstruir las ciudades para superar la pobreza identifies the obstacles to urban poor's access to public goods and assesses the effectiveness of present policies.

Alianzas institucionales: el desafío de la década analyzes how decentralization has impacted urban development and governance

Aprendiendo de los Éxitos y de las Dificultades de la Gestión Urbana draws on five case studies on city management and strategic development to extract applicable conclusions for successful administration of urban centers

Volume II also includes a review of the World Bank's history of urban interventions in Mexico.

II. A Still Evolving Urban System

2.1 Mexico is a “mature” urban country, in the sense that it has largely completed its urban transition. With two-thirds of the population already living in urban areas, the rate of growth of the urban population has slowed to around 2% and is projected to fall further as the urbanization rate slowly converges to about 80% (table 1.)

Table 1: Mexico has largely completed its urban transition

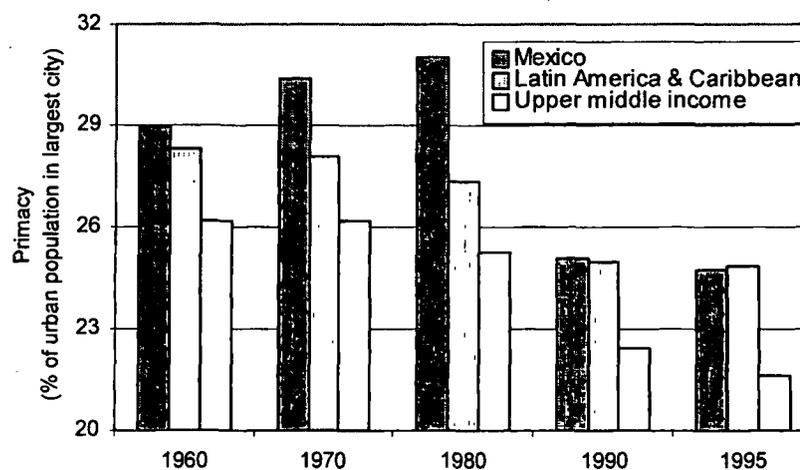
Urban population	1950	1960	1970	1980	1990	2000	2010	2020	2030
Million	11	18	28	45	58	72	87	99	110
% total population	43	51	59	66	71	75	77	79	82
Rate of growth /1	..	4.8	4.7	4.6	2.6	2.2	1.8	1.4	1.1

1/ Preceding decade annual average. Sources: INEGI 2000; UN 1999.

2.2 Mexico’s level of urbanization is similar to that of other countries at its level of income, and so is the speed at which this urbanization has occurred. Where Mexico stands out, however, is in the extent to which its urban population was concentrated in Mexico City and how this has reversed with political and economic openness since the 1980s (Fig. 1.)

2.3 Concentration of the urban population in the largest city is normal and even efficient, particularly at low levels of urbanization and economic development, when the concentration of scarce resources helps achieve economies of scale and scope. But in Mexico, this concentration was remarkably high, even by Latin American standards. At the peak, in 1980, a third of Mexico’s urban population was concentrated in Mexico City, which was the world’s third largest city (after Tokyo and New York.)

Figure 1. Mexico’s degree of primacy has declined steadily since the 1980s



Source: World Development Indicators, 2001.

2.4 Today, Mexico City accounts for less than 25% of the urban population, and the locus of economic and population growth has shifted to a second tier of cities, around the metropolitan area and in the central region, but also on the northern border and in the tourism areas. Part of this evolution is due to the normal dynamics of city formation: as industrialization proceeds, manufacturing activities begin to move to smaller cities outside the capital. It also reflects profound changes in Mexico's economic and political structure.

A. THE ROOTS OF MEXICO'S URBAN SYSTEM

2.5 The concentration of population and economic activities in Mexico City finds its roots in the import substitution model followed by Mexico until the early 1980s. By then, Mexico City accounted for 46% of manufacturing employment and close to half national value added in manufacturing (Hanson, 1998; Tamayo Flores 1997.)⁶ Political centralism, with investment and pricing policies that favored Mexico City contributed to this concentration (Rowland and Gordon, 1993).

2.6 With the opening of the Mexican economy to trade in the mid-eighties and improvements in transportation and communication infrastructure, for many industries, the market advantage of Mexico City no longer offset its high and increasing congestion costs. In addition, political liberalization probably decreased the need for large companies to locate their headquarters in Mexico. As a result, regional industrial centers have replaced the dense concentration of industries in the metropolitan area and Mexico City's share of manufacturing employment fell from 47% in 1970 to 26% today (table 2.) Manufacturing employment is now weakly concentrated in the Central region (34%), with the Border region accounting another 26%.

Table 2: Manufacturing employment is no longer concentrated in Mexico City
(Share of manufacturing employment, by region 1970-2000)

Region	1970	1980	1993	2000
Border	19	21	30	26
North	5	5	6	6
Central	22	23	27	34
Greater Mexico City	47	46	29	26
South	7	6	8	8

Source: 1970-1993, Hanson (1998); 2000, own calculations based on 2000 census data. Border includes all border states; the North is the next tier of states; the Center includes Aguas Calientes, Colima, Guanajuato, Hidalgo, Jalisco, Michoacan, Puebla, Queretaro, Tlaxcala, and Vera Cruz; Greater Mexico City area includes Federal District, Mexico State – which accounts for 16% of national manufacturing employment– and Morelos; the South are all the states south of Mexico City.

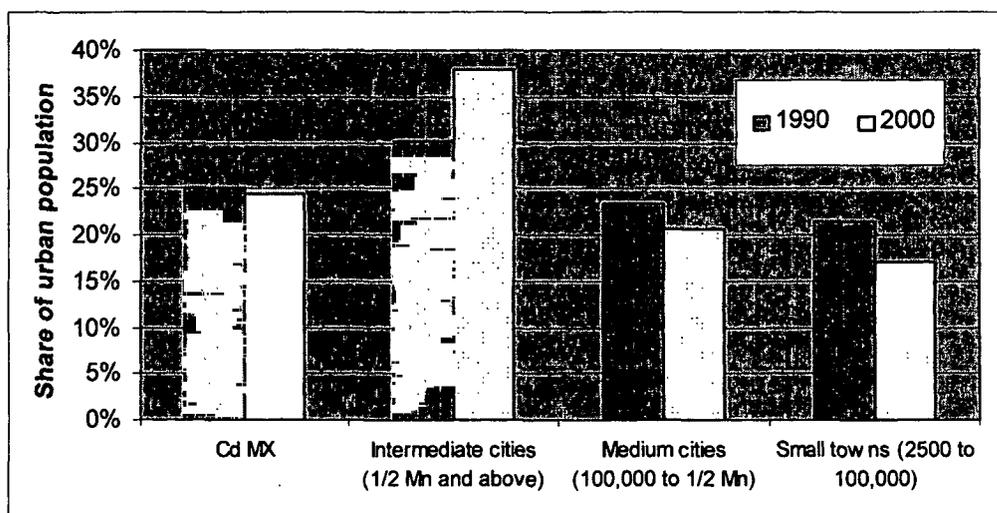
⁶ Though trade barriers were high, they were not prohibitive so that two types of industry centers emerged consistent to trade theory: a principal center (Mexico City) in which firms produced for the domestic market, and a smaller center (in Northern Mexico) where firms produce partly for the foreign (U.S. market.) In 1980, five years before trade liberalization began, 69% of manufacturing employment was concentrated in the central region (Mexico City and surrounding states) and 21% in the states along the border (Hanson, 1998.)

B. THE EMERGENCE OF A MORE BALANCED URBAN SYSTEM

2.7 The emergence of a more balanced urban system is coming about through the rapid growth of a number of Mexico's second tier of cities. Intermediate cities (between 0.5 and 4 million in size) grew at more than 3% per annum in the last decade, and now account for close to 40% of the country's urban population (Figure 2.) Meanwhile, Mexico City's share has remained around 25% while medium and small towns' declined to 21% and 17% respectively.

2.8 These averages hide wide variations within the groupings. Among intermediate cities, traditional large centers such as Guadalajara, Monterrey, or Leon grew relatively slowly over the last five years while border towns such as Tijuana and Ciudad Juarez or the metropolitan areas of Puebla-Tlaxcala and Toluca around Mexico City grew very rapidly. Similarly, the relative decline of medium towns occurred despite the rapid growth of a number of them, such as the Southern state capitals.

Figure 2. The rapid growth of Mexico's intermediate cities, 1990-2000



Source: INEGI, 2001

2.9 The recently released census data allows us to identify Mexico's fast growing cities—those that have been growing at more than 2% per year over the 1995-2000 period (see Annex I and II for list and map.) Looking at these cities, the following typology emerge:

- o **Fast growing Border Region towns, whose average annual growth of 3.8% per annum over the last five years is largely associated with the Maquiladora industries and trade with the U.S.** The largest are Tijuana in Baja California and Cd. Juarez in Chihuahua, but also growing very fast are a number of smaller ones in Baja California (Ensenada), Sonora (Nogales), Coahuila (Monclova, Cd Acuna and Piedras Negras) and in

Tamaulipas (Nuevo Laredo, Reynosa, Matamoros.) All but Monclova and Ensenada, are located directly on the border.

- o **Manufacturing towns around Mexico City and in the Central region, with average annual growth of 4.4%:**⁷ Cuautla, Mor.; Toluca, Méx.; Aguas Calientes, Ags; Queretaro, Qro; the ZM of Puebla-Tlaxcala; Pachuca de Soto, Hgo. and the smaller Guanajuato, Gto. Further west, in the state of Colima, the state capital, Colima, and the port city of Manzanillo also grew rapidly. On the eastern side, in the oil and shipping state of Vera Cruz, the ZM of Poza Rica grew by more than 12% per annum while the state capital, Jalapa also increased in size.
- o **Tourism destinations:** Puerto Vallarta, Jal. and Cancun, Q.Roo have been growing at 4.5% and 7% per year respectively.
- o **Southern state capitals, with average annual growth of 2.8%:** Oaxaca, Oax.; Villahermosa, Tab.; Tuxla Gutierrez, Chis. and smaller Chilpancingo in the state of Guerrero.

2.10 Two cities do not fit in this classification, both in Chiapas. One is San Cristobal de las Casas, whose rapid population increase is due to political upheaval that surrounded the Zapatista popular movement of the last few years but also to religious conflicts in surrounding small towns and villages that have resulted in mass expulsions of communities. The other is Tapachula, on the border with Guatemala, which is a medium sized town with some international manufacturing plants – an oddity in that part of the country – but also an important role as the largest border crossing with countries south of Mexico.

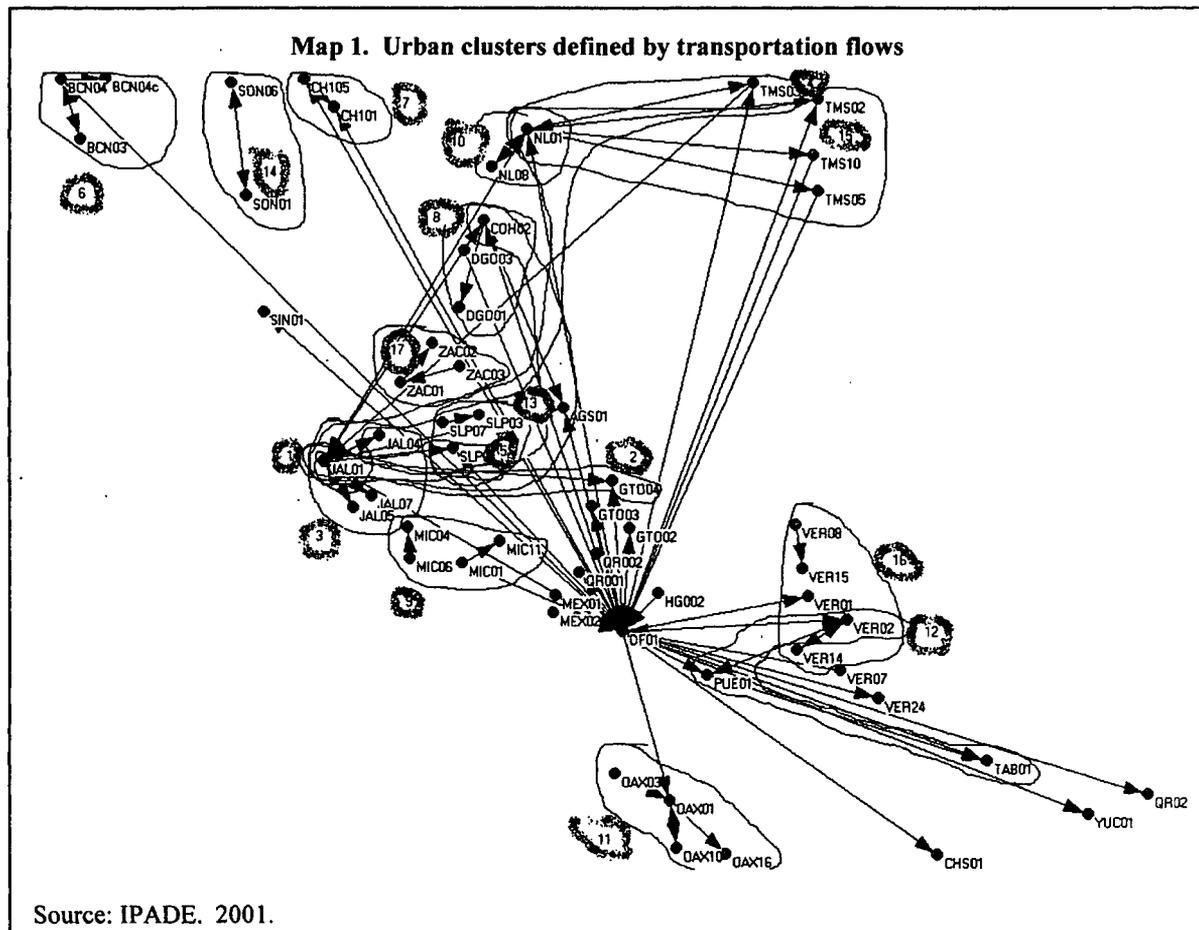
2.11 As to the metropolitan area of Mexico City, while it has continued to grow in absolute terms, poor living conditions and the limited availability of suitable housing have driven much of the population out of the central district and into the outer municipalities.⁸ The Federal District's share of national population decreased from 10% in 1990 to 8.8% in 2000 as it lost much of its residents to out-migration.

2.12 In addition, to the typology described above, groups of cities seem to form clusters of economic activity. A study of financial flows in Mexico (Banamex, 1999) and an analysis of national transportation flows (IPADE, background paper) suggests the existence of clusters of cities linked internally by strong commercial and financial ties. Map 1 shows these city sub-systems based on the transportation flow data. They are

⁷ This is largely driven by Puebla-Tlaxcala and Poza Rica. Excluding these two, average growth is 2.9%.

⁸ The center of Mexico City has been in decline since the 1950s. Depopulation was initially caused by the expansion of commercial activity in the central area, and accentuated by urban renewal project which decimated the low income rental accommodations: in the 1960s several major road schemes destroyed some 48,000 housing units while the construction of the major public housing complex of Tlatelco destroyed a lot more. During the 1970s, 50,000 homes were destroyed by official efforts to remove the "lost cities" and decaying rental tenements and through the road-widening programs of the Echeverria administration. Source: Gilbert 1996. In addition, the housing finance system in Mexico is biased towards new construction which has hampered renovation of old urban centers (see section on urban finance below.)

mostly situated on the border and in the north-central region.⁹ Most cities continue to have strong ties with Mexico City, but the emergence of sub-systems of cities is a positive development. It suggests that the growing secondary towns identified above can play a role as regional growth poles, and warrants exploring regional economic development strategies based on these groupings.



C. THE URBANIZATION OF POVERTY

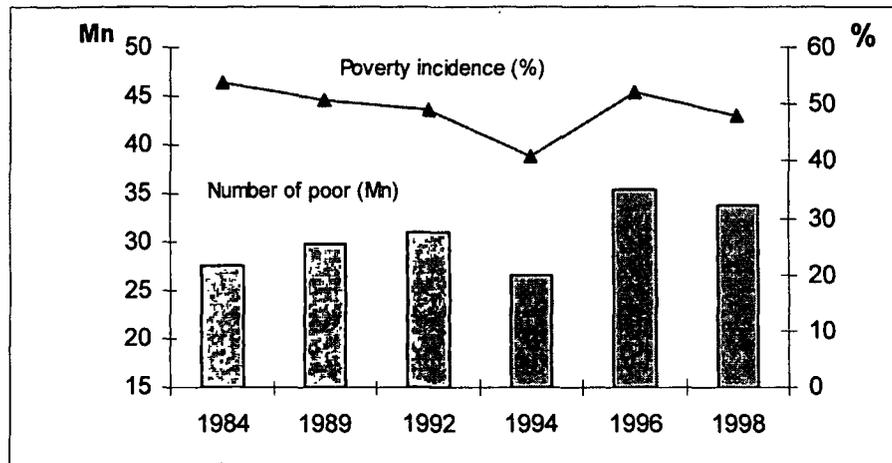
2.13 As the population has urbanized, so has poverty: thirty five million poor people live in Mexico's cities, accounting for almost half the urban population or 64% of Mexico's poor. Of these, 12 million live in extreme poverty, representing 44% of the country's extreme poor. As for the poverty gap (the supplemental resources needed to bring poor people's income up to the poverty line), it follows the same pattern: urban areas account for 56% of the overall poverty gap and 38% of the extreme poverty gap.¹⁰

⁹ Some of the border clusters are (6) Tijuana (Bcn04) – Ensenada (Bcn03); (7) Ciudad Juarez (Chi105) – Cuauhtemoc (Chi101); (14) Hermosillo (Son01) - Nogales (Son06); (10) Monterrey (NL01) -Linares (NL08). Some of the north-central ones are: (1) Guadalajara (Jal01) – Tepatiplan (Jal04) – El Salto (Jal 05); (17) Zacatecas (Zac01) – Fresnillo (Zac 02) - Victor Rosales (Zac03).

¹⁰ This estimate is based on 2000 population figures and 1998 poverty incidence estimate from Wodon forthcoming.

- 2.14 Poverty incidence decreased somewhat in the late 1990s but not enough to recover from the damage caused by the 1995 financial crisis (Figure 3.) Between 1994 and 1998, the number of urban poor increased by more than 7 million. Poverty then is a key challenge for an urban strategy.

Figure 3. Urban poverty incidence has improved somewhat but the number of urban poor has increased since the mid-eighties



Source: World Bank 1999 (Government programs and poverty) for 1984 to 1994 figures and World Bank (forthcoming) for 1996 and 1998

- 2.15 Incidence of income poverty usually decreases as city size increases, but this is offset, in Mexico, by the fact that the majority of the population lives in large cities.¹¹ Thus, a third of Mexico's poor lives in large cities (population greater than half a million.) The other two thirds are spread more or less equally between smaller cities and rural areas (table 3.)

¹¹ In most developing countries, income poverty incidence decreases with city size becoming lowest in the larger cities and highest in rural areas. This can be explained by several factors: one, cities tend to attract better off people and tend to be places of wealth creation; two, income poverty is a measure that tends to underestimate urban deprivation. Note however, that regional differences can be more important than urban/rural ones.

Table 3: Where do the poor live— by city size

	Poverty (% of country's poor)	Extreme Poverty (% of the country's extreme poor)	Poverty Gap (% of country's poverty gap)	Extreme poverty gap (% of country's extreme poverty gap)
All urban areas, Of which:	64%	44%	56%	36%
ZMCM and large cities (1/2 million and above)	32%	16% to 17%	25%	12%
Medium size cities (100,000 to ½ million)	11% to 16%	8 to 12%	15%	10%
Small towns (less than 100,000)	15% to 19%	15% to 19%	15%	13%
Rural areas	36%	57%	44%	64%

Based on 1998 poverty incidence calculation from Wodon (forthcoming) applied to the population shares used in that study and to those of INEGI 2000 – where the two population estimates differ, yielding a different estimate of the share of poor in that category, both are shown. According to the study, the total number of poor in the country is 55 million, of which 26.6 million live in extreme poverty; the incidence of poverty is 39% for large cities, 60% for medium cities, 66% for small towns, and 80% for rural areas.

2.16 City level poverty estimates are not yet available from the 2000 census, but state level poverty estimates are. The majority of the poor (36.5%) are in the Central Region, while the South and Greater Mexico City Area account for about 18% each (table 4.) Applying urbanization rates to these poverty estimates suggest that the majority of the country's urban poor is in the central region but more than a fifth are concentrated in the greater Mexico City. The Federal District alone accounts for close to 5% of the country's poor or 7% of the urban poor.

Table 4: Where do the nation's poor live— by region, 2000

	Poverty incidence	Share of nation's poor	Share of the nation's urban poor/1
Center	34%	38%	33%
Greater Mex. City	25%	18%	22%
South	44%	19%	19%
Border	29%	14%	16%
North	34%	10%	9%
Country total	33%	100%	100%

Source: INEGI (2001); own calculations. 1. Estimated by applying the regional urbanization rate to the region's share of the nation's poor. Poverty incidence is calculated as the proportion of the population living under 2 minimum salaries and is unadjusted for differences in cost of living.

D. PREVIOUS GOVERNMENT PROGRAMS FOR URBAN DEVELOPMENT

2.17 In recent years, the Mexican Government has generated a number of initiatives for urban development. Most notable is the *Programa Nacional de Desarrollo Urbano 1995-2000* whose main objectives were to favor the efficient spatial organization of people and economic activities and encourage sustainable urban development. This was to be achieved through four principal initiatives: (a) *Programa de 100 ciudades*; (b) *Programa de consolidación de las Zonas Metropolitanas*; (c) *Programa de ordenamiento territorial y promoción del desarrollo urbano*; (d) *Programa de impulso a la participación social en el desarrollo urbano*. These initiatives were under the general direction of SEDESOL, the *Secretaría de Desarrollo Social*, and its under-secretariat for urban affairs.¹²

2.18 The *Programa de 100 ciudades* was the most important initiative in terms of its size and impact. It reached 116 fast growing small and medium size cities, focusing on land use, urban transport, environmental concerns, and revitalization of city centers. Since 1999, however, program resources were integrated into Ramo 33. The *Programa de consolidación de las Zonas Metropolitanas* was to support inter-municipal coordination (notably for transport) and slum upgrading for the four largest metropolitan areas of the country (Mexico City, Guadalajara, Monterrey and Puebla.) This resulted in the adoption by the State of Mexico and the *Distrito Federal* of a *Programa de Ordenación de la Zona Metropolitana del Valle de México*. Similar initiatives are under way in the other metropolitan areas.

2.19 The *Programa de Ordenamiento Territorial y Promoción del Desarrollo Urbano* provided technical assistance to states to help develop the laws governing land use and urban development. The *Programa de Impulso a la Participación Social en el Desarrollo Urbano* created coordination mechanisms for urban development that allowed the participation of all tiers of governments as well as civil society. By July 2000, there were 75 city level consultative councils and 19 state councils for urban development. A national level council is also functioning, although its achievements are more symbolic than tangible.

E. IMPLICATIONS FOR THE URBAN STRATEGY

2.20 Mexico's cities account for three quarters of the population, two thirds of the country's poor, and the vast majority of the country's wealth and wealth creation. Most of these people and assets are concentrated in the country's largest cities, although the country now has a relatively well balanced and stable urban system. A number of fast growing intermediate cities are acting as regional growth poles and employment centers in the North, the Center and even in the slower-growing southern states. This more balanced urban system is a positive development since it implies the emergence of cities large enough to experience substantial agglomeration economies while being more manageable in terms of congestion costs. It also heralds more balanced regional

¹² <http://sedesol.gob.mx>

development for the country as these cities act as catalysts of growth for the regions around them.

2.21 The challenge of the urban strategy is to ensure this urban system is *sustainable* – environmentally, through the adequate provision of land, housing and urban services; socially, by addressing problems of poverty, violence and inequality; and economically, through job and wealth creation. What follows looks at the agenda for making cities more livable and competitive (Chapter III) and the institutional and regulatory reforms needed to implement this agenda (Chapter IV.) These recommendations apply to the country as a whole, and most of them require federal interventions.

2.22 This can only be a part of the urban strategy, however. Additional work is needed to look at the specific problems of the fast growing cities identified earlier. **Fast growing cities must be at the heart of the urban strategy.** First, because people move for good reasons– mostly for jobs.¹³ Rapidly growing population centers are typically where the dynamic sectors of the economy are located, and where urban interventions can be an important part of the national growth and development agenda. Second, because rapidly growing cities are often the ones that are experiencing problems of congestion, environmental problems, and growth of irregular settlements. They also typically have large pockets of poor people (often underestimated by official statistics.) And third, because it is the fast growing cities in Mexico that are contributing to the emergence of a more balanced urban system – something that at this stage of Mexico’s development is inherently desirable.

2.23 The attention paid to fast growing centers should **not obfuscate the importance of Mexico’s historical population centers.** The metropolitan areas of Mexico City, Guadalajara and Monterrey together still accounts for 25% of the country’s population.¹⁴ And the ranking among a country’s larger cities exhibit remarkable stability over time, implying that Mexico City, Guadalajara and Monterrey will continue to account for a sizable share of the country’s population and wealth. A better understanding of their problems and potential for success is therefore crucial to the country’s economic and social prosperity.

2.24 The next chapter examines a number of these issues, discussing what is needed to ensure Mexico’s cities are livable and competitive. Chapter IV then looks at the institutions needed to support this objective.

¹³ Of those who specified a reason for migrating in the 2000 census, 35% had moved for work related reasons, 35% to be reunited with family or for marriage, and 10% had moved for studies, health or violence/insecurity reasons.

¹⁴ ZM Mexico City accounts for 18.3% while Guadalajara and Monterrey have 3.8 and 3.3% of the nation’s population.

III. LIVABLE AND COMPETITIVE CITIES

3.1 If cities are to promote the welfare of their residents and of the country, they must be livable – meaning they must offer decent living conditions and equitable opportunity for their residents. The agenda for improving livability includes reducing urban poverty and inequality, creating a healthy urban environment, and enhancing personal security (minimizing the risk of crime, violence, traffic accidents and natural disasters).

3.2 Livability also requires that cities generate broad-based growth of employment, incomes and investment – in other words that cities be competitive. Many factors affect a city's competitive position but broadly speaking, policies that improve a city's competitiveness are those that maximize comparative advantage (including agglomeration economies) while minimizing diseconomies (from congestion and pollution for example).

3.3 At the **local level**, actions that affect urban competitiveness are those that promote efficient land markets, affect labor markets (through housing, urban transport, basic infrastructure, education and training), ensure reliable – rather than just inexpensive – infrastructure services and minimize the transaction costs imposed by cumbersome regulations. Cities' ability to provide these local public goods affect the local business environment as well as overall livability.

3.4 At the **national level**, many sectoral and macro policies have spatial implications. Most important however are those that set the stage for land and housing markets and the provision of infrastructure. Also significant are policies that promote the emergence of systems of cities rather than the concentration of activity in one center – for example inter-urban and international transport, communication infrastructure, a well-developed national banking system or the deconcentration of political and regulatory power.¹⁵

3.5 What follows reviews the priority areas that the urban strategy should focus on – the means to promote livable and competitive cities. This includes developing efficient land and housing markets and supportive urban transport system (which help people locate efficiently and move about at minimal cost) and providing reliable quality infrastructure services (which affects job creation but also quality of life, public health, and the environment.) Tackling these two challenges will do much to decrease poverty, inequality and social exclusion. But the poor require additional measures, which implies a third area of intervention must be urban poverty alleviation. As to the institutions necessary to implement or manage these actions, they are discussed in Chapter IV.

¹⁵ Public investment in transport infrastructure will not only affect investment location, but also help reduce inventories, thereby improving business efficiency. A recent study showed inventory levels in Mexico to be on average 50% higher than in the US, primarily because of poor infrastructure (roads and ports.) Other determinants were poor integration in global supply chains, missing markets, limited IT development and poor business environment. The study also showed that a one standard deviation improvement in infrastructure decreases inventory levels by 27% to 47%. Source Guasch and Kogan (2000)

A. WHAT MAKES A CITY COMPETITIVE?

3.6 What makes a city competitive are its markets – *output markets*, determined by the size and wealth of the city itself, but also by the proximity and ease of access to national and international markets; and *input markets*, such as those for land, labor, capital, primary and intermediate goods. The size, depth and well functioning of these markets are affected by a number of exogenous factors (such as location, natural resources or tourism attractions) or hard to change ones (population size; inertia of pre-existing investments.) They are also affected by national and local policies.

3.7 One measure of competitiveness for cities is their ability to attract or retain investment. As part of the background work for the urban strategy, 862 entrepreneurs, covering all sectors and firm sizes across the country, were surveyed about determinants of investment location both in their city of residence and in alternative locations (see IPADE, background paper.) Averaging across sectors and firm sizes, the factors that were important to all were distance to market, transport cost, and infrastructure and basic services (table 5.) Investment inertia was also important, though mostly for large firms.

Table 5: Distance to market and cost of transport are key determinants of investment location across sectors of activities

	By sector of activity				
	Average ranking	Primary	Secondary	Of which: Manufacturing	Tertiary
Distance to market	1	5	1	1	1
Cost of transport	2	2	2	2	12
Inertia of investment	2	1	5	5	6
Infrastructure and basic services	3	8	3	3	11
Security and honesty	4	11	4	7	10
Living standards (housing, education, income)	4	9	7	6	9
Internet, computer skills, English	4	12	11	11	3
Intermediate and technical education	4	4	6	4	14
Labor training willingness/ability	4	6	10	8	5
Existing commercial network	5	15	13	9	8
Development of industrial parks	5	16	12	13	4
Cost of land, labor and capital	5	7	9	10	15
Supportive local authorities	5	3	8	16	17
Existing competition	5	18	17	12	2
Business association	5	19	14	14	7
Airport infrastructure	6	10	15	15	13
Low labor and environmental costs	7	13	16	17	18
Tourism attraction	8	20	19	19	16
Parastatal activities	9	17	20	20	19
Access to ports and rail transport	10	14	18	18	20

Source: Adapted from IPADE (Background paper.) The four most important factors of each column are in bold.

3.8 Overall, determining factors varied quite substantially across sectors, with the only essential one being the distance to market. Some interesting differences also emerged across firm size. The attitude and support of the authorities was only relevant for large firms (more than 2,500 employees) suggesting they are the only ones who usually get into partnerships with the public sector. For smaller firms, security and honesty, internet access, and the availability of workers with English and computer skills were more important.

3.9 The implication then is that location decisions depend on the specific sector and size of the firm relative to the individual characteristics of a city. On the other hand, the importance of the distance-to-market factor supports the continued concentration of economic activities in the Central Region (where the domestic market is concentrated) and on the Border. As to the cost of transport variable, however, it is one that can be affected by public investments.

3.10 Cities can also attempt to affect firms' location decision by developing pro-active local economic development strategies. This often involves actions to attract new firms or industries, but to be effective these should aim to enhance comparative advantage and avoid costly efforts to simply attract investments from other locations with tax and public investment incentives. Well documented experiences from North America and Europe shows such steps to be unproductive and lead to an expensive "race to the bottom" (World Bank, 1999.) In addition, such strategies must be consistent with macro and sectoral policies – which often have implicit unintended spatial outcomes and dwarf regional policy instruments. A review of how local and national factors have influenced manufacturing location in Mexico shows that where these have been at odds, it is national policies that have dominated (Tamayo Flores, 1997.)

3.11 Local economic development efforts that work tend to be the ones that mobilize a city's stakeholders to identify local strengths, bottlenecks and market opportunities and commit to joint actions.¹⁶ And such efforts must supersede the narrow boundaries of a city to include its zone of economic influence or hinterland. Particularly noteworthy examples from Mexico and elsewhere are discussed in Box 1. Local competitiveness is also affected by regional conditions. As Annex II shows, fast growing cities are mostly located in states that experienced economic growth (the causality surely runs in both directions.) And the fastest growing states were those with the better business environment.

¹⁶ For a discussion of how to design a local economic development strategy see: "Local Economic Development: A primer" available at <http://www.worldbank.org/urban/led/>

Box 1 : Local economic development initiatives that worked: some examples

Local economic development (LED) initiatives can take many forms, and pursue different objectives. They can aim to improve the competitiveness of a region, focus on a city or a specific neighborhood, or can target disadvantaged groups. In all cases, the urban authorities of the major urban center(s) need to be involved in partnership with the private sector. Assistance from higher levels of Government is usually helpful. The following provide some examples of LED. More cases, as well as practical advice for designing successful LED initiatives can be found at <http://www.worldbank.org/urban/led/>.

The emergence of an industrial state: Aguas Calientes

Up to the late 70s, Aguas Calientes's economy relied primarily on agriculture. This has changed radically since the early eighties, a period of fast industrialization for the State. The transformation started in 1974 when a survey launched by the incoming Governor among manufacturers and labor unions showed that the state lacked important conditions to attract investment, particularly basic infrastructure. At the same time, an industrial park was created with federal support, which was successful in bringing in some national manufacturing firms. Efforts resulted in the creation of important infrastructure requirements and of networking institutions such as chambers of commerce and finally a radical change in the image of Aguas Calientes which started building a reputation as an industrial state. Continued efforts resulted in the state's first international project in 1979, a Texas Instrument plant, soon followed by a number of other international firms. Today's challenge is now to foster greater linkages from local SME suppliers to the multinationals – despite active vendor development programs, the amount of inputs provided locally is still quite small. The success of Aguas Calientes, like that of many other LED, is very idiosyncratic however: industrial parks were an adequate entry point for Aguas Calientes in the 1970s, but are hardly the answer in the modern Mexican economy. Private-public programs tailored to local circumstances but informed by global realities are the order of the day. (Source: World Bank, 2001.)

Creating a vision on which to regenerate a city: Rio de Janeiro

In 1993, motivated by the success of Barcelona in regenerating itself, the mayor of Rio launched what has become one of the most successful vision-building process in Latin America. A very sophisticated marketing operation underlay the effort. The process was initially driven by a small "promotion group" formed of the city's secretary for urban development, and the presidents of the Federation of Industries and of the Commerce Association. This group was soon supported by high quality full time staff, as well as a larger Directive Council composed of 24 recognized leaders of the city from all segments of society. A large assembly of 400 individuals representing the broad spectrum of society met on a bi-annual basis to examine proposals, provide feed-back and formally ratify key decisions. One third of the project was funded by the mayor, and the rest by the private sector. The result of this process has been important both in terms of generating a sense of upward momentum for the city, but also in identifying critical investment in terms of infrastructure, educational and training needs and other social development projects as well as investments in industry and services. A number of major private-public initiatives in distance learning, tourism development housing and infrastructure are in the making, some of which have already resulted in specific project finance deals. (Source: World Bank, 2001.)

An example of Area Targeting: Town Center Management, Thessaloniki, Greece

The old port center of Thessaloniki, the second largest city in Greece, started to decline after a major earthquake in 1978. By the mid-eighties, the port and the surrounding shops and warehouses were mostly abandoned, and the area had become a slum due to the threat of a proposed main road extension, traffic problems and more general socio-economic development. The venture to rescue the port was part of a comprehensive effort to upgrade the historic center of Thessaloniki, and was co-funded by the European Union. The first step was to reverse the negative attitude of citizens towards preservation. The merchants were persuaded that investing in the dilapidated buildings would increase their property value. Public authorities and institutions were encouraged to settle in the area. Careful planning interventions were made with the active participation of owners and tenants. Architects were mainly engaged in the design of the new specifications and top priority was given to issuing restoration licenses. The area has now become a main tourist attraction, which is still managed through a partnership between the authorities and a local business association. (source: <http://www.worldbank.org/urban/led/>)

B. LAND, HOUSING MARKETS AND URBAN TRANSPORT:

3.12 Perhaps the major challenge facing Mexican cities are the poorly functioning land and housing markets and inefficient urban transport. Today, 24% of Mexico's urban households, representing 3.65 million families, are living in irregular settlements. Another 3%, representing half a million households cannot access own housing and are forced to live in crowded conditions (Sedesol, 2001b.) In addition, the quality of housing is very poor among lower income households, 36% of which live in dirt floor houses. (Sedesol, 2001a.) And this is not specific to small semi-rural towns: among the country's 124 largest cities, a third of the population lives in sub-optimal housing, characterized by dirt floors and/or walls and ceilings made of non-durable materials (table 6.)

Table 6. A third of the population of the country's 124 largest cities lives in sub-optimal housing

Number of cities	% of households living in sub-optimal housing
18	3% to 12%
38	13% to 23%
15	24% to 32%
35	33% to 54%
18	55% to 92%
Total: 124	Weighted average: 32%

These are cities with population 50,000 and above, representing 57.3 million people. Suboptimal housing is defined as houses with dirt floors and/or walls and ceilings made of non-durable materials. Source: Sedesol, 2001b.

3.13 Yet, land, housing and urban transport are key to urban prosperity: agglomeration economies, by definition, require proximity; and minimizing congestion costs requires that households and firms be able to make efficient decisions about where to locate within a city. Making a city both competitive and livable therefore requires that land and housing markets function efficiently, a goal that is intimately tied with the housing finance and urban transport systems.

*Land markets and land use Planning*¹⁷

3.14 *Land markets: the problem of ejido land.* The uniquely complicated Mexican urban land problem is discussed in details in "Mexico Low Income Housing: Issues and Options", but is summarized here, given its importance for urban development. Currently the creation of urban lands falls far short of the demand for shelter, much less the needs of the poor, largely because of inefficient regulation and dated and complicated land market structures. Unless improvements are rapidly brought to the workings of the urban land markets, the situation is likely to worsen, as urban growth will require about 16,000 ha per year over the next 5 years.

¹⁷ This section is based on CIDE, 2001.

3.15 About 65% of the developable land surrounding medium and large cities are in *ejidos*, a form of communal land tenure created by the 1917 Mexican constitution, which established that certain peasants have rights to land for agrarian purposes in perpetuity, not to be sold, rented or mortgaged. The remainder is mostly in private hands, largely controlled by large developers holding the land in reserve for future middle and high income residential projects.

3.16 Reforms in 1992 allowed for titling and eventual sale of ejido land. However, the results have been disappointing, and, if anything, have reduced the land available for low income housing. Government involvement has resulted in one of the largest titling efforts in the region but has suffered from:

- (i) a fissure between urban management and the process of converting lands from rural to urban use,
- (ii) cumbersome public interventions and titling procedures that have been overtaken by the market: illegal sales abound, particularly on the low end of the market, with buyers typically having to pay twice, and implying that now, most efforts need to focus on corrective rather than preventive actions, and
- (iii) conflicts regarding the allocation of rents caused by land titling and urbanization, with the agricultural and urban authorities developing parallel and sometimes contradictory programs.

Overall, inconsistent land and urban policies have exacerbated the negative externalities associated with urbanization, notably environmental degradation, sprawl and under-served neighborhoods (by law utilities cannot services illegal settlements.) In addition, improved titling in the absence of other policy tools to stimulate investments in productive use of land has increased speculative purchases and further reduced the availability of urban land.

3.17 *Land use planning.* Decisions on land use should, in theory, be based on municipal plans and programs. This suffers from two problems in Mexico. First, planning is weak and often a mere formality (some notable exceptions are reviewed in the background paper "*Allianzas institucionales.*") Second, land use is often controlled by States, or, in the case of interstate metropolitan areas, by the Federal Government.

3.18 State constitutions and laws, which allocate urban management responsibilities between themselves and municipalities, typically grant municipalities very few exclusive responsibilities (table 7.) States typically retain powers to establish urban plans, promulgate laws that regulate human settlement (including zoning and land use laws) and participate in the governing of metropolitan areas. Thus, municipalities usually have limited control of zoning, urban development, land use or land regularization.

Table 7: States typically grant few exclusive responsibilities to municipalities for urban development; an illustration from six states

	Tlaxcala	San Luis Potosí	Guanajuato	Oaxaca	Nuevo León	Estado de México
Zoning	P	P	M	P	P	P
Planning	M	M*	M	M	M	M
Land reserves	P	P	P	P	P	P
Ecological zones	P	P	P	P	P	P
Land use	P	P	P	P	P	P
Metropolitan administration	P	P	P	P	P	P
Protected natural areas	P	P	P	None	None	None
Ecology	P		P	P	P	P
Land tenure regularization	P	P	P	P	P	P
Licences (construction, subdivisions)	M	M	M	M	M	M
Expropriation	S	S	S	F	S	S
Sanctions and infractions	P	P	P	P	P	P
Regulation of private sector participation in urban services	M	M	M	M	M	M

Adapted from CIDE, 2001.

M: Indicates an exclusive responsibility of the municipality (M*: requires state congress approval.)

P: Indicates a partial responsibility of the municipality (who is consulted, participates in the regulation or definition of the action, or administers on behalf of the state.)

S: State level responsibility.

F: Federal level responsibility.

3.19 The formal control of ejido land and its legal status is a federal prerogative. This implies that in cases of irregular settlements of ejido land, municipalities cannot intervene without the explicit authorization of the federal authorities – which is often slow in coming, thereby raising the cost of future intervention and regularization. It also implies that as municipalities grow, they have less autonomy and powers to manage their development since the growth occurs at the periphery on land that the municipality does not control.

Housing Finance and its Impact on Urban Development¹⁸

3.20 Access to housing is influenced by both local and national policies. Locally, land use planning, zoning, and the norms and regulations imposed by cities determine the availability of land and the type of buildings that can go up. At the national level, the housing finance system determines who has access to formal housing, and as explained below, heavily impacts urban development.

¹⁸ This section is based on World Bank 2001a.

3.21 The housing finance system in Mexico is dominated by the public housing funds (INFONAVIT, FOVISSSTE), which control three quarters of the mortgage market. This is largely targeted to workers of the formal sector and is highly subsidized. As a result, it crowds out private lending, increases the government's contingent liabilities, and leaves limited options and resources for low income families. Households with less than three minimum wages (about 54% of the population) are effectively excluded from the mortgage market, and resort to self-help housing.

3.22 The inefficiency and inequity of the current housing system negatively impact cities in two major ways. First, the public housing funds are biased towards new housing and housing projects from a limited group of large developers. Increasingly, formal housing creation is taking the form of large developments in new suburbs. There is no available financing for used housing renovation. This is one of the explanations for increasingly dilapidated inner cities – and for the population losses of inner cities. Another explanation lies with distortions in the rental market due to an unfavorable tax treatment, and the legacy of years of rent controls.¹⁹

3.23 Second, the absence of alternatives for low income families pushes the majority of individuals into self-help housing, which typically occurs on illegal settlements. Eventually, these plots of land get serviced, but at a higher cost both for the individuals and for cities. Meanwhile, the central areas which are already serviced are losing population. In addition, these illegal settlements are often in ecologically marginal areas, or in dangerous locations due to unstable lands or incompatible land uses.

3.24 Recently, the Federal Government has pulled out of low income housing, leaving it a state responsibility. Funding to the federal housing program FONAHPO has declined to less than 2% of all mortgages in 1998. Though the Federal Government in recent years began housing subsidy programs (PROSAVI for up-front subsidies for finished housing and VIVAH for progressive housing), these have been small in comparison to the scale of housing needs. The various state, and in some cases city, Housing Institutes are now the key actors in slum upgrading and the provision of sites and services. This shift to a state level responsibility can be particularly positive if it leads to greater local (municipal) involvement and leadership and could be complemented by stepped up federal financial support based on the importance for housing in poverty reduction.

Urban Transport²⁰

3.25 Urban transport is at the heart of urban congestion costs. Time lost in traffic can add up to a substantial share of a city's output as it reduces the size of the effective labor market, imposes the need for higher inventory and more generally affects individual productivity.²¹ Inefficient transportation often burdens the poor disproportionately, as they depend on public transportation and often have the longest commutes. Urban traffic

¹⁹ The rent controls have been lifted after decades of being in effect. However much of the older rental stock is in dire condition, and since it is hard to evict long standing tenants, landlords do not find it worth it to renovate.

²⁰ This section is based on Pokorny and James, 2001; Stren, 2001; Flora, 2001; Cervero, 2001; Figueroa, 1996; World Bank 2000.

²¹ In Bangkok, admittedly an extreme, it is estimated at a third of the city's gross development product.

is also a major source of pollution – about 65% of atmospheric pollution in Mexico is vehicular in origin, and about a quarter of this is generated within Mexico City.²²

3.26 Automobile use increases as incomes rise and employment is decentralized to the outskirts of cities, weakening mass transit systems. In Mexico, between 1990 and 2000, the number of motor vehicles on the road grew by 42%. At the same time, the population of Mexico's medium and large cities grew by about 25%, while the number of trips grew even faster than the population. Inefficient administration of the already inadequate road space, in particular arising from poor vehicle parking practices and incomplete road signage contributes significantly to the congestion problem. Commercial transport of freight is affected by congestion in central business districts, poorly maintained road surfaces and inadequate terminal facilities. The proliferation of informal transport services is affecting the financial viability of the formal ones and worsening congestion. In addition, in many cities, the highly polluting aging fleet of diesel buses (15 years on average) will soon require replacement if contamination of the atmosphere is to be managed.

3.27 Municipal governments are poorly equipped to manage these challenges (Box 2.) First, most large cities are divided into several municipalities and have no metropolitan body to oversee regional transport. This results in limited coordination in intermodal services, despite the fact that, in Mexico City at least, more than a third of trips involved changing from one mode to another. Second, as discussed above, Mexican municipalities have limited land use planning powers. Third, the allocation of responsibilities between states and municipalities is inefficient: states are responsible for allocating public transit routes, while municipalities manage the road infrastructure. This has led to fractured services, weak transport companies, and irrational and unsupervised route operation. Finally, municipalities have limited resources with which to fund road investment. This is particularly problematic for the financing of road improvement for poor communities on the city peripheries. Moreover, these limitations mean that municipalities have limited capacity to promote inter-modal competition and carry out the transport planning necessary to develop long-range policies that will maintain public transport in the face of rising car use and reduce the spatial marginalization of the poor.

Box 2. The elements of good urban transport

Good urban transport management requires interventions both on the demand and on the supply side. On the demand side, the most important is that transport policy be integrated with land use planning to promote efficient location of people and businesses. This can be supplemented by regulation of gasoline prices, the charging of tolls or fees for entering congested areas, or the raising of parking fees in the central city at peak time. On the supply side, it requires a well designed and constructed basic road network (the "hardware") and good transport management (the "software") that affects circulation and parking.

3.28 The metropolitan area of Mexico City typifies the difficulties created by the poor institutional setting for land, housing and urban transport management. The central city

²² Another 3.5% is generated in Guadalajara and 3% in Monterrey. Source: Banamex 1999.

has been in decline since the 1970s as people fled pollution and the lack of housing opportunities, settling in the outer rings (table 8.) The negative implication of this population redistribution is exacerbated by the administrative division between the Federal District where roughly half of the population lives, and the municipalities located in the neighboring states of Mexico and Hidalgo. Total state and municipal expenditures in the latter are about a third of the Federal District's, even though the outer municipalities are the ones expanding rapidly (table 9.) These municipalities are generally poorer with a limited ability to service their growing population.

Table 8: Mexico City's center has been losing population while its outer rings have grown very rapidly
(population growth in the Mexico City metropolitan area, 1970-90)

	Average annual population growth	Share of the population	
	1970-90	1970	1990
Central city	-2	33	13
First ring	2	53	48
Second ring	6	14	31
Third ring	22	0.1	7
Average/Total	2.3	100	100

Source: Rowland and Gordon 1997

Table 9: The two Mexico City: the gap between the Federal District and conurbated municipalities in the state of Mexico

	Part of the Mexico City metropolitan area located in the Federal District	Part of the Mexico City metropolitan area located in Mexico State
Population (2000)	8.6 million	9.2 million
Mean annual growth rate (1990-95)	0.5%	3.3%
% of houses without indoor running water	28	45
1992 local government budget per capita	US\$ 640	US\$ 141
Annual investment in public transport (1992)	US\$ 1000 million	US\$ 80 million

Source: Conolly, 1999

C. INFRASTRUCTURE AND BASIC SERVICES

3.29 Close to 5.7 million city dwellers do not have running water, 8.7 million do not have access to sanitary drainage (sewer or septic tanks) and 1.3 million do not have electricity (table 10.) Between 1990 and 2000, the absolute number of people without access to water increased in 38% of Mexico's cities, and for sanitation, in 43% of cities (Sedesol, 2001.) Thus, even if access to services in urban areas in Mexico is relatively high and compare reasonably well with Latin American peers, there is no room for complacency.

Table 10: Overall coverage is high, but still leaves many urban dwellers without services
(access to services in localities of more than 15,000 people, 1997)

	Urban households with access (%)	Urban population without access
Water	92.14	5,659,200
Storm and sanitary drainage	87.93	8,690,400
Electricity	98.18	1,310,400

Sources: INEGI 2001. Water includes connection within the house or on the property. Drainage and sanitary sewerage includes connections to sewer and septic tanks – sewers alone, is 78.8%.

3.30 Compounding the problem is the fact that quality can be very poor and service partial. Less than half (41%) of the used waters generated by large cities is treated. Once smaller cities are included, this percentage falls to 14% by some estimates. Less than 30% of piped water undergoes potabilization through a water treatment plant - although 95% is disinfected. Earlier this year, Ciudad Juarez, a city of 1.3 million inhabitants, opened its first waste water treatment plant to help decontaminate 75 million gallons of sewage dumped daily into the Rio Grande (New York Times, 2/11/01.) Frequency and reliability of service can be an issue -- according to the latest census, less than half the households with piped water are serviced everyday, 24 hours a day.

3.31 In addition, access statistics hide wide differences within cities. Thus, Mexico City has high service coverage, but this varies between the Federal District and the conurbated municipalities in the State of Mexico. In the Federal District, 72% of households have indoor piped water, while in the surrounding municipalities in the state of Mexico, this number decreases to 55%. On the border, 88% of the population has reliable access to clean water and nearly two thirds is connected to a sewage system, but in many of the irregular settlements that percentage falls to zero as entire colonias are serviced by water trucks or have no formal service of any kind (New York Times 2/11/01.)

3.32 The issue of wide differences in coverage between the center of a city and its periphery is also true for other services. Table 11 below illustrates the point (though it includes rural municipalities.)

Table 11: The central city has much higher service coverage than the periphery
(municipal service coverage, 1995)

	Service coverage (% population)	
	In the municipal seat	In the rest of the municipal territory
Potable water	85	63
Drainage and sewer	64	25
Street lighting	84	61
Policing	80	54
Traffic signage and management	51	23
Street cleaning	67	4
Solid waste collection	81	37
Street paving	51	22
Markets	41	10
Cemetaries	90	66
Footpaths/sidewalk	51	13
Parks	63	30
Gardens	63	30
Public transport	64	45

Source: CEDEMUN, Los Municipios de México, Secretaría de Gobernación, 1998, quoted in CIDE, (background paper.) Sample includes 2,395 rural and urban municipalities

3.33 Solid waste is a case in point, where service coverage is twice as high in the central neighborhoods than in the periphery. In highly urbanized and fast growing states such as Mexico and Baja California, municipalities are not keeping up with waste collection – 5 to 7% of households do not get any kind of regular waste collection.

3.34 Solid waste is a general problem in Mexico where only 77% is collected, and less than 35% disposed of under sanitary conditions. The seven largest cities have reasonable coverage, but among the rest of the country's 100 largest cities, only 42% of solid waste is properly disposed of – and this falls to 4% in smaller cities. Key barriers to expansion of service are poor financial management and cost recovery (Vergara, 2001.)

3.35 Waste disposal capacity -- notably for hazardous waste-- is particularly weak along the border, which is reported to offer the fewest waste treatment and disposal options of any industrially active region in Mexico. In 1995, more than a quarter of the 164 tons of hazardous waste generated daily by the *maquiladoras* was unaccounted for – neither returned to the US for treatment nor disposed of by Mexican authorities (Wasserman 2001.)

D. THE NEEDS OF THE URBAN POOR

3.36 The characteristics and priorities of the urban poor vary not only across degrees of poverty, but across regions, city size, and within cities, across neighborhoods. This diversity, along with the lack of any recent in depth studies on urban poverty makes it difficult to provide a clear picture of urban poverty although a broad brush picture can be drawn based on a combination of sources.

Characteristics of the Urban Poor

3.37 Typically, the urban poor live in the outskirts of the cities in *colonias populares* where homeownership is quite high and self-help housing is the norm.²³ At first the settlements are without services, which are provided gradually following pressures from the population. Access to service is therefore determined by a combination of income of the household and the age of the settlement.²⁴

3.38 Health outcomes, such as the incidence of diarrhea among children, are about the same among the urban poor as among their rural counterparts, despite the urban poor having much higher access to basic services (water and sanitation.). This is due to the problems of quality and reliability of services mentioned earlier which hurt the poor most. It is also linked to the public health implications of incomplete coverage. Access to water is still far from universal, and a full 50% of the urban poor have no piped sewerage (table 12.) As to electricity coverage, it is typically very high, but generally through illegal connections.

Table 12: Access to services among the urban poor is very low, especially for sewerage, 1996

	Urban population		
	Poorest 10%	Poorest 30%	All
Population with:			
▪ no piped water	18	15	7
▪ no piped sewerage	50	37	18
▪ no electricity	5	3	0.9

Source: INEGI Household survey, 1996

3.39 Priorities vary quite substantially from city to city. Transport (time and cost) is a key problem in larger cities. Violence plagues poor neighborhoods everywhere, but is particularly acute in border towns (four out of the five states with the highest rate of delinquency are on the border.) The lack of jobs is an issue in the South and in small towns, more so than in northern border towns. As to infrastructure services, electricity access is universally high, while access to water and sanitation varies across regions, cities and settlements.

²³ Mexico City still has some inner city slums, though most of the poor who were living there were displaced by urban upgrading programs. In other cities, as a norm, the slums are in the outer rings where geographic isolation compounds social exclusion.

²⁴ The speediness of the provider/municipality in integrating a new settlement into the grid or the possibility of illegal connection also matter.

3.40 A study of 4 *colonias* around Mexico City in the mid-nineties (Boltvinik, 1997) suggests that within-city differences were higher in terms of overall basic needs than they are in terms of income. Poverty incidence, measured by a poverty line was 84% in the colonias as opposed to 73% for the ZMCM. If measured through unsatisfied basic needs, it was 92% vs. 65% for ZMCM. Within the colonias, about 55% of residents have access to water, but this varied from a low of 42% for the poor of one colonia, to 100% for the middle class of another more established one. Access to drainage averaged 69% (38% for the poorest.) The indicator that varied most across income groups within the colonias was access to health services.

3.41 A survey of 1200 families from low income neighborhoods in Ciudad Juarez, Tijuana and Matamoros points to differences even among relatively similar border towns. (Capital Advisors, 1998.) Home ownership varied substantially between the three cities, with 75% of low income residents in Cd Juarez living in a house owned by themselves or by a relative but 90% in Tijuana and Matamoros. Access to water was almost universal in Ciudad Juarez and Matamoros, but in Tijuana, a full 10% did not have access. Access to drainage varied across cities – from a high of 81% in Juarez to a low of 50% in Tijuana.

3.42 Compared to rural areas, urban areas have lower social capital. About 2/3 of households formed of only over-65 people live in cities. Four fifth of female headed households live in cities, and in half the case these women are the only adult in the house. Organized childcare is therefore a critical issue. Crime and violence are particularly acute issues notably among youth. Informal settlements tend to be very densely populated without community space (community centers, field for soccer, etc.), which compounds the problem.

3.43 Urban poor have relatively higher human capital, with higher literacy and enrollment rates than in rural areas, although this varies across city size. Primary enrollment rates are very similar across all types of cities but vary substantially for pre-school, secondary and superior (table 13.) Differences in educational achievements across quintiles are larger in smaller cities than in large ones. Similarly, poorer children work more in all cities, but the differences are highest in small towns where teenage labor is more frequent.

Table 13: Net enrollment rates of the poor vary across city size

	Large cities	Medium cities	Very small towns
Pre-school	14%	3%	7.1%
Primary	78%	79%	77%
Secondary	39%	27%	27%
Superior	4%	3%	1.3%
12-14 years old working last week	8%	18%	19%
15-17 y.o. working last week	25%	33%	39%

Source: World Bank (forthcoming.) Figures are for the poorest quintile in the income distribution.

3.44 Overall employment rates among the poor are broadly similar across city size – although 18 to 24 year old are more likely to be inactive in small cities, while the opposite is true of people of retirement age (older than 64.) Working two jobs is more common in small cities, though poorer residents of large cities tend to work longer hours suggesting broad differences in the labor markets.

3.45 As to the impact of household characteristics on income, the gains from education are generally higher in smaller cities – possibly due to the scarcity of skilled labor. In large cities, the difference between having no or low levels of education is negligible while in small cities, return to labor increases in step with every increment in the education level. Finally, the impact on income of having a head of household unemployed is much stronger in small cities. The Government has a program of training for the unemployed (*Programa de Becas de Capacitación para Desempleados* or PROBECAT) but this appears to be more effective as (well-targeted) safety net program, than as a means of helping the poor get out of unemployment or gain marketable skills (Wodon and Lopez Acevedo, 2000).

3.46 Slightly more than half (55%) the urban poor and extreme poor work in the informal sector. Average compensation is slightly higher among the informal self employed and slightly lower among the informal salaried. About 70% of informal workers are informal by choice and cite greater flexibility and higher returns as the reason for informality. Informal workers are not covered by health or pension funds, which can lead to private hardships and public burdens later in the life cycle (Maloney, 2001.)

Children at Risk

3.47 More than one million urban children under five years suffer from malnutrition chronic enough to cause stunting – accounting for 11% of the age group (Hall and Arriagada, 2001.) Among children of the lowest quartile, one in four is affected. Health conditions among poor urban children are as bad as among their rural counterpart: 21% had suffered a severe respiratory disease with fever in the two weeks preceding the latest health and nutrition survey, while 15% had experienced diarrhea.²⁵ Estimates, only

²⁵ Equivalent numbers for rural areas are 24% and 14% respectively. SEDESOL, 2001.

available for Mexico City, show that in 1995, there were more than 13,373 street children, concentrated in the inner city. This was a 20% increase from 1992.

3.48 The lack of childcare is a particularly problematic issue for poor families in urban areas. Good early childhood development programs are associated with better primary school performance and improved enrollment of older female siblings. In addition, childcare is essential for poor single mothers, as well as being a key determinant of the labor force participation of married women (who often function as the safety net to catch the family when the primary breadwinner cannot satisfy household needs.)²⁶ Unfortunately, the existing high quality *Centros de Desarrollo Infantil* are only accessible to mothers employed in the formal sector, and are expensive.²⁷ A recent study on childcare in Mexico city found that total demand is not large, relative to the number of children under 4, but that responding to the unsatisfied demand would require doubling current available supply of child care (Myers, Castorena and Márquez, 2000.)²⁸

3.49 Two leading indicators of social risk, inactivity and unemployment rates, are extremely high among poor urban children and young adults, much more so than in rural areas (table 14). Inactivity rates – the proportion of children who are neither in school nor working – affects more than a third of teenagers and almost half of young adults. High inactivity rates are compounded by high unemployment rates, particularly for poor young males age 15 to 24 for whom it rises to 24%. These numbers may explain why in a recent victimization study in Mexico City, 61% of the aggressors in violent crimes were reported to be youths.²⁹

Table 14: Leading indicators of social risk are high among poor teenagers and young adults, (1996)

	Poorest 10% of the urban population		
	Age 12-14	Age 15-17	Age 18-24
Inactivity – neither in school nor working/looking for work	21%	37%	49%
Unemployment rate		Male: 24% Female: 12%	

Source: Hall and Arriagada (2001.)

Public Spending on Infrastructure for the Urban Poor³⁰

3.50 Three quarters of the MX\$ 45 billion of public spending for the poor was allocated to the rural poor in 1999. This pro-rural bias has been justified in the past by the fact that rural areas contribute more to the depth and severity of poverty (World Bank 1999.) The continued urbanization of poverty justifies revisiting this allocation however,

²⁶ For a discussion of the economics of gender in Mexico, see Correia and Katz, 2001.

²⁷ Velez Bustillo, 2001.

²⁸ The study offers a detailed analysis of the childcare situation for poor families in Mexico city and makes detailed recommendations for improving supply and overall quality in a cost effective manner.

²⁹ Mexican Health Foundation, 1999 available at www.worldbank.org/laccrime.

³⁰ This section draws on World Bank 1999 and on the background paper by IberoAmericana.

as it implies that only 25% of poverty reduction spending goes to the 64% of the poor and 43% of extreme poor who reside in urban areas.³¹ In particular, there is a dire need for programs for poor urban children and youth at risk.

3.51 A substantial share (35%) of public spending on poverty reduction is allocated to infrastructure spending, most of it through the *Fondo de Aportaciones para la Infraestructura Social* (FAIS.) FAIS channels resources (MX\$ 13 billion in 1999) to states and municipalities to fund public works for population living in poor condition. It covers investments in both urban and rural areas for clean water, sewerage, drainage, electricity, infrastructure for basic education and health, rural roads, rural productive infrastructure and urbanization.

3.52 FAIS is largely (90%) channeled to municipalities (via state governments) through the *Fondo de Infraestructura Social Municipal* (FISM.) Most studies agree that it is fairly well targeted towards the poor and the very poor. Nevertheless, by construction it is biased away from the urban poor since the criteria used – the proportion of the population that is illiterate, lives in houses without sanitary drainage, is without electricity and who earns less than two minimum salary -- are systematically lower in urban areas (Box 3.) An interesting contrast is between the state of Mexico and Guerrero, both of which receive around 9% of FISM – but Mexico accounts for 11% of the country's poor, and Guerrero, for 5% (Figure 4.) This difference also exists across cities: larger cities receive about 41 pesos per poor person, while smaller towns receive more than 4 times that amount (Figure 5.)

Box 3. Comparing apples and oranges: measures of deprivation in urban and rural areas

Even the poorest, flimsiest shacks in the worst slums usually have electricity in urban areas. This is because it is extremely easy to obtain an illegal connection. Access to electricity is therefore not a good measure of an individual's needs or living condition in urban areas.

Similarly, access to drainage in urban and rural areas measure different things – urban neighborhoods that do not have piped sewerage, or at least some form of sanitary drainage are in seriously dismal conditions. Interventions are justified on public health criteria alone. On the other hand, piped sewerage is not generally appropriate in low density areas (less than 25 person per ha, equivalent to 5 families per block) where on-site systems such as septic tanks are better suited. More generally, when comparing two areas without sanitary drainage or sewerage priority should be given to the area with greater population density. Finally, the cost of installation of a sewerage system is around \$150 per person in urban areas, three times higher than the rural cost – but so are the externalities.

As to illiteracy rate it is always much higher in rural areas, in part because the illiterate are less likely to migrate.

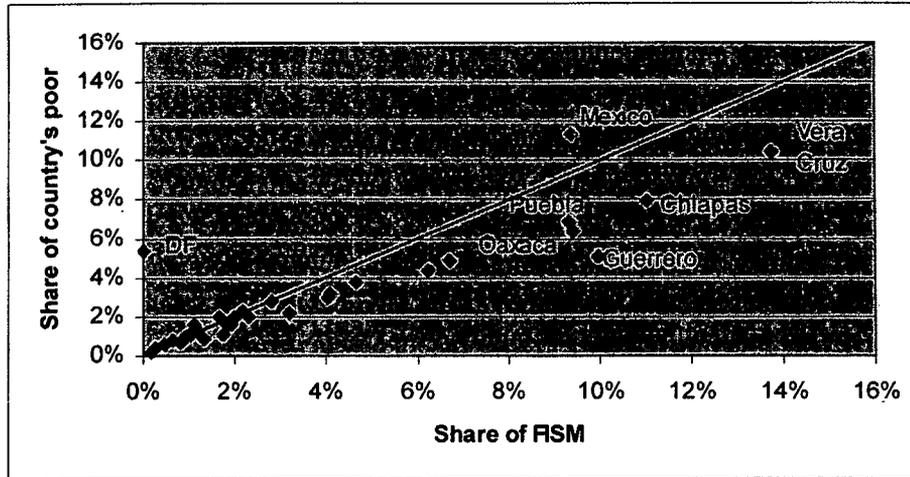
Better indicators that are readily available and capture well the needs and living conditions of a population group regardless of whether they reside in urban or rural areas are: access to piped water, quality of houses (durable material on roof or walls,) and, for education infrastructure, school rooms to school-age children ratios.

Box Table 2: Indicators of Poor Living Conditions

	piped water		w/o durable materials in walls		w/o durable materials on roofs		W/o sanitary installation	
	Percent without	Million without	Percent without	Million without	Percent without	Million without	Percent without	Million without
Urban	4%	3.0	11%	7.8	25%	18.1	9%	6.2
Rural	25%	6.2	47%	11.7	66%	16.2	21%	5.2

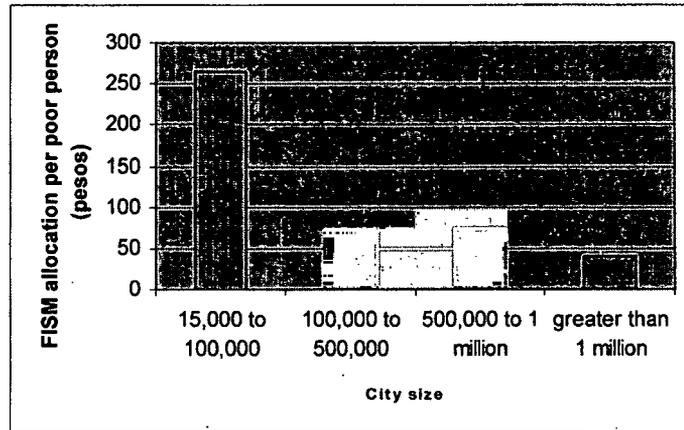
Source: INEGI 2001. Memo item: total urban population is 72.4 million and rural, 24.6 million.

Figure 4. The distribution of FISM favors rural states



Source: De la Torre and Velásquez (2001) for FISM data; INEGI (2000) for share of national poor, calculated as households living below two minimum salaries.

Figure 5. FISM resources tend to favor smaller cities, 1997



Source: De la Torre and Velásquez (2001)

3.53 Poor urban areas suffer from important deficiencies in terms of infrastructure – deficiencies that have severe implications in terms of environment and public health. In fast growing cities, the backlog of investment in these new settlements can be enormous. In addition the cost of providing service to already settled areas is very high, particularly for sewers. Few cities can fund these upgrades out of their regular budgets suggesting the need for reassessing the amounts of federal resources available for urban infrastructure for the poor.

E. PRIORITIES FOR REFORM

3.54 A good part of the problems in the land and housing markets, and in the delivery of urban services have to do with the allocation of responsibility and the paucity of professional specialized staff – both of which are discussed in more detail in the next chapter. In short, however, a priority for reform is to ensure urban land management is a municipal responsibility; that municipalities have the powers necessary to manage urban transport, which, in the case of metropolitan areas, should be delegated to a metropolitan transport authority.³² The transfer of responsibility needs to be accompanied by technical support, possibly through *Institutos de transporte*, as many municipalities may still lack the required human resources.

3.55 In the case of housing, one priority is to increase the liquidity of the housing market and the range of housing products (used, rental, progressive.) This requires developing lending for used housing (a policy which will do much to revitalize decaying city centers) and foreclosure capacity. It also requires developing the rental market – rent control policies have been in place for decades, and although they have now been lifted, their effect lingers on.³³ A second axis of reform is to expand low income housing. This, can be done through lower subdivision standards, a streamlined land development process and a number of complementary measures aiming at mimicking the gradual way in which the poor typically acquire housing – all of which is discussed in more details in “Mexico Low Income Housing: Issues and Options” (World Bank, 2001.) Since the best mix of housing solutions varies substantially by region, states and municipalities should be allowed to develop their own programs within the parameters set by the federal housing program.

3.56 Regarding urban poverty, the Mexican Government has started work to developing a program to address the needs of the urban poor (SEDESOL, 2001.) Issues are complex and may require additional analysis – notably to determine where the urban poor are, how best to target the poor in urban areas with high diversity of socio-economic groups, and how priorities differ across city size and regions, and so forth. Nevertheless, the following are some suggestions for priority interventions:

- Actions are needed to help the poor develop their **assets** – which in urban areas are basically housing and human capital. This requires developing the low income housing policies mentioned above, but also slum upgrading programs (Box 4.) An immediate measure that could be taken, is to revisit the criteria used for the allocation made currently of FAIS/FISM funds and base it on a location neutral set of indicators. In addition, OPORTUNIDADES could be expanded further in urban areas where it can provide integrated support program for education, health and nutrition for the very poor.³⁴

³² Regional or more “macro” planning should remain a state or federal responsibility.

³³ In part because of ineffective eviction policy. In addition, rental income may suffer from an disadvantageous tax treatment. The issue is complex enough to warrant further study.

³⁴ OPORTUNIDADES (formerly known as PROGRESA) was developed in and for rural areas. In 2001, it has started serving urban areas, where it is in the process of including about 500,000 urban poor families. Estimates are that an additional 700,000 urban families need to be integrated into the program. A key question, currently under study by the OPORTUNIDADES research staff, is whether adjustments need to be made to the program’s design to adapt it to an urban setting.

Box 4. Slum upgrading – an essential and effective instrument to tackle urban poverty

Slums are the products of failed policies. Bad governance, corruption, inappropriate regulation, dysfunctional land markets, unresponsive financial systems, and a fundamental lack of political will are to blame. Some slums are more than fifty years old, some are land invasions just underway. They range from high density, squalid central city tenements to spontaneous squatter settlements without legal recognition or rights, sprawling at the edge of cities. They typically lack basic municipal services (water, sanitation, waste collection, storm drainage, street lighting, paved footpaths, roads for emergency access), schools and clinics within reach, safe areas for children to play or places for the community to meet and socialize.

Slum upgrading, at its simplest, consists of improving the existing infrastructure, e.g. water reticulation, sanitation, storm drainage and electricity, up to a satisfactory standard. It does not usually involve home construction, which the residents can do themselves, but instead may offer optional loans for home improvements. Further actions include the removal of environmental hazards, providing incentives for community management and maintenance, as well as the construction of clinics and schools. An essential part of upgrading is transferring tenure rights to the occupants at prices they can afford. The security provided by transferring these tenure rights has been shown to motivate occupants to invest two to four times the amount of funds that the government invests in infrastructure improvements in a slum area.

Upgrading has significant advantages over alternatives: it is much less expensive than clearance and relocation (which cost up to 10 times more), and minimizes the disturbance to the social and economic life of the community. Contrary to common perception, upgrading does not induce in-migration. Numerous studies have shown that the major factor inducing in-migration is the difference between rural and urban incomes and job opportunities. The next influence is facilities for better education. Better housing is a negligible factor.

The benefits of upgrading are an improved, healthy and secure living environment for slum dwellers, without being displaced. The investments they have already made to their properties remain and are enhanced - this is significantly better than removing them to costlier alternatives that are less acceptable to them. Recognizing title and security of tenure makes a positive contribution to both the economic prospects of the poor, as well as to the national economy. Experience has shown that slum upgrading projects yield very high social and economic benefits. For example in a recently upgraded area of El Mezquital, Guatemala, infant mortality rates fell by 90 percent and crime by 43 percent. Regularization of land tenure results in significant private investment in these communities - US\$7 private investment for \$1 of public funds.

Most slum upgrading are targeted towards a particular neighborhood or slums of a single city. However, a number of countries (such as Jordan, Tunisia and Indonesia) have successfully implemented nationwide programs while scaled up programs of significant scale are underway in Ghana, Venezuela, Brazil, India, Morocco and the Philippines.

National programs of upgrading require active political will and an ability to deal with thorny problems such as land regulations, land ownership, changes in zoning or planning standards, and policies and institutions governing housing and infrastructure provision. Also, government turnover, lack of knowledge about what can be done among local officials, lack of voice on the part of slum dwellers, lack of consistent advice and support from the donor community have all been factors that affected scaling up. Finally, upgrading should be considered a necessary precondition, but not a sufficient condition for reducing poverty in slums. Actions must also be taken to increase access to economic opportunities, as misguided policies that contribute to social and economic isolation can lead to slums as well as failed land, housing and infrastructure policies.

Adapted from "Upgrading Urban Communities: A resource for Practitioners"
<http://web.mit.edu/urbanupgrading/>

- Urban specific interventions to help the poor improve their **income earning capacity** include public transport (discussed above), training and child care:
 - On *training*, PROBECAT should be thoroughly redesigned given that the evidence suggests it functions more as a safety net program than an effective training scheme. Schemes to facilitate entry into labor markets for school leavers and graduates are needed. One may learn from the experience of the Chilean program CHILEJOVEN, which provides vocational training to bridging the gap between skills provided by the public education system and those demanded by industry. Finally, apprenticeship contracts could be reintroduced though they need to be carefully designed to prevent abuse.³⁵
 - *Childcare* is essential for single mothers, as well as being a key determinant of the labor force participation of married women. Other countries have experimented with subsidized community child care, which have the double advantage of inexpensively providing a needed service and creating home based employment.³⁶

3.57 Interventions to improve **security** need to address income insecurity, violence and social capital.

- Social insurance programs (IMSS and ISSSTE) which absorb 75% of social protection expenditures, are only available to formal sector workers and mostly benefit the upper and middle class. The reforms under way to open these programs to informal sector workers are essential and should be continued. In addition, it may be helpful to encourage formalization of the informal sector. For workers who are informal by choice, this requires strengthening the currently weak link between payroll contribution and subsequent benefits – for example through a fixed-quota contribution that entitle the employee to minimum benefits and through increased IMSS efficiency (Wodon and Velez, 2001.) For informal workers who would prefer to be formal, formalization requires reducing the costs of being formal.³⁷
- The remaining 25% of the social protection fund a large number of program that serve to transfer resources to the poor, but mostly target the rural population. Workfare programs need to be developed for urban areas, possibly learning from an evaluation of PET, a temporary employment program for rural areas, or the Argentine *Trabajar* program.³⁸ This could gradually replace the costly and overlapping targeted food subsidy programs that still exist.
- Programs to address violence are complex but are urgently needed in Mexico, where delinquency rates have been increasingly steadily since 1980.

³⁵ For more detailed analysis and recommendations on employment and training issues, see Maloney 2001.

³⁶ For a review of early childhood education and care programs see <http://www.worldbank.org/children/>. For a Latin America specific review, see Fort, 2001.

³⁷ Registration costs could be reduced through a one-stop registration process. Regulatory costs, estimated at a quarter of total costs for microenterprises, could be cut through a reform of the social security program and through a simplification of the taxation system. See Maloney, 2001.

³⁸ Ravallion, et al. 2001.

International experience, such as Brazil's successful approach to reducing crime and violence in Rio may offer some useful ideas on how to proceed.³⁹

- Regarding social capital, it is difficult to foster directly, though the provision of community space in poor urban areas helps. In addition, community based approach to service delivery can help develop community bonds and contribute to greater social capital.

F. NEW GOVERNMENT INITIATIVES ON URBAN DEVELOPMENT AND POVERTY ALLEVIATION

3.58 The suggestions developed above are in line with new Government initiatives for urban development and poverty alleviation. In terms of urban development, the Subsecretaria de Desarrollo Urbano is creating "Habitat" agencies in all cities across Mexico, with the objective of coordinating the work of the three levels of Government. Initially conceived as pure urban development agencies, the aim now is to use them to coordinate urban poverty work and link it with urban development.

3.59 In particular, it is hoped the Habitat agencies will help coordinate two new urban poverty initiatives are being piloted in 10 medium size cities across Mexico. These two new programs, "*Programa para la superación de la pobreza urbana*" and "*Mujeres jefes de familia*" are targeted towards poor urban communities, and the specific projects they are to finance are to emerge from community self-diagnostic, and community development plans. They are to be co-funded with either the state or the municipality, with a participation of the beneficiaries. Specific subprojects and objectives are outlined below:

- *Programa para la superación de la pobreza urbana: dignificación del barrio* (improvements of schools, health centers and markets, parks and community space,...); education and training; community and family development centers: creation or rehabilitation; projects with Civil society organization targeted towards human and family development projects, training and workshop on intra-family violence, drug addiction, and "life skills."
- *Programas para Mujeres Jefas de Familia*: projects that respond to common needs of women who are their family's main support, and are focused on education and training for work skills, social assistance, and health. More specifically this includes medical and nutrition support for women and community based childcare services.

These programs are to be rolled out to the rest of the country in 2003.

³⁹ Documentation on Brazil's very rich experience with urban poverty alleviation programs (which includes programs to address urban violence) is available at : <http://inweb18.worldbank.org/External/lac/lac.nsf/4c794feb793085a5852567d6006ad764/a0aa75a4359674aa85256a760069d0bd?OpenDocument>

3.60 In addition, the Government and the Bank are developing a national urban upgrading project, which aims to : (a) provide financing for progressive housing and home improvement, (b) deliver more efficient up-front subsidies, combined with new savings instruments; (c) expand the supply of urban land, with progressive infrastructure provision, and (d) improve the legal and regulatory framework for real estate development and land tenure regularization. The project will include pilots in about 6 cities across Mexico.

Finally, **OPORTUNIDADES** is being extended to cities of less than one million inhabitants (which excludes Mexico City, Monterrey and Guadalajara.) The objective is that about half of the planned 1 million new enrollments be urban families (see box 5 for details.) The data generated through OPORTUNIDADES questionnaires may help generate new insights into urban poverty, which could supplement the poverty mapping efforts currently underway within SEDESOL.

BOX 5. ROLLING OUT OPORTUNIDADES IN URBAN AREAS

Currently the service offered in urban and rural areas is the same, but a process of analyzing questionnaires is underway to investigate how the services may need to change. In particular, it is already clear that the health and education challenges are different between urban and rural areas, so that the package offered by OPORTUNIDADES may need to differ.

The roll-out in urban areas is targeted towards “*AGEPs (census tracts) de alta marginación*”, using a similar methodology to the one developed in rural areas. The definition of “*alta marginación*” is similar to the one in rural areas, although some variables are being adjusted to account for urban or regional specificities (more information is to be provided.) This allows for an estimate of the number of poor that need to be enrolled, an estimate that is then reviewed with state authorities.

The organizational structure of OPORTUNIDADES in urban areas is somewhat different than in rural areas. Each city has one or several modules or offices, which serves the city’s entire “zone of influence.” This corresponds to the city’s hinterland and is defined in a consultative manner for each participating city. Approximately 150 modules are currently operating in about 130 medium size cities, and have enrolled approximately 300,000 families. A key problem being encountered is that schools and clinics tend to be completely saturated in poor urban areas, yet integration into OPORTUNIDADES requires the family to integrate a clinic and children to attend schools.

IV. MANAGEABLE CITIES⁴⁰

4.1 Improving the livability and competitiveness of cities requires good urban governance. This in turn depends on the country's subnational institutional and financial framework and the design of intergovernmental relations. In Mexico, unfortunately, these are such as to endow municipalities with very limited means, in terms of powers or resources, for good urban management and no incentive to improve their performance.

A. LIMITED POWERS WITHIN AN AMBIGUOUS INSTITUTIONAL FRAMEWORK

4.2 The current assignment of expenditure responsibility is characterized by many concurrent responsibilities between all three levels, limited responsibilities assigned to the municipal level, and a one size fits all approach which grants the same responsibilities and status to the country's 2400 municipalities. The result is weak municipal urban management capacity, and generally poor service delivery.

Limited Responsibilities, Jurisdiction and Capacity

4.3 Despite a process of constitutional reform (1983 and 1999) that has formally devolved responsibilities to the municipal level, the states continue to dominate urban affairs. This is due to several factors. First, Mexican law does not clearly define the respective responsibilities of each level of government with regard to urban affairs. Three levels of government as well as an array of laws, programs, and plans are all involved in urban issues, on many occasions in contradictory ways. The main confusion exists between the states and municipal government, and the ambiguity serves to perpetuate the traditional authoritarian, hierarchical control of states over municipalities. Second, the states have been slow to enact the reforms and put them into practice. In particular, states have been reluctant to relinquish responsibility for revenue generating services, such as water and sanitation services.

4.4 Complicating matters is the fact that growing urban areas often expand well beyond the borders of a single municipality, to encompass several local governments (table 15.) The country's 372 cities are governed by 481 municipalities, and even relatively small cities can span a large number of municipalities -- Oaxaca (population less than half a million) has 19. This poses particularly acute problems where poor suburbs to a central city develop within a separate, smaller municipality.⁴¹ Thus urbanization gives rise to problems and challenges that the existing legal framework is unable to effectively address.

⁴⁰ This section is mostly a summary of the background paper "Alianzas institucionales: el desafio de la decada," although it also draws extensively on Giugale and Webb (2000) particularly for the recommendation section.

⁴¹ This is a problem common to a number of countries, which is discussed below in the context of metropolitan governance.

Table 15: Composition of Mexico's largest metropolitan areas

Zona Metropolitana	Number of constituent municipalities
Mexico City	50 in two states (Federal District, México)
Guadalajara, Jalisco	7
Monterrey, Nuevo León	10
Puebla-Tlaxcala	48 in two states (Puebla, Tlaxcala)
León, Guanajuato	3
Toluca, México	6
Torreón, Coahuila	3
San Luis Potosí, San Luis Potosi	2
Merida, Quintana Roo	5
Queretaro, Queretaro	3
Tampico, Tamaulipas	6

Source: Indicadores Sociodemográficos de México, 1930-2000, 2001

4.5 Further weakening municipalities are their limited human and administrative resources – not always sufficient to adequately discharge their responsibilities. A single status exists for all municipalities, large or small, urban or rural, which does not distinguish according to the wide range of institutional development and administrative capacity that exists. Generally, the larger and more urban a municipality, the stronger its institutions and capacity, but overall, municipal institutions are weak. In 1995, for example, more than 60% of municipalities did not have basic regulations for administrative procedures; and more than 70% did not have basic rules for the collection and actualization of the property tax. In 1993, only 13% of municipal staff involved in finance were technicians.

Weak Urban Planning Structures

4.6 Attempts at strengthening urban planning have had limited impact as the plans are rarely applied. The formal planning mechanisms at the state and municipal levels are the *Comités de planeación para el desarrollo del estado* (COPLADEs) and *Comités de planeación para el desarrollo municipal* (COPLADEMUNs), both designed as part of the national planning system to bring civil society groups into the prioritization process. In practice, the committees are controlled by the governor or municipal president and see little independent citizen input. Planning conceived as a tool and guide for the achievement of a future objective essentially does not exist.

4.7 Nevertheless a few municipal governments have created relatively autonomous municipal planning institutes, such as IMPLAN in León and IMIP in Ciudad Juárez, both of which focus on traffic and transport planning. These have allowed for a professionalization of staff, for longer term planning (spanning more than one mayoral mandate) and for a metropolitan vision. In Guanajuato, the state has made an effort to establish criteria for the transfer of responsibilities from the state to the municipal level -a plan of action for more effectively dealing with city growth.⁴² These experiences could serve as models for other states and municipalities.

⁴² These experiences are discussed in more details in *Alianzas Institucionales: el Desafío de la Década*, background paper.

Implications for Service Delivery

4.8 Since the early 1980s, subnational authorities have progressively been granted direct responsibility for most basic infrastructure services. As mentioned earlier, this decentralization has not helped improve services delivery as municipalities struggle to maintain existing facilities, let alone respond to growing demand. Some urban municipalities are heavily engaged in public service delivery, others are less so, and still others have minimal capacity to administer these responsibilities.

4.9 Concurrent obligations at all three levels often leave functions like maintenance, regulation and inspection without any level taking adequate responsibilities. Separating the responsibilities for maintenance and operation of infrastructure facilities from responsibility for capital investment is a persistent problem, leaving each level of government to blame the other. Box 6 discusses the case of water and sanitation services.

4.10 National legislation establishes the principles upon which private participation in public service delivery is based, but it is states that set the enabling legislation and specific parameters that regulate private participation within their territory. They typically allow municipalities to enter in concession agreements, subject to approval by the local congress.

4.11 Traditionally, private sector involvement in urban development has been limited to the construction of large federal public works and the development of land for commercial establishments and housing for the wealthy. As the government has withdrawn from a variety of activities, the role of the private sector has grown in importance. Private firms are engaging in the development of land for middle and low income populations and participating in concessions for the delivery of public services.

4.12 With respect to public services, concessions have not played an important role with the exception of public transport, slaughterhouses and wholesale markets. Where concessions have occurred in solid waste collection or water and sanitation services the experience has been mixed, with failures attributable to precipitous decisions, bad planning and poorly designed contracts. In a number of cases, concessions have become highly politicized and the source of conflicts between outgoing and incoming municipal governments. Overall then private sector participation in infrastructure has been less successful than in other countries. This is due to an unclear regulatory framework, poor concession design and implementation and the lack of a vision of the respective strength and roles of the private sector (World Bank and PPIAF, 2001.)

Box 6. The institutional framework for urban water supply and sanitation

In principle, municipalities have primary responsibility for water and sanitation service. They control the water use rights granted by the Federal Government and have the powers to delegate or concession water service and to guarantee the commercial autonomy of service entities. Water is mostly delivered through municipal water companies (2000 of which serve 65 million inhabitants) although in 8 states, some or all of the urban municipalities have delegated service provision responsibility to the state government.

In practice, state governments have continued to play an important role in the sector, as evidenced by the fact that they set tariffs in about two thirds of municipalities. More generally, they administer water within their jurisdictions, distribute certain federal transfers to municipalities, control access to credit, and frequently provide fiduciary and financial guarantees for municipal water company undertakings. However states, with some notable exceptions, do not have clear sectoral investment policies, tariff setting rules, and financing strategies. Where regulations exist, their enforcement is uneven. Most states' water laws stipulate that urban water companies are to operate as autonomous entities, but the degree of managerial autonomy afforded to water companies varies considerably. Operational decisions are often taken by the mayor and the water company board which s/he appoints and chairs. Tariffs are seldom based on cost and are generally set following the same rules as taxes and expenditures setting.

Federal water sector policy explicitly promotes private participation as a tool for improving the efficiency and quality of the sector. In practice, this has primarily involved wastewater BOTs and a few service contracts. Very few municipalities have had any success in attracting long term private funds or in improving service through private management. The sector as a whole faces parallel trends of declining investments, low revenue mobilization and limited cost recovery. The reasons for this relate to pricing, commercial and technical inefficiency, and continuing dependence on federal transfers.

Subsidy policies and the tariff structure need to be reexamined in order to increase the degree and efficacy of private participation arrangements. In addition, the government needs to pursue a progressive reform agenda encompassing changes in the three areas described below as well as conclude the associated legal and regulatory reforms. Transitional federal, state, or municipal (Ramo 33) financial support will be required to assist local utilities as they move towards cost recovery.

Enabling environment. A credible regulatory environment is necessary for reducing investor uncertainty. Very few states have put in place regulations governing private sector participation and none have established distinct regulatory entities to oversee service provision. Greater clarity and coherence is required on policy goals; on institutional responsibilities for regulating service providers; and on pricing policies commensurate with those goals.

Reorienting Private Participation. BOTs are inappropriate for water systems characterized by high losses, poor commercial practices and low tariffs. Instead, integrated management contracts or leases of relatively short duration can be used initially to raise operating efficiency and cash flow. Together with gradual increases in tariffs, this can set the stage for subsequent private arrangements where the operator would take more risks and provide greater benefits, particularly with respect to the mobilization of debt and equity financing for investment.

Refocusing Federal Financial Support. Local authorities remain highly dependant on federal transfers not only for financing new investments but increasingly for rehabilitation and even periodic maintenance. Federal transfer programs and development bank lending need to be conditional on reform. In addition, revamped lending policies and instruments are critical. For water companies which already generate substantial net revenues, a first step would be to redirect much of Banobras' resources towards supporting subnational governments in issuing debt in private financial markets.

Source: World Bank and PPIAF, 2001.

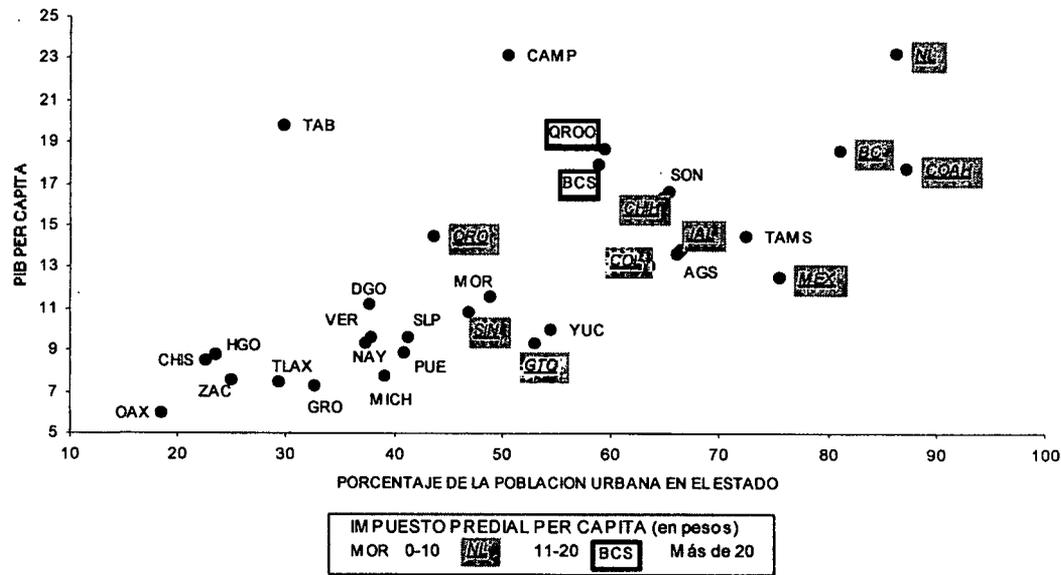
B. LIMITED OWN FINANCIAL RESOURCES AND UNPREDICTABLE TRANSFERS

4.13 The fiscal system in Mexico remains highly centralized, and has emphasized the decentralization of expenditures more than revenues. Municipalities account for a low 4% of the public budget in contrast to 10% in Brazil, 12% in Chile and 17% in Colombia.⁴³ Municipal governments have limited revenue-generating authority and their ability to collect revenue is governed by laws enacted by the state legislature. Since 1999, municipalities have had the power to present proposals on property tax rate levels to the state legislature. On average, about a third of municipal revenue is own-source income, although this varies both within and across states. Municipal governments are thus highly dependent on external (federal and state) sources of revenue, the amounts and timing of which are unpredictable

4.14 Among municipal taxes, the most important is the property tax which averages 13% of municipal revenues but varies tremendously from a low of 0.5% (Chiapas, Morelos, Tabasco) to highs of 17% in Guanajuato and 22% in the Federal District. These differences can be explained in part by differences in wealth and degree of urbanization, but also by the level of effort (Figure 6.) Overall, however, the property tax is underutilized in Mexico, where it only represents 0.25% of GDP, in contrast with countries such as Argentina and Chile, where it represents 1.4%. Part of the problem is that states, who were traditionally responsible for the administration of the property tax, were not always efficient. To date, only 23% of states have up-to-date legislation on cadastres and property tax and only 25% of cadastres have actualized and homogeneous property tax rates. Baja California, Jalisco and Sonora (which has the country's only institute for land registry and cadastre) are the only three states where public registries have been significantly improved. Starting in 2000, municipalities will be responsible for maintaining their own cadastre, which is likely to be a challenge for most of them.

⁴³ States account for about 23% of national expenditures.

Figure 6. Differences in property tax collection are only partly due to differences in income per capita and degree of urbanization



Source: Cide (background paper.)

4.15 Municipalities have limited capacity or incentives to control expenditures. Since the late eighties, municipal expenditure has become increasingly oriented toward administrative expenses or operating costs, while spending on public works and investment has dropped considerably. By 1997, municipalities spent 3 times more on current expenditures than on investment.

4.16 In the financial realm, as in many other areas, municipalities are subject to the control of the state government. The state's role in the administration and control of municipal resources can create tension. The state government can influence the timing of the delivery of federally mandated revenue-sharing transfers and states also interfere with the flow of Ramo 33 funds to municipalities. In addition, the state legislature must approve municipal budgets, income laws, tax rates, and fees, among other items. State comptrollers are political appointees, so the audits of municipal governments are often politicized.

4.17 A number of urban municipalities have demonstrated innovative financial practices, management systems, mechanisms for increased fiscal transparency, and public-private financing that have generated greater efficiency in urban management. Nevertheless, most have poor and un-transparent financial and fiscal situation. This is partly due to the fact that a full third of the Mexican states haven't yet enacted legislation on budget procedures, accounting systems, and public expenditure rules. Such regulations could help bring more order to the management of municipal finances.

4.18 The lack of transparency in financial operations leaves room for politicization, provides opportunities for mismanagement and corruption, and inhibits the potential for urban growth. Multiple, complex transfer mechanisms for the distribution of resources to states and municipalities makes it difficult for subnational governments to determine in advance their levels of funding from year to year. Transfer formulas are obscure --the formula for the distribution of health transfer under Ramo 33 is unknown-- and federal officials have an equally difficult time determining if they are accomplishing their objectives. In 1993, a third of Mexico's states did not have their own fiscal coordination law, which provides a measure of predictability and transparency to state transfer to the municipal level. Information gathering and evaluation in these and other areas is inhibited by the lack of clarity.

4.19 Subnational governments in Mexico, notably in cities with strong financial and technical capacity, are seeking to improve their access to capital markets. International credit rating agencies have issued ratings for a number of states and municipalities. Subnational debt is indeed expanding, but limited, and so far has not posed a threat to macroeconomic balance. The limited use of debt financing is a result of the lack of subnational borrowing capacity (prompting calls for reform) and the Federal Government's past absorption of fiscal shortfalls before they could become debts. Municipal governments cannot incur debt in a foreign currency; they borrow mainly from commercial and development banks.

C. AN INCENTIVE STRUCTURE THAT DOES NOT PROMOTE RESPONSIBLE URBAN MANAGEMENT

4.20 The principal weakness of the Mexican local government system lies in the limited accountability it imposes upon municipalities and in the absence of appropriate fiscal incentives. Political institutions that foster short term vision and a lack of downward accountability, a fiscal framework based on unconditional transfers, and ineffective mechanisms to promote inter-municipal coordination are at the heart of the problem.

Political institutions that foster short term vision and a lack of accountability

4.21 The system of local political representation presents a number of problems. The three-year term of government (for municipal officials and state legislators) and a prohibition on reelection makes institutional continuity difficult and promotes very short-term policy perspectives. It also restricts the development of electoral accountability. Political accountability is further limited by the election of local officials by party slate, which creates incentive to respond to the interests of their parties as opposed to the wishes of the community (although there has been some movement recently toward direct election in submunicipal Districts). Finally, the municipal cabildo is organized such that

the party of the president (or mayor) is guaranteed a majority of members, which limits the need for compromise in decision making.

4.22 Compounding the short term vision, is the high administrative turn over due to the fact that the political system is highly clientelistic and a municipal civil service career does not yet exist. As a result, a new administration takes office every three years. As to mechanisms for citizen participation in local decision making, they typically serve more as decorative structures than opportunities for real citizen involvement in the decision making process.

A Fiscal Framework that Doesn't Promote own Resource Collection and Expenditure Management.

4.23 Own-source income increased significantly from the early eighties to 1994 and has been declining since. The 1983 constitutional reform accorded Mexican municipalities the authority to administer the property tax, and local officials' immediately began to take advantage of the change and increased collection. After 1994, however, own-source income began to decline sharply both in absolute and relative terms. The 1995 economic crisis explains some of this, but so does the emergence of new transfers (Ramo 26 which then became today's Ramo 33) from the Federal Government at this time which created disincentives for local officials to collect local taxes.

4.24 The intensification of local political competition, which often centers around the promise of no increases in local taxes, has made the creation of incentives for own tax collection even more imperative. Opposition parties are quick to attack for political benefit a local administration that insists on raising rates or more effectively collecting taxes

No mechanism to promote inter-municipal/metropolitan cooperation

4.25 Metropolitan areas have emerged throughout Mexico, but coordination among municipalities within metropolitan areas has not been a priority of local decision makers. Efforts at such coordination has typically been characterized by a concern with the immediate, which usually means dealing with conflicts among the constituent municipal governments. A metropolitan vision has been lacking, overtaken by isolated action on the part of individual municipalities. Mechanisms for regulating metropolitan areas -- plans, commissions, etc.— exist and are governed by the *Ley General de Asentamientos Humanos* but have not led to the creation of a true metropolitan policy.

D. PRIORITIES FOR REFORM

4.26 The agenda for reform is fairly clear, though its implementation may be complex and some measures may require time to implement. Concerning expenditure assignment, the ambiguity and overlap among the three levels of government should be eliminated.

This is particularly urgent for water and sanitation, and construction and maintenance of schools and roads. Failing a new national law, a good vehicle for clarifying the division of responsibility between state and municipal governments is the Budget Process Law of each state. Specific actions that need to be taken are:

- Where concurrent responsibilities are maintained, the law needs to specify clearly the attribution of each tier. As a general rule, responsibility for construction and maintenance should never be separated since this creates unworkable arrangements and perverse incentives.
- Municipalities should be granted exclusive competence for municipal management – notably zoning, land use planning and regularization, and urban transport. The state or the federal government may continue to define standards with respect to ecological and environmental issues with cross-jurisdictional externalities. Authority over the conversion of land from agricultural to urban should be decentralized to the state level, but procedures must involve the municipalities concerned. These reforms would do much to reduce the cost and improve the availability of low-income housing.

4.27 There is an urgent need to improve accountability. The current laws do not allow states or the federal government to condition grants and transfers upon the receipt of budgets and audited accounts. A longer term recommendation is then to change the law to allow such conditioning and/or to establish minimum reporting standards based on the absolute volume of transfer. In the meantime, incentives for better accountability could be created by granting more responsibilities and/or resources to municipalities that respect minimum reporting standards (see below.) As to improved downward accountability, it will require electoral reform to eliminate the restriction on consecutive terms for the mayor, and/or allow for direct elections of council members rather than the current system of party list.

4.28 Additional measures that can help improve expenditure efficiency are associations of municipalities around the provision of services – something that can be encouraged at the state level – and increased reliance on the private sector for the delivery of services. The latter requires clarifications in states' legal framework to minimize uncertainty around concessions. The federal government could help by developing guidelines. In addition, incentives for PPI could be developed, possibly through BANOBRAS. Finally, both municipal capacity for concession design and states' ability to control the legality of concessions need to be strengthened. Such technical assistance for concession design and regulation, could be developed centrally (through SEDESOL) or at state level. These measures however can only supplement sector reforms, particularly in the water sector.⁴⁴

⁴⁴ World Bank and PPIAF (forthcoming 2001) discusses in more details the institutional and sectoral reforms needed for greater private sector participation.

Box 7. Improving accountability for public transfers – the example of FISM

The Fondo de Infraestructura Social Municipal (FISM) is transferred to municipalities as part of federal transfers included in Ramo 33. On average it accounts for close to 50% of municipal investments in Mexico. FISM is a conditional transfer with a specific objective, and as such the federal government can impose accountability. The requirements specified in the Fiscal Coordination Law, are that the municipalities are to:

- publish amounts received, the works to be financed, their costs and beneficiaries
- promote community participation in the selection, programming, execution and monitoring of FISM projects
- publish results and achievements at the end of each fiscal year
- provide all required information to the Secretaria de Desarrollo Social

Nevertheless, the efficiency of FISM expenditures is constantly being questioned. A recent SEDESOL report, quoted in the background paper "*Allianzas Institucionales*," concluded that the use of FISM funds is not always in line with stated objectives. Nor is the fund always allocated in a participatory manner – in 30% of the cases, allocation decisions are made exclusively by the municipal presidents, in 39% by the municipal council, and only in 28% of the cases does the COPLADEMUN intervene. Finally, the resources seem to mostly target works in the municipal seat, rather than poor neighborhoods: in 1998, only 17% of the resources benefited poor neighborhoods (*colonias populares*.) Analysis done in Chiapas, Guerrero and Oaxaca, some of the country's prime beneficiaries of FISM shows that investments also suffer from weak technical capacity at the municipal level, often resulting high cost, poor efficiency investments.

Improving the efficiency of FISM would require setting guidelines (for example regarding targeting and costs of individual sub-projects), greater monitoring, and incentives for better management. As it is, the reporting requirement have little impact, since poor performance does not have any consequence.

4.29 On the revenue side, incentives for municipalities to improve their own revenue raising efforts could be built into the transfer system, though such measures have typically met with limited success.⁴⁵ Concerning property tax, the following measures could be taken to improve its administration:

- Eliminate or greatly limit exemptions (national standards can be set) and publicize all exemptions.
- Explore alternatives to expensive, complex and hard to maintain cadastres. Two commonly used approach are simplified fiscal cadastres, which provide only the basic information needed to place houses in one of a limited number of categories, and self assessment.⁴⁶
- Develop state technical assistance programs to help smaller municipalities update and maintain their cadastres, bill and collect (such as the one offered through the *Programa de 100 Ciudades* to help update cadastres.) It is not recommended to have states collect the property tax on behalf of

⁴⁵ Bahl and Linn, 1992. This in fact does exist in Mexico, through one of the Funds of Ramo 28. However it is not done in a simple or transparent way and does not appear particularly effective. The way such incentives are typically designed is to make a portion of transfers proportional to tax effort. This can be complex due to the difficulty of measuring tax effort. Alternatively collection efficiency or improvement in collection efficiency could be used, as was done quite successfully in Colombia.

⁴⁶ The self assessment model is used in Bogotá, Colombia, where it has resulted in a rapid increase in property taxation revenue. To function it requires the collection of information on property sales, and a visibly unbiased enforcement of sanctions – such as the right for the municipality to purchase a property at 1 or 1.5 times the declared valuation in cases where under-valuation is suspected. Hybrid administration is also possible whereby the traditional property tax register is maintained as a floor, together with self declaration based on market values. Vehorn and Ahmad, 1997.

municipalities since that usually results in poor yields; instead, states can encourage municipalities to join efforts for tax administration. Incentives need to exist however, for states to support property tax collection – for example, by letting them recover a portion of the improved revenues or through a federal program rewarding states most active in their support.

As suggested by Giugale and Webb (2000), there is a clear need for a study on property tax to examine means to improve its administration, create incentives for states to support it, and to better disseminate lessons of the successful cases of property tax administration in Mexico.

4.30 Both on the revenue and expenditure side, a distinction needs to be made across different type of municipalities based on inherent characteristics (size, urban/rural) but more importantly according to capacity. Municipalities' responsibilities and tax collection powers should be increased according to their institutional and administrative capacity. This could be done following an opting-in scheme, whereby municipalities that satisfy certain requirements demonstrating appropriate administrative, financial and institutional capacity can be granted additional resources and responsibilities.⁴⁷ This would have the additional advantage of creating incentives for municipalities to improve administrative capacity.

4.31 Additional measures to strengthen administrative capacity are needed. Training, technical assistance, and legal advice should be organized at state level. This could be provided through a re-tooled INDETEC or through SEDESOL. Finally, and most importantly, it is crucial to remove current institutional barriers to sustained improvements in capacity. In particular, municipal technical staff should not be removed every three years when elected officials are replaced. Creation of a municipal civil service is not necessary – the creation of professional associations (of municipal treasurers and so forth) and the creation of career ladder for municipal employees should suffice.

4.32 The lack of a metropolitan vision calls for the establishment of incentives for interurban cooperation and coordination– such as metropolitan investment funds for transport and other services whose nature requires inter-municipal coordination-- or, if it is politically feasible, the creation of a multipurpose authority (Box 6.) Regardless of the model followed, metropolitan coordination bodies must be given sufficient decision making power and resources.

4.33 In sum, for decentralization to contribute fully to improved urban management, a number of reforms are urgently needed. The principle guiding the process should be the creation of incentives rewarding good management. This entails giving priority to developing an opting-in system that encourages better municipal administration and responsiveness and perhaps other measures promoting good urban management. And it requires urgently creating incentives for states to promote good municipal administration.

⁴⁷ These requirements can be: existence of basic regulations or manuals for administrative procedures and budgeting (a national model can be developed), existence of an up-to-date plan, up-to-date satisfactory audits, etc.

Box 8. The “Metropolitan Problem”

The “metropolitan problem” is the political fragmentation that exists in most metropolitan areas, where anywhere from a dozen to several hundred overlaying jurisdictions of municipalities, school districts and special authorities can coexist. In the US for example, the “average” metropolitan area has a population of 635,000 and 104 local governments (counties, municipalities, townships, school districts, special districts and so forth.)

The creation of a single metropolitan government, through the merging of existing municipalities is rarely the solution. Typically it is very difficult to do because of political and administrative hurdles and takes years to implement. Nor is it more than a stopgap measure: within a few decades or less, population spills over the boundaries of the new entity, tempering whatever success was achieved.

In the US, Canada and Europe, most attempts at major metropolitan reform have failed. Conditioning central government grants on the existence of metropolitan planning and /or the creation of councils of government grouping constituent municipalities has often stimulated more cooperation, but no major restructuring. The response to the metropolitan problem has usually been the creation of a special authority to deal with one aspect of metropolitan governance – transit authority, water basin agencies, etc. This poses problems for services which require close links, such as land-use planning and transportation, housing and finance, social services and housing provision.

One response to the proliferation of single-purpose authorities is to allow states to establish a metropolitan level multi-purpose authority with its own resources, and responsibility for services of metropolitan interest (such as water and sanitation, mass transport, refuse collection, environmental protection.) The metropolitan authority is composed of representatives of constituent municipalities, possibly with an appointed representatives of the state. The drawback of this option is that it reduces accountability to the voters.

The lessons from international experience suggests that no single solution exist, and that typically each city develops its own solution. Choices should be based on an analysis of the costs and benefits of each options, though political feasibility is often the dominant concern. It also shows that the following are necessary for metropolitan solutions to emerge:

- Active participation of higher levels of government: left to their own devices, local governments are unlikely to enter into cooperative agreements – particularly not those that impose redistributive taxes on their own residents;
- Exclusive powers, veto rights and access to a secure funding base for the metropolitan authority(ies) created, whatever its/their form;
- Flexibility in the strategy adopted -- but within a context of known rules.

Sources: Bourne (2001); Stephens and Wikstrom (2000.)

V. CONCLUSIONS AND POLICY IMPLICATIONS

5.1 The urban strategy for Mexico should be three-pronged. One prong should address the **institutional and regulatory problems** that hamper good urban management. This will help all municipalities and is largely a federal responsibility. A second prong should focus on **urban poverty**. This needs to be federally driven, but actively involve municipal and state government in the design and implementation of programs. The third prong needs to tackle the problems of **cities that are of prime importance** within the country's urban system. These are the fast growing cities – medium size towns where jobs are being created, and which are encountering problems of congestion, pollution, increased concentration of poverty and irregular settlements – but also the country's historical population centers (Mexico City, Guadalajara and Monterrey) where a quarter of the country's population is still concentrated.

5.2 Federally driven institutional reform should focus on the decentralization framework to clarify, expand or consolidate municipal responsibilities for urban management, with particular emphasis on the creation of instruments (financial and institutional) to tackle metropolitan issues. It also requires the improvement of the states' legal framework for private participation in infrastructure. Equally important is the reform of the housing finance system to open up access to formal housing to a greater share of the population and contribute to renewal of central cities. The World Bank is currently collaborating with the Mexican government on a study on these issues (World Bank, 2001a.) Concerning urban poverty, urgent work is needed to develop a clear vision of what needs to be done for the urban poor – particularly the extreme poor.

5.3 The Government has started developing an urban poverty program. To be effective such a program will need to help the poor develop their **assets** (housing and human capital), improve their income earning capacity and overall security (financial and physical.) This entails a combination of general purpose measures (improved land management and urban transport, reform of the housing, housing finance and social insurance systems) and interventions specifically targeted towards the poor (slum upgrading, the ongoing expansion of OPORTUNIDADES in urban areas, developing workfare, training and school-to-work programs, and subsidized community child care.) It may also require revisiting the current allocation of targeted spending between urban and rural poor.

5.4 As to interventions to help specific cities, they should certainly result from joint local and federal efforts, and probably include states. Current knowledge about the typology of fast growing cities and historical population centers, suggest the interventions would need to address the following problems:

- **In the older mature cities which are not growing fast but are very important in terms of population, assets and output** (Mexico City, Monterrey and Guadalajara), there is a need to address the problem of decaying city centers, manage traffic and pollution and generally cope with

congestion and poverty – the negative externalities associated with size. This will require developing a metropolitan management system since in Mexico City and Guadalajara in particular congestion issues spans several municipalities. Lending for used housing and efforts to develop rental markets could help reverse the outflow of population away from central districts and do much to alleviate problems of traffic and pollution. In addition, these cities are in a transition phase, concerning their economic and productive roles. Their fate is to lose their manufacturing bases, so their future growth is predicated upon positioning themselves as centers for services and innovative industries. They also have an important role to play in linking the country with the rest of the world. In all three cases, there is scope for innovative local economic development strategies and improving the business environment – the business climate of Jalisco, Nuevo Leon and Federal District are ranked as 8th, 24th and 32nd (or absolute worst) among Mexico's constituent entities.

- In the **fast growing large and medium manufacturing towns of the north and the center**, investments are needed to handle rapid growth and tackle emerging congestion, environmental and social problems that could preclude further growth. A recent survey in Chihuahua shows that for small and medium scale enterprises the binding constraint currently is infrastructure, while recent press coverage in the US emphasized the water issues and lack of appropriate housing in the fast growing border towns. In addition, private sector development analysts expressed the fear that the maquiladoras of the North may be going the Puerto Rico route (low skill, low wage activities in an enclave model) developed in isolation from the rest of the economy. This suggests the need for local economic development strategies to foster local linkages.
- In the **tourism cities** such as Cancun, and Puerto Vallarta, the priority should be infrastructure to protect their fragile ecological environment, and managed growth plans.
- As to the **southern capital cities**, their growth appears to be driven more by a lack of opportunity in the surrounding country side than by a dynamic private sector. A local economic strategy for them could help assess their potential .

5.5 These suggestions could help ensure the urban strategy is well aligned with the country's National Development Strategy whose central criteria are inclusion, sustainability, competitiveness and regional development. Table 14 below summarizes these recommendations, separating them according to short, medium and long term feasibility.

Table 14. Time horizon for policy recommendations

<i>Axes of intervention</i>	Short term	Medium Term	Long term
1. INSTITUTIONAL AND REGULATORY REFORM			
a. Revisit decentralization framework	<ul style="list-style-type: none"> • Clarify responsibilities of state and municipalities through budget law • Eliminate separate responsibilities for construction and maintenance • Grant municipalities exclusive competence for municipal management • Develop opting in scheme granting more responsibilities to municipalities that respect minimum reporting standards • Set national standards on very limited exemptions for property tax and publication of exemptions • Study on property tax 	<ul style="list-style-type: none"> • Decentralize authority for ejido conversion to the states • Legal change to make transfers and grants conditional upon the receipts of budgets and audited accounts • Explore and disseminate best practice on property tax drawing on domestic and international experience (self reporting in Mexico, simplified fiscal cadastres.) • Create incentives for states to support improved property tax, develop demand driven TA (for fiscal, financial and managerial issues) • Create professional association and career ladders for municipal technical staff • State/federal government to develop single or multipurpose authorities for large metro areas 	<ul style="list-style-type: none"> • Electoral reform to eliminate restriction on consecutive terms for mayors and/or allow for direct election
b. Improve regulatory environment for PPI in urban services	<ul style="list-style-type: none"> • Central government guidelines for concessions • Create incentives for municipal PPI (possibly through BANOBRAS) 	<ul style="list-style-type: none"> • Technical support and training to states and municipalities for concession design and regulation • Develop state level regulatory agencies 	<ul style="list-style-type: none"> • Sector reform (especially for water.)
c. Reform land and housing system	<ul style="list-style-type: none"> • Lower subdivision standards • Study on how to revitalize the rental market 	<ul style="list-style-type: none"> • Develop lending for used housing • Improve foreclosure capacity • Streamline development process • Implement measures to revitalize rental market 	<ul style="list-style-type: none"> • Implement measures to revitalize rental market

Axes of intervention	Short term	Medium Term	Long term
2.	URBAN POVERTY PROGRAMS		
a. Measures to develop assets of the poor	<ul style="list-style-type: none"> • Same as 1.c • Expand PROGRESA's reach in urban areas • Base allocation of FAIS/FISM on location neutral indicators 	<ul style="list-style-type: none"> • Same as 1.c • Develop national slum upgrading program 	
b. Measures to improve income, earning capacity of the poor		<ul style="list-style-type: none"> • Redesign PROBECAT to improve its training impact • Develop training programs for school leavers and school drop-outs • Expand childcare options, private and public • encourage formalization of informal sector • strengthen link btw payroll contribution and subsequent benefits • Develop workfare programs • Develop programs to address urban violence, especially targeting youths at risk 	
c. Measures to improve security of the poor	<ul style="list-style-type: none"> • Continue reforms to extend IMSS/ISSSTE to informal sector • Subsidize and promote creation of community space in poor neighborhoods 		
3. City specific problems for fast growing cities and major population centers	Develop city specific strategy and action plan for : <ul style="list-style-type: none"> • Historical population centers (MX city, Monterrey Guadalajara) • Fast growing large and medium manufacturing towns of north and center • Tourism cities (Cancun, Puerto Vallarta) • Southern capital cities 		

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ANNEX I: THE FAST-GROWING LARGE AND INTERMEDIATE CITIES OF MEXICO,**1995-2000**

	2000 Populatio (in Mn)	Average annual population growth 1995-2000, (%)
MÉXICO CITY BELT		
ZM Toluca, México	1.25	3.17%
ZM Cuautla, Morelos	0.26	4.98%
CENTER		
ZM Puebla-Tlaxcala	2.30	10.01%
Queretaro, Queretaro	0.79	3.12%
Aguas Calientes, Aguas Calientes	0.70	2.17%
ZM Poza Rica, Vera Cruz	0.44	12.38%
Jalapa, Vera Cruz	0.42	2.56%
Pachuca de Soto, Hidaigo	0.29	3.04%
Colima, Colima	0.21	2.48%
Guanajuato, Guanajuato	0.14	2.04%
Manzanillo, Colima	0.12	2.49%
BORDER		
Ciudad Juárez, Chihuahua	1.22	4.08%
Tijuana, Baja California	1.20	4.44%
Matamoros, Tamaulipas	0.42	2.91%
Reynosa, Tamaulipas	0.40	4.91%
Ensenada, Baja California	0.37	3.44%
Nuevo Laredo, Tamaulipas	0.31	2.66%
Monclova, Coahuila	0.28	2.28%
<i>Nogales, Sonora</i>	0.16	3.84%
Piedras Negras, Coahuila	0.13	2.02%
<i>Ciudad Acuna, Coahuila</i>	0.11	7.06%
SOUTH		
ZM Villa Hermosa, Tabasco	0.60	2.49%
ZM Oaxaca de J, Oaxaca	0.47	3.85%
Tuxla Gutierrez, Chiapas	0.43	2.46%
Cancún, Quintana Roo	0.40	6.92%
Tapachula, Chiapas	0.24	2.15%
San Cristóbal de las Casas, Chiapas	0.13	2.67%

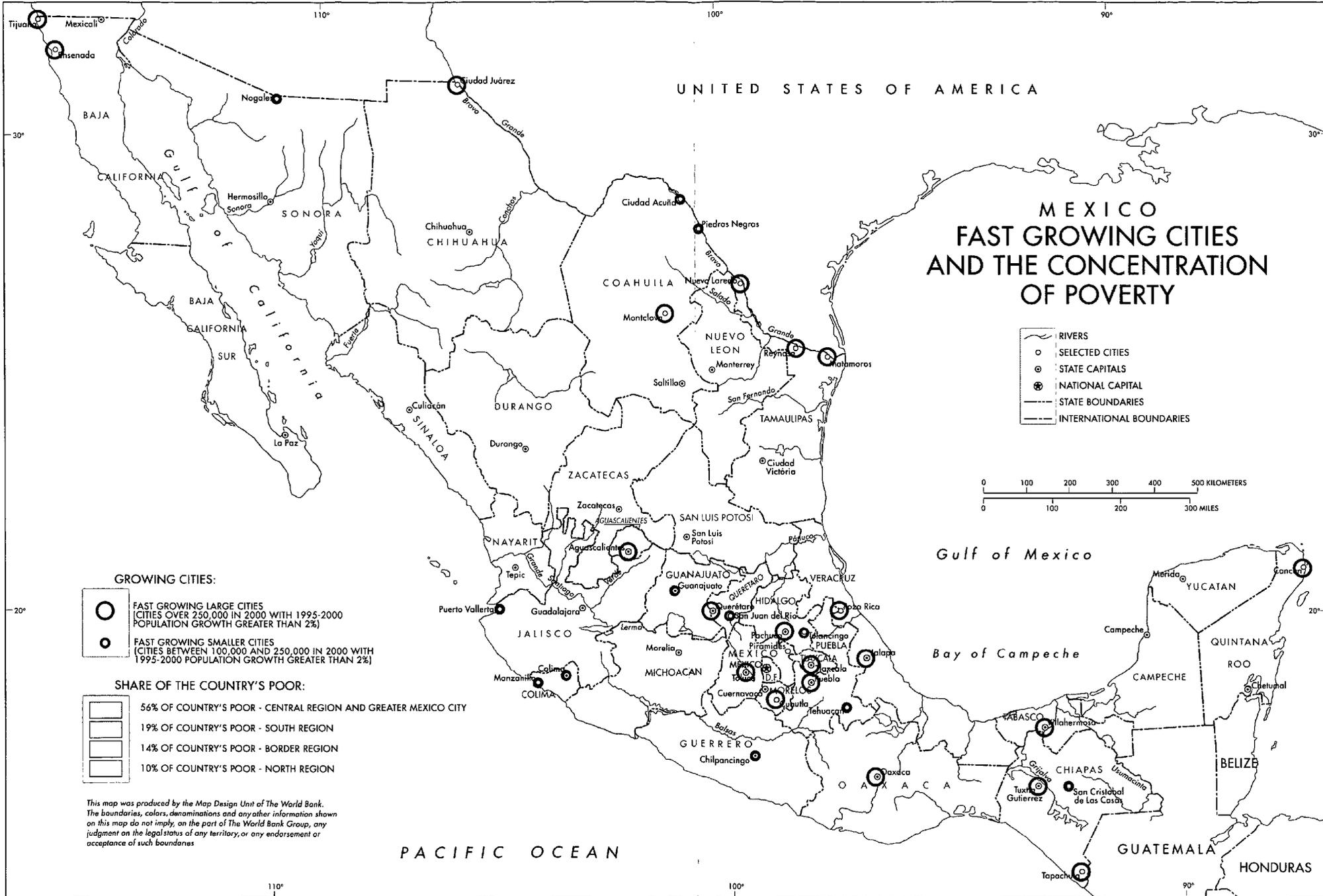
Memo item: Based on an analysis of all cities with population of more than 250,000 in 2000. The average population growth rate of these cities between 1995 and 2000 was 1.96%. The slower growing important cities (population above 750,000) are: the ZM of Mexico (pop. 17.8 Mn, growth rate: 1.33% p.a.); Guadalajara, Jal (3.7 Mn, 1.2 p.a.); Monterrey, N.L. (3.3 Mn, 1.66% p.a.); León, Gto. (1.3 Mn, 1.77% p.a.); Torreón-Gomez Palacios, Dgo. (0.91 Mn, 1.00%); San Luis Potosí, S.L.P. (0.85 Mn, 1.72% p.a.); Merida, Yuc. (0.85 Mn, 1.75 p.a.) and Tampico, Tmps (0.76 Mn, 1.1% p.a.). **Source:** INEGI 1997 and 2000.

ANNEX II: STATE BUSINESS CONDITIONS AND FAST GROWING CITIES

	Business Climate Ranking	State GDP growth (1988-98)	State pop. growth (net migration 1995-2000)	State GDP per capita growth	Fast Growing Cities (with population over 100,000 in 2000)
BORDER					
Baja California	4	+++	+++	+++	Tijuana, Ensenada
Chihuahua	2	+++	++	+++	Ciudad Juárez
Coahuila	12	++	0	++	Monclova, Cd Acuna, Piedras Negras
Nuevo Leon	24	++	+	++	
Sonora	13	++	0	+	Nogales
Tamaulipas	14	++	++	++	Matamoros, Reynosa, Nuevo Laredo
NORTH					
Durango	21	++	--	++	
Nayarit	29	0	-	0	
San Luis Potosi	30	+	-	+	
Sinaloa	26	+	-	+	
Zacatecas	19	0	-	-	
CENTER					
Aguas Calientes	1	+++	++	+++	Aguas Calientes
Colima	5	++	+	++	Colima, Manzanillo
Guanajuato	6	++	0	++	Guanajuato
Hidalgo	20	0	0	0	Pachuca de Soto
Jalisco	8	+	0	+	Puerto Vallarta
Michoacan	15	+	-	++	
Puebla	16	++	-	++	Puebla-Tlaxcala
Queretaro	3	+++	+++	+++	Querétaro
Tlaxcala	9	+	+	+	ZM Puebla-Tlaxcala
Vera Cruz	7	0	---	-	Jalapa, Poza Rica
MEXICO CITY BELT					
Morelos	10	++	++	++	Cuatla
México	25	+	++	-	Toluca
Federal District	31	++	---	++	
SOUTH					
Campeche	23	-	0	-	
Chiapas	32	+	-	+	Tuxtla-Gutierrez, Tapachula, San Cristóbal de las Casas
Guerrero	28	+	---	+	Chilpancingo
Oaxaca	18	+	--	+	Oaxaca
Tabasco	22	-	-	-	Villahermosa
TOURISM					
Baja California Sur	27	+++	++	++	
Quintana Roo	11	+++	+++	+++	Cancún
Yucatan	17	++	0	++	

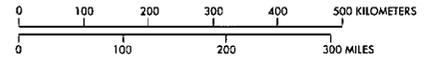
Highlighted are the four fastest growing states, which are also the four with the best business environment ranking. Sources: Business climate ranking and state GDP per capita growth from XX quoted in Kuznetsov (2000) State population growth from 2000 census. For GDP growth, +++ is for annual GDP growth greater than 6% p.a. over 1988-98; ++ for growth between 4 and 6%; + for growth between 2 and 4%; 0 for growth between 0 and 2%; - for negative growth. For GDP per capita growth, +++: >4%; ++: 2-4%; +: 0.75 to 2

MAP SECTION



MEXICO FAST GROWING CITIES AND THE CONCENTRATION OF POVERTY

- RIVERS
- SELECTED CITIES
- STATE CAPITALS
- NATIONAL CAPITAL
- STATE BOUNDARIES
- INTERNATIONAL BOUNDARIES



- GROWING CITIES:**
- FAST GROWING LARGE CITIES
(CITIES OVER 250,000 IN 2000 WITH 1995-2000 POPULATION GROWTH GREATER THAN 2%)
 - FAST GROWING SMALLER CITIES
(CITIES BETWEEN 100,000 AND 250,000 IN 2000 WITH 1995-2000 POPULATION GROWTH GREATER THAN 2%)
- SHARE OF THE COUNTRY'S POOR:**
- 56% OF COUNTRY'S POOR - CENTRAL REGION AND GREATER MEXICO CITY
 - 19% OF COUNTRY'S POOR - SOUTH REGION
 - 14% OF COUNTRY'S POOR - BORDER REGION
 - 10% OF COUNTRY'S POOR - NORTH REGION

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IMAGING

Report No.: 22525 ME
Type: SR