

Public Disclosure Authorized

Report No. 37324-BR

Brazil

São Paulo: Inputs for a Sustainable Competitive City Strategy

(In Two Volumes) Volume I: Main Report

March 10, 2007

Finance, Private Sector and Infrastructure Management Unit
Latin America and the Caribbean Region

Public Disclosure



Public Disclosure Authorized

Public Disclosure Authorized

Document of the World Bank

CURRENCY EQUIVALENTS

Currency Unit - Real (R\$)

EXCHANGE RATE

February 28, 2007 – R\$2.10 = US\$1

WEIGHTS AND MEASURES

Metric System

FISCAL YEAR

January 1 – December 31

Acronyms and Abbreviations

CDHU	Companhia de Desenvolvimento Habitacional e Urbano	Housing and Urban Development Company of the State of São Paulo
CDTI	Comitê Diretor de Transporte Integrado	Integrated Transport Administration Committee
EMURB	Empresa Municipal de Urbanização	Municipal Urbanization Company
FRL	Lei de Responsabilidade Fiscal	Fiscal Responsibility Law
IBGE	Instituto Brasileiro de Geografia e Estatística	Brazilian Institute for Geography and Statistics
ICA	Relatório sobre o Clima de Investimentos	Investment Climate Assessment
ICS	Pesquisa sobre o Clima de Investimentos	Investment Climate Survey
ICMS	Imposto sobre Circulação de Mercadorias e Serviços	State Sales Tax
IFC	Corporação Financeira Internacional	International Finance Corporation
IGP-DI	Índice Geral de Preços – Disponibilidade Interna	General Price Index – Domestic Availability
IPEA	Instituto de Pesquisa Econômica Aplicada	Institute for Applied Economic Research
ISO	Organização Internacional de Normalização	International Organization for Standardization
MRSP	Região Metropolitana de São Paulo	Metropolitan Region of São Paulo
MSP	Município de São Paulo	Municipality of São Paulo
PAR	Programa de Arrendamento Residencial	Housing Leasing Program
PHRD	Desenvolvimento de Recursos Humanos e Políticas Públicas	Policy and Human Resources Development
PNAD	Pesquisa Nacional por Amostra de Domicílios	Brazilian Household Survey
PPA	Plano Pluri-Anual	Multi-Year Plan
PPP	Parceria Público-Privada	Public-Private Partnership
SABESP	Companhia de Saneamento Básico do Estado de São Paulo	Sewerage Company of São Paulo State
WSS	Provisão de água e saneamento básico	Water supply and sanitation
ZEIS	Zonas Especiais de Interesse Social	Zones of Special Social Interest

Vice President:	Pamela Cox
Country Director:	John Briscoe
Sector Director:	Laura Tuck
Sector Manager:	John Harry Stein
Sector Leader:	Jennifer Sara
Task Managers:	Jose Guilherme Reis and Mila Freire

ACKNOWLEDGEMENTS

The “São Paulo: Inputs for a Sustainable Competitive City Strategy” report was prepared under the Task Management of José Guilherme Reis and Maria Emilia Freire based on contributions from a team of Bank staff and consultants, named below.

Volume I

- José Guilherme Reis.

Volume II

- Chapter 1: Tito Yepes;
- Chapter 2: Fernando Blanco;
- Chapter 3: José Guilherme Reis, Mariam Dayoub and Monica Romis;
- Chapter 4: David le Blanc;
- Chapter 5: Tito Yepes, André Herzog and Monica Romis;
- Chapter 6: José Guilherme Reis.

Natalie Palugyai contributed to the editing of the report. The team would like to thank the peer reviewers Ellen Hamilton, Christine Fallert Kessides, and Jose Luis Guasch for providing important and insightful comments. The report also benefited from helpful inputs from Makhtar Diop, Jack Stein, Susan Goldmark, Marianne Fay, Ethan Weisman, Jennifer Sara, Martin Gambrell, Bernice K. Van Bronkhorst, Jorge Rebelo, and Daniel Hoornweg.

The background papers prepared for this report include Urani, A. “Novas Estruturas Institucionais para a Governança da Região Metropolitana de São Paulo”; and, Biderman, C., and T. Yepes “Returns to Scale and Location of Economic Activities in Brazil.”

The team acknowledges the important contributions received from government officials in São Paulo, especially from Francisco Luna, Planning Secretary, and his successor Manuelito Pereira Magalhães Júnior and from Geraldo Biasoto, Vice-President of EMURB. Javier Toro, from the Planning Secretariat, provided invaluable support. The team also benefited from insights provided in an international meeting organized by the World Bank in São Paulo in April 2006 and from comments received in a meeting organized by the Planning Secretariat in São Paulo in December 2006.

The findings and views expressed here are exclusively those of the World Bank and neither represents the views of the government of São Paulo nor of the federal government.

São Paulo: Inputs for a Sustainable Competitive City Strategy

Table of Contents

Executive Summary	3
I. Tools to Reach a Sustainable Competitive City: The Fiscal Context	6
II. City Competitiveness and Business Environment	7
III. Service Delivery: The Housing Sector	11
IV. Partnerships	13

List of Figures

Figure 1. Brazil and selected metropolitan regions: unemployment rate, 1992-2004 (percent).....	3
Figure 2. Selected metropolitan regions in Brazil: poor population as a share of total population, 1992-2004 (percent)	3
Figure 3. Brazil, São Paulo state, and MRSP: index of industrial GDP, 1970-2000 (1970=100)...	4
Figure 4. Change in manufacturing GDP by city size, 1970-2000 (percent)	4
Figure 5. Services sector: change in shares in value-added by skill level, 1991-2000 (percent)	4
Figure 6. Services sector: change in job shares by skill level, 1991-2000 (percent).....	4
Figure 7. Investment climate <i>versus</i> Location factors	9

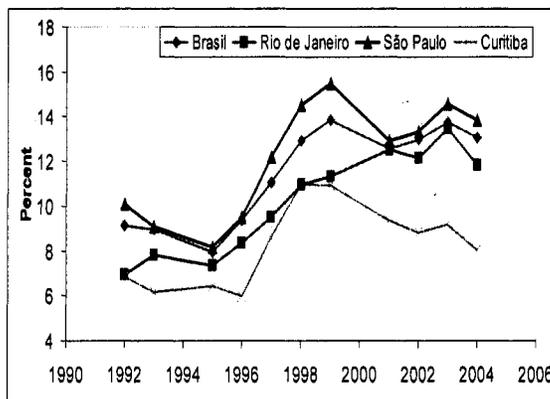
List of Boxes

Box 1. World Bank Support to Strengthen Public Sector Management in São Paulo.....	7
Box 2. World Bank Support to Reduce Crime and Violence in Brazil	10
Box 3. Housing and the World Bank in São Paulo.....	13
Box 4. Water and Sanitation and the World Bank in São Paulo	15

Executive Summary

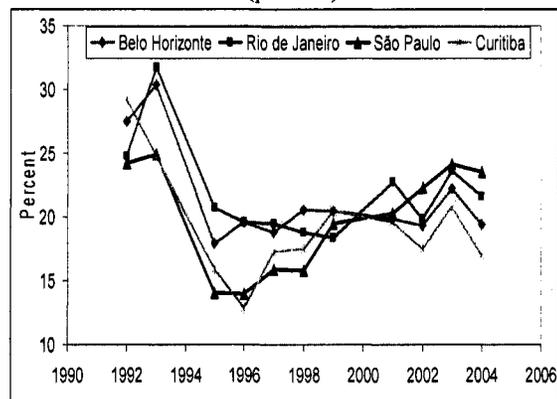
1. **The Metropolitan Region of São Paulo (MRSP), the largest in South America, with 19.1 million people living in 39 municipalities, is facing the challenge to achieve higher rates of growth and standards of service delivery under severe fiscal constraints.** Rapid urbanization, and a process of deindustrialization and economic stagnation, resulted in a region afflicted by social problems, including rising unemployment, crime, and a limited capacity to face competition from other areas with regards to attracting investment. Although these problems are common to other metropolitan regions in Brazil, some of the most important indicators have been more negative in the MRSP than for the other regions (Figures 1 and 2). Of the 26 metropolitan regions in Brazil, the MRSP has the highest population density (2,245 inhabitants per km²), the highest prices for housing rental, the fourth highest share of population living in slums (9 percent), and the fifth highest share of population living in informal housing (16 percent) (Cities Alliance, 2004).

Figure 1. Brazil and selected metropolitan regions: unemployment rate, 1992-2004 (percent)



Source: Based on PNAD/IBGE.

Figure 2. Selected metropolitan regions in Brazil: poor population as a share of total population, 1992-2004 (percent)



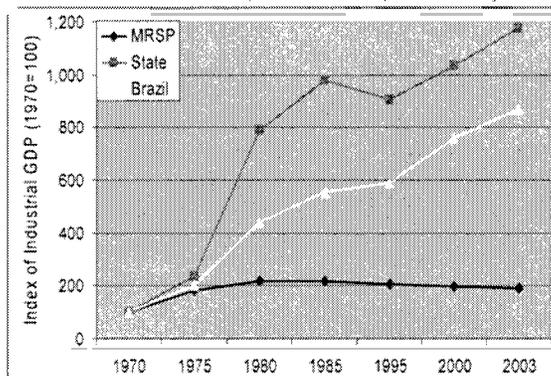
Source: Based on PNAD/IBGE.

2. **The manufacturing sector suffered the most drastic changes.** Signs of sluggish growth and structural transformation in São Paulo started after 1970. From that point on there has been a decline in the MRSP's share of Brazilian manufacturing from 40 percent of GDP in 1970 to less than 20 percent in 2001. Firms in the MRSP did not move out massively, but their production did not grow as much as in other areas. Between 1970 and 2003, real production in Brazilian industry grew nearly 6.8 percent per year in areas outside of the state of São Paulo, 7.7 percent per year in the rest of the state excluding the MRSP, and only 2.0 percent per year in the MRSP (Figure 3). The loss in manufacturing in the MRSP was absorbed by smaller areas in the country as a whole: (a) areas with less than 1 million inhabitants increased their share by 10 percent, (b) areas with 1 to 2 million inhabitants increased by 7 percent, and (c) areas with 2 to 3 million inhabitants increased by 6 percent. The same pattern is observed among all other Brazilian metropolitan areas, with the exception of Curitiba, which increased its share from 1.3 percent in 1970 to 3.3 percent in 2000 (Figure 4).

3. **It is not yet clear to what extent São Paulo is transforming itself into a non-manufacturing city.** An exercise using data for 1970 and 2000 shows that MRSP's participation in non-manufacturing production dropped in real terms from 21 percent to 18 percent, with this difference being absorbed by smaller population agglomerations. In the MRSP, the service sector

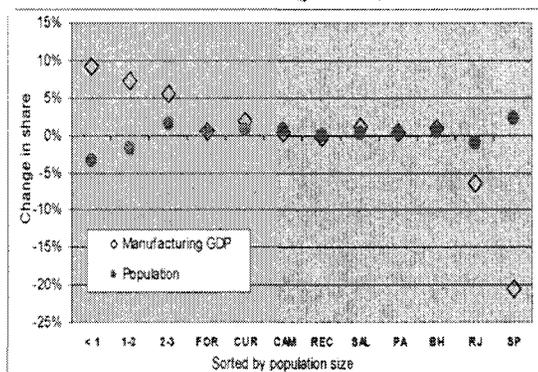
is replacing manufacturing in terms of job creation, especially in business services. Figures 5 and 6 show service industries divided into two groups: (a) business services (e.g., finance, insurance, real state, software, and consultancy), and (b) personal services (e.g., lodging, restaurants, and entertainment).¹ In terms of jobs, business services are the only aggregate sector in which the MRSP actually increased its proportion during 1991-2000. The share of jobs in personal services for the MRSP decreased by more than 1 percent during the same period.

Figure 3. Brazil, São Paulo state, and MRSP: index of industrial GDP, 1970-2000 (1970=100)



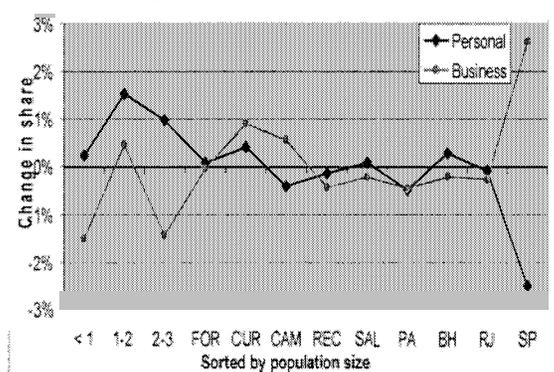
Source: Based on IPEA data.

Figure 4. Change in manufacturing GDP by city size, 1970-2000 (percent)



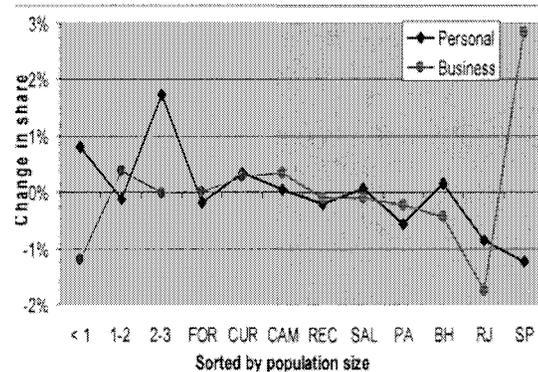
Source: Based on IPEA data.

Figure 5. Services sector: change in shares in value-added by skill level, 1991-2000 (percent)



Source: Based on data from the Brazilian Ministry of Labor.

Figure 6. Services sector: change in job shares by skill level, 1991-2000 (percent)



Source: Based on data from the Brazilian Ministry of Labor.

4. **This study explores the different inputs that could set in motion a successful recovery strategy for the MRSP, in which the recuperation of economic growth and the delivery of high-quality services are central.** This study first presents the underlying factors of the economic transition and challenges in the MRSP; second, it offers inputs for a successful recovery strategy for the MRSP and the Municipality of São Paulo (MSP), comprised of four key areas: (a) fiscal performance and creditworthiness, (b) competitiveness and the investment climate, (c) institutional partnerships, and (d) services delivery. Lastly, it presents a policy agenda that brings together the key recommendations from each of the four recovery strategy areas.

¹ In 2000, the approximate number of jobs per sector in the MRSP was: (a) manufacturing (915,000), (b) business services (1 million), and (c) personal services (550,000).

5. **Besides the presentation of new evidence on the investment climate in São Paulo, its relationship with the current economic trends in the region, and an in-depth analysis of a specific area of service delivery (i.e., the housing sector), the contribution of this study is to attempt integrating these different areas into a long-term view of the metropolitan region's development.** Besides analyzing specific areas, including the fiscal performance, this report aims at providing an integrated view of the challenges and opportunities faced by the municipality and the metropolitan region. It must be acknowledged, however, that there are important aspects not covered by the report. Relevant areas of service delivery, like security and transport, are not analyzed. In addition, important short- and medium-term issues for the MRSP, like fostering job creation and sector specific targeted policies, are not discussed.

6. The critical messages of this report are:

- **The MRSP is not a degraded or decadent area, but rather a transforming metropolitan region. All cities go through periods of crisis and seeming rebirth and São Paulo has many ways to overcome the current situation.**² Like in other large metropolises, there is a deindustrialization process, only partially replaced, so far, in the case of the MRSP, by other sectors. The drop in manufacturing employment is not explained by an exodus of firms from the MRSP, but predominantly by the reduction of jobs in incumbent firms and by closings of firms. Global experience shows that firms keep their headquarters or high-skilled workers in their original cities rather than relocating them into new industrial centers and São Paulo, representing a concentration of the headquarters of most large firms in the country, has not been different. The city and the metropolitan region have to focus on qualitative growth, pursuing increased productivity, reinforcing policies supporting its main assets, including infrastructure and innovation, and attracting firms that demand high-skilled workers.³

- **In order to achieve faster growth and excellence in service delivery, São Paulo has to reinvent its institutions.** The experiences of large cities around the world suggest that it is crucial to develop a common long-term vision for the city and the metropolitan region. Implementing a coherent strategy for the development of a metropolitan region requires a collaborative framework. In the specific case of services delivery, the city and the other actors of the metropolitan region can reinforce and create new mechanisms of metropolitan governance in order to achieve increased coordination. There is a wide array of policy, legal, and institutional innovations available to promote inter-governmental cooperation, public-private partnerships, and more accountable and transparent governments. In a context of fiscal constraint and increasing demand pressures, coordination with other public agents and private sector participation are crucial.

- **São Paulo needs to pursue a solid fiscal adjustment and commit to recover creditworthiness.** In spite of the size of its debt, the municipality of São Paulo is in a position to manage it – between January 2005 and June 2006 the level of net debt was brought down from 226 percent to 206 percent of net current revenues without any tax increase. Deepening fiscal controls will allow the city to reach manageable levels of indebtedness, without incurring excessive cuts on either social spending or investments. If the Brazilian economy could achieve a

² Glaeser (2005a, 2005b).

³ The Municipality of São Paulo is one of the pilot cities in the World Bank's city indicator program (along with Belo Horizonte, Bogotá, Cali, Montreal, Porte Alegre, Toronto, and Vancouver). The indicators will measure performance of service delivery and quality of life in a manner that facilitates global comparisons across cities and over time. The first set of indicators will be piloted in 2007. São Paulo already has extensive information on city indicators, which will be incorporated into the proposed indicators.

period of sustained growth at rates higher than those obtained in the last two decades, this would help the city to manage its fiscal situation, provided a sound combination of expenditure control and revenue increases is maintained and deepened.

- **Finally, working on the investment climate to attract new businesses is a key factor for the city and the metropolitan region to recover higher growth rates.** Evidence examined in this report provides a roadmap for interventions in this area. One of São Paulo's main assets is its high stock of capital, both human and physical, that appropriately explored can continue to attract highly productive firms. Furthermore, high-quality infrastructure intersects with the advantage of São Paulo's location, marked by proximity to domestic consumers, suppliers, and the main Brazilian port. There is, however, room to enhance the business climate: a recent survey from the World Bank Group ranks São Paulo 11th out of 13 large Brazilian cities in terms of the ease of doing business. Soft infrastructure is perceived as a disadvantage of being located in the MRSP. Specifically, the need for more agility in public services provision, such as the time and cost of opening a firm, simplification of tax payments and property rights are mentioned as areas for improvement. Finally, along with this soft infrastructure side, there is the challenge of safety and security, as high level of crime is perceived as the second main disadvantage of locating in the metropolitan region.

In summary, there is no single solution that provides a magic bullet for solving São Paulo's challenges. Rather, a multi-track, integrated, sustained set of actions is needed, complemented by a new partnership process with key actors. The following paragraphs summarize the four key areas for the MRSP's recovery strategy.

I. Tools to Reach a Sustainable Competitive City: The Fiscal Context

7. **The MSP has a high level of indebtedness that has been limiting its capacity to provide goods and services to the population.** Public policy challenges are increasing given the concentration of low-income groups (with higher needs for social and urban services). Tax revenues per capita grew only 0.8 percent per annum in real terms between 1995 and 2004. This low growth was not compensated by other fiscal revenues, since total revenues grew 0.6 percent per annum in real terms over the same period. At the end of 2005, net consolidated debt was equal to 223 percent of net current revenues, far above the Fiscal Responsibility Law (FRL)⁴ ceiling of 174 percent, which needs to be reduced to 120 percent of net current revenues by 2016. With high population density that characterizes São Paulo, there is a large demand for municipal expenditures in transportation, water and sewage, housing, waste management, and urban infrastructure services in general. Thus far, the municipality has not been able to appropriately supply these demands.

Policy Recommendations

8. **The municipality faces the challenge of implementing a strong fiscal adjustment, while having to maintain minimum levels of public services and investment.** The city needs to go to the root causes of the fiscal crisis and adopt a permanent, sustainable fiscal approach. Projection exercises show that, albeit not easy to implement, this is feasible: the city can reach the FRL ceiling and yet have the level of primary expenditures in 2005 and onward higher than in 2000. This could potentially permit the municipality to maintain minimum investments in urban infrastructure, even acknowledging the changes in the quantity, quality and coverage of the public services currently provided by the Municipality. Cities such as Barcelona, New York, and

⁴ Complementary Law No. 101/2000.

Philadelphia followed this path, and turned themselves into more competitive cities. The fiscal accounts of the MRSP's municipalities present a different, more positive trend than the one observed for the Municipality of São Paulo: in terms of indebtedness, of the 39 municipalities that comprise the MRSP, only the Municipality of São Paulo is above the legal ceiling set by the FRL.

9. **Maintaining and improving São Paulo's favorable endowment of infrastructure is essential.** Implementing the fiscal adjustment while maintaining investments in urban infrastructure is the main challenge. Although investment in infrastructure can be achieved through private sector participation, the public sector remains essential, especially in some key areas, such as housing and transportation. However, the focus of public expenditures in infrastructure should be on quality, rather than on quantity. Given the financial constraints, it is imperative to enhance municipal expenditure management through the strengthening of the municipal planning system and the World Bank has already begun to support such efforts (Box 1).

Box 1. World Bank Support to Strengthen Public Sector Management in São Paulo

The activities under the Technical Assistant non-lending activity "Strengthening the Planning Capacity of the Municipality of São Paulo" supported the preparation of the São Paulo Multi-Year Plan (*Plano Pluri-Annual*, PPA) 2006-2009. This was done through training of SEMPLA staff and the staff in other sector Secretariats involved in PPA preparation and the design of a methodology for coordinating the central planning unit and line Secretariats. The PPA preparation process for the Municipality of São Paulo showed the limitations in the existing planning, budgetary, and expenditure execution instruments.

A second group under actions of the Technical Assistant activity focused on the preparation of analytical studies to evaluate the municipally planning system and proposed a set of measures to strengthen it. In particular, the following six areas for improvements were identified: (a) structuring the institutional channels of coordination between the central command of the municipal planning system and the execution units, (b) enhancing the planning capacity of the line Secretariats, (c) improving the integration between planning, budgeting, and expenditure execution, (d) strengthening information systems, (e) defining the core of strategic programs described in the PPA, and (f) building up monitoring and evaluation systems.

II. City Competitiveness and Business Environment

10. **What are the main strengths and weaknesses of the MRSP in terms of attracting new private investments?** What do municipal governments have to focus on in order to raise the competitiveness of the MRSP? This study tries to answer these questions using both econometric models and tested surveys carried out by the World Bank Group, like the Doing Business and the Investment Climate Survey (ICS). Responses from a follow-up survey (Location Factors Survey 2006) with 447 manufacturing firms selected among the 1,642 firms interviewed for the Brazil ICS carried out in 2003 were also used. Firms were interviewed using a computer-assisted telephone interview system. The methodology is reported in Annex 1 of Volume II.

11. **Connectivity is the main advantage of the MRSP. When asked about the advantages of their location, the majority of surveyed firms in the MRSP mentioned proximity to markets and infrastructure.** Considering the importance given to proximity to consumers and suppliers, the emphasis on infrastructure is possibly related to transportation and communications services (i.e., "connectivity"). Infrastructure is seen as an asset by firms located inside the metropolitan region, and the Investment Climate Assessment (ICA) indicators of infrastructure quality confirm this positive view. In addition, both the MSP and the MRSP have many location assets to attract private investments: (a) favorable geographic location, (b) they are a natural hub for air transportation, (c) they are close to the main Brazilian port (Santos), and (d) they are close

to agricultural and manufacturing production. This is recognized by entrepreneurs, since the state and the city of São Paulo were ranked first as the best state and city, respectively, to do business in Brazil (as shown by the Location Factors Survey 2006 with 447 manufacturing firms spread over four distinct regions).

12. **The MRSP is facing problems in certain dimensions of “soft” infrastructure, notably in business regulation; thus, the road map for action should include short-run measures to improve several areas of business regulation in the MRSP.** Compared with other cities in the world and within Brazil, São Paulo performs poorly in terms of the ease of doing business – it was placed 11th among 13 Brazilian state capitals. This low rank is related to: (a) the length of time required to open a business in São Paulo (152 days, which is, for example, 8 times the length of time it takes to accomplish this same task in Belo Horizonte), (b) the difficulty of paying taxes in the city (São Paulo is the city ranked 2nd in terms of how complicated it is to file tax forms), and (c) the procedural complexity for enforcing contracts (São Paulo imposes the 2nd largest burden on entrepreneurs). In addition, the ICS-2003 shows that a significantly higher share of firms in the MRSP ranks the government in the provision of public services as “inefficient” when compared to other regions. Thus, one measure likely to yield results quickly is the initiative to reduce the number of days to start a business in São Paulo city – given that municipal requirements are the most onerous in the process of opening a business in Brazil. With the support of the International Finance Corporation (IFC), the municipality is currently carrying out a program to reduce transaction costs of formality for firms by diminishing time and requirements for operational and construction licenses.⁵

13. **The MRSP has a comparative advantage when skills and technology are considered.** The share of workers with college degree in firms located in the MRSP is significantly higher than among firms not located in this region. The same is true for the share of workers who frequently use computers to perform their duties. Although the quality of the labor force is an important feature of the MRSP, it was not among its top five location factors; however, infrastructure was ranked 2nd, and was also considered the 3rd main advantage for firms locating in the MRSP. Finally, an econometric exercise showed that proximity to suppliers, the quality of the labor force, and urban infrastructure are the main drivers of firm’s productivity in the MRSP.

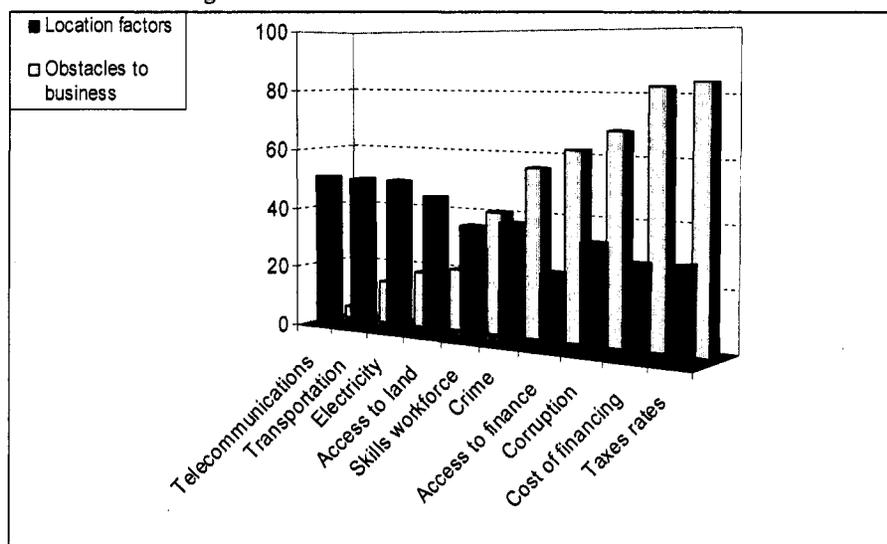
14. **Infrastructure is the factor that most affects firm location decisions and São Paulo provides infrastructure of higher quality when compared to other regions in the country.** When the quality of infrastructure services was analyzed (as the share of total sales lost due to infrastructure services outages), the MRSP clearly provides services with higher quality than other Brazilian regions. When asked about the factors that constrain growth, as is done in the ICS, infrastructure is not ranked as a significant inhibitor to growth.

15. **Factors, such as infrastructure, that strongly influence a firm’s location decision are different from the factors that a firm considers in assessing a region’s or city’s business environment.** Factors that most adversely affect the MRSP’s business climate are related to tax rates, cost and access to finance, corruption, and crime. This is particularly evident when the two rankings – location factors and obstacles to business – are placed in the same chart (Figure 7).

⁵ The project is being implemented by a technical secretariat, formed by local consultants appointed to work with the city of São Paulo, and an Advisory Council that is composed of public and private sector stakeholders. The project design ensures active participation of the private sector (in addition to the municipal authorities) in the implementation of reforms.

16. Crime and violence are key issues in the MRSP. The analysis in Chapter 2 of Volume II reinforced the generalized agreements that (a) from 2000 to the 2006, they have worsened in the MRSP, and (b) the high level of crime is perceived as a serious disadvantage of being located in the MRSP. From 2002 to 2005, the share of total sales lost due to criminal activities increased by almost 4 times (however, such increases occurred in all regions except the Northeast). These sales losses in the MRSP were significantly higher than those in the South and the Northeast regions. On the other hand, it is important to acknowledge that, according to *Fundação Seade*, between 1994 and 2004, the homicide rate in the state of São Paulo fell by 29 percent. In addition, a recent World Bank study found that a 10 percent decrease in homicides in Brazil during 1991-1995 would have led to a 0.2-0.8 percent increase in per capita income over the following five years (World Bank, 2006a). When location factors were considered, crime and violence were ranked the 2nd main disadvantage for firms located in the MRSP and the proportion of firms mentioning this disadvantage was significantly higher than the proportions for firms located elsewhere. To deal with crime and violence, most firms located in the MRSP either hire security guards or buy commercial insurance. Working with public policies to curb crime and violence is likely to be on the top of the agenda of public administrators. Beyond the social and human impacts of this agenda, the economic implications for the metropolitan region can be very important.

Figure 7. Investment climate versus Location factors



Source: Investment Climate Survey 2003 and Location Factors Survey 2006.

Policy Recommendations

17. Our analysis points to some short- and medium-run actions concerning business regulation and the investment climate. Both the Doing Business in Brazil report and the Investment Climate Assessment suggest that there are areas for improvement in business regulation: complexity of contract enforcement, time and cost to start a business, and complexity of paying taxes. Unifying start up procedures and introducing electronic procedures and payments to start a business, as established in the program currently being carried out by the municipality with support from IFC, as well as accelerating the creation of the Development Agency are our main policy recommendations in this area. By the same token, efficient public policies to reduce crime and violence, especially integrated municipal programs for crime prevention, are also

necessary and urgent in the MRSP – not only for business development and growth, but also for the well being of the whole population (Box 2).

Box 2. World Bank Support to Reduce Crime and Violence in Brazil

The main analytical work done by the World Bank on crime and violence in Brazil, “Crime, Violence and Economic Development in Brazil: Elements for Effective Public Policy,” presents six key messages of which two are related to the MRSP:

(a) Prevention is crucial, complementary to control measures, and cost-effective. In Brazil, estimates suggest that prevention is more cost-effective than control or repression. Some of the approaches include prevention programs targeting at-risk youth and gender-based violence, control of alcohol sale, police reform, and integrated municipal (and state) public safety programs.

(b) The municipal level is an important entry-point for the prevention of crime and violence, and integrated municipal programs are one of the most effective ways to reduce crime. Many municipalities in Brazil assume a crime and violence prevention role, but they need more technical assistance, resources, and coordination with other levels of government to be fully successful. There is need for the participation of municipalities in a state-led crime and violence prevention framework.

On the urban program side, partnerships were the main activity developed by the World Bank. The program promotes collaboration with partners inside the Bank as well as with other international agencies, national agencies, and nongovernmental organizations (NGOs). Among the different partnerships are: (a) the Inter-American Coalition for the Prevention of Violence, (b) the founding partnership of the Reference on Urban Security Nucleus (*Núcleo de Referência em Segurança Urbana*), with UN-Habitat Safer Cities Programme, IDB, and the National Coalition of Brazilian Mayors (Frente Nacional de Prefeitos do Brasil), (c) clearing house and website for municipalities on support, materials, and capacity-building in urban crime and violence prevention, and (d) partnerships in the municipal capacity-building program with research institutes, civil society (e.g., *São Paulo Contra a Violência*), and municipalities.

A relevant case is that of Jardim Angela in Diadema, where the homicide rate was more than 100 per 100,000 people in 2000, but fell 73 percent by 2004. Several factors are behind these improvements, including: (a) the use of integrated information systems and geo-referenced crime mapping, which has allowed for more proactive policing, and involved communities and city and state agencies to address the issues in the city’s problem areas, (b) targeted implementation of municipal social programs (e.g., *Renda Mínima*, *Bolsa Trabalho*, and *Começar de Novo*), public transportation improvements, and other advancements in the city’s 10 most violent districts since 2000, (c) participation of civil society in violence prevention, developing a large number of activities, many targeting at-risk youth and including skill training, income generation, and cultural programs, and (d) alcohol restrictions, since, in Diadema, restrictions on alcohol sales after 10 p.m. have contributed to a significant decline in related homicides (from 76 per 100,000 people in 2000 to 35 in 2004).

18. **From the medium- to long-run perspective, attention should be directed to the main drivers of firm’s productivity in the MRSP, notably urban infrastructure and skills of the labor force.** These are areas in which São Paulo performs relatively well compared to other regions as shown by the ICS-2003 and the survey on location factors carried out in 2006. However, these two factors deserve continuous attention to reinforce MRSP’s comparative advantage. Infrastructure requires particular attention because it is one of the most important location factors for firms in all regions. The problems and costs of traffic congestion in the city, affecting both passengers and cargo, clearly point to the need to focus on the transport sector, addressing both quality and sustainability of urban transport in the MRSP. The challenge, therefore, is to establish partnerships with other municipalities as well as with the federal and state governments to increase and streamline investments in this area. To support these efforts in the area of urban transport, the main World Bank work with the MRSP is “The São Paulo Metro

– Line 4.” It aims at improving the quality and sustainability of urban transport in the MRSP, by interconnecting the existing subway, commuter rail, and bus networks through the construction of the metro’s Line 4 (12.8 kilometers with 11 stations). It has two main components: (a) an infrastructure and equipment investment component to build the metro’s line 4, which includes transferring stations between road and rail based systems. This project is the first enterprise in Brazil done using the Public-Private Partnership (PPP) mechanism, and (b) a technical assistance component to support and finance the project management oversight. A financial management cost recovery study with recommendations on tariff structure is included, as is a follow-up on project finance studies.

III. Service Delivery: The Housing Sector

19. **The report also addresses services delivery, specifically the case of the housing sector in the Municipality of São Paulo.** The housing sector was chosen because of its importance in the municipal investment budget and the coordination challenges involved, as well as being an area in which policies can have high social impacts. MRSP is experiencing moderate population growth, typical in which central regions are stable or decreasing, while the periphery is still growing rapidly. Central areas, which include 13 core municipal districts, have witnessed a decline in population and a departure of wealthier households. The periphery of the city has witnessed continued inflows and illegal construction, either on public land (*favelas*) or on privately-owned and illegally subdivided plots. Lastly, the headwater-reservoir systems (*mananciais*), also located in the city’s periphery, are critical, environmentally-sensitive areas, since they provide raw water for potable supply for the MRSP and are suffering the same disorderly occupation pressure from low-income residents. Despite these *mananciais* areas having been subjected to severe land-use restrictions through decades-old water resources management and environmental legislation, nevertheless illegal settlements have proliferated.

20. **Efficiency and targeting of housing programs are limited.** Finished housing units produced by the MSP do not constitute a sustainable solution for households with income below three minimum wages. This is relevant because housing deficiencies are concentrated among the low-income segments of the population. As the distance from the municipal center increases, residents are, on average, poorer and less educated, and suffer more from the lack of basic amenities in their dwellings.

21. **The direct production of housing units is the dominant mode of housing intervention and the public sector provides a significant part of it in the MSP, while the scale of slum upgrading actions has been small.** However, these figures do not exactly translate into new housing (net) supply. Many units produced under *Locação Social*, the Housing Leasing Program (PAR), and the MSP partnership with Housing and Urban Development Company of the State of São Paulo (CDHU) have been mainly used to relocate people from slums and high-risk areas. In those cases, no new net supply was involved. Slum upgrading programs have comparatively reached fewer households over time, most of which were located in the Guarapiranga basin, since the MSP has concentrated its efforts on this region given the nexus of key water pollution and social exclusion issues faced there. However, even in this area, the number of families assisted each year was probably less than the number of new irregular households being formed.

22. **The involvement of the private sector in housing programs has been problematic.** The framework of the Special Zones of Social Interest (ZEIS) is not conducive to private sector involvement because it is complicated and restrictive. Zones classified in ZEIS are subjected to strict provisions for redevelopment and do not promote financial viability. Urban Operations have

met varying success rates, but other ambitious public-private partnerships (PPPs) have not been implemented. Even when trying to involve the private sector in the rental market, efficiency has been low. Rent subsidies (*Bolsa Aluguel*), a form of personal rental allowance, was created to allow selected low-income families to find an accommodation in the private rental market.⁶ Theoretically, this system was attractive because it involved the private sector's supply of rental units. However, there are two main problems with its parameters: (a) the maximum rents permitted (via maximum rent-to-income ratios) are too low and correspond at best, to a small portion of the formal rental supply, and (b) subsidy rates reach 80 percent or higher for households with monthly incomes under three minimum wages, which makes scaling-up unfeasible.⁷

23. Different municipalities within the MRSP present highly idiosyncratic situations with respect to the way they face low-income housing problems. This report illustrates that housing Secretariats in the different municipalities within the MRSP do not maximize cooperation and information sharing. Housing programs should be consistent with a metropolitan strategy for housing and externalities should be addressed in a coordinated fashion between municipalities. Although this may seem ambitious, there is room for information sharing and exchanges in practices between municipalities (e.g., with respect to the monitoring systems). These types of exchanges need neither highly formal institutional settings, nor to be budget consuming. Nevertheless, they would be a very efficient way to improve municipal practices in various areas in addition to the housing sector (e.g., education and health). The exception to this rule is the collaboration that took place under the World Bank-financed Guarapiranga project, which is currently being furthered during the preparation of the proposed follow-up *mananciais* project in which a dozen municipal governments are discussing with state authorities a combined effort for urban upgrading (including housing improvements), social inclusion, and water pollution control in areas of *mananciais* (Box 3).

Policy Recommendations

24. Our analysis points to actions concerning partnerships and public finance so that the service delivery of low-income housing could be improved. Regarding partnerships, there is a need to strengthening the coordination with both the federal and the state governments – a key partner in this process should be CDHU – and between municipalities that are part of the MRSP. The expected outcomes of this effort should be less volatile financial sources, harmonization of similar programs run by different levels of government, creation of an information center concerning low-income housing demand, and development of programs targeting environmentally sensitive areas, especially *mananciais*. In addition, coordination among different MSP' Secretariats should be enhanced by integrating their individual information systems and building up program monitoring and evaluation systems. Ultimately, coordination would improve efficiency and targeting of the housing programs.

25. Three sets of financial actions should be pursued by the MRSP. This would support the development of a unified housing strategy in the long-term with better targeting of subsidies. It is necessary to realign resources so that funds and subsidies for self-construction would boost and housing micro-credit programs could be effectively implemented. With vertical and horizontal coordination among different government levels, a study on the rental market should be undertaken in order to identify alternatives to finished housing units produced by the

⁶ The subsidy comprises a monthly allowance that covers part or all of the rent plus a system of guarantees for the landlord.

⁷ Nowadays, the scale of the program is negligible, with only 1,500 beneficiaries.

public sector. By improving COHAB's financial situation of, the coverage and targeting of municipal programs could be enhanced. To do so, it would be necessary to revise policies and parameters of municipal programs (e.g., *locação social* and *bolsa aluguel*) as well as decreasing the depth of subsidies on household financing for *mutirões* and *conjuntos*. Finally, actions to leverage public resources for housing should be pursued. These actions include revising the classification of areas under ZEIS, introducing market incentives for the production of middle- and low-income housing units in the renovation process of the MSP's central areas, and expanding (with the appropriate adjustments) the program *bolsa aluguel*. It would also be helpful to develop a study on the possibility of land readjustments schemes as well as the development of an inventory strategy for public land. World Bank support in this area has already begun (Box 3).

Box 3. Housing and the World Bank in São Paulo

In 2005, the "Programmatic Sustainable and Equitable Growth – Housing Sector Reform Loan Project" was approved by the World Bank to support the Brazilian Government's efforts to improve access by the poor to better housing and serviced/serviceable land, while maintaining fiscal discipline. The program aims at (a) developing a sound national policy, and institutional framework for housing and urban development, (b) strengthening the housing credit, and savings systems, and provide incentives for the housing finance market to expand, (c) designing and implementing a unified federal housing subsidy system to address the affordability of housing solutions for the poor, and (d) reducing the costs of formal urban land development by strengthening land subdivision and land use legislation, regulations, and real property registries. Furthermore, the program provides a conceptual framework to help the Government monitor the segments of the housing market, including those relevant for poor and middle-income families.

In addition, the World Bank has been working closely with Cities Alliance. The main project that emerged from this partnership between the MSP, the Bank, and the CA was in support of the municipality's *Bairro Legal* slum upgrading and land tenure regularization program (2002-2004). The goals of this technical assistance were (a) developing an integrated and participatory methodology for intervention, (b) supporting institutional capacity-building and the development of the needed coordination mechanisms, and (c) supporting the mobilization of resources from national and international financial partners for the financing of the proposed interventions. The three outputs of this partnership were (a) the evaluation of recent housing policies of the MSP and the definition of a clear regularization and upgrading policy for slums, (b) the preparation of the general methodology for the intervention of the program, including mapping and diagnosis of slum settlements, the establishment of objectives, and the definition of strategies, and (c) the preparation of three participatory housing and urban development plans for the districts of Jardim Ângela, Brasilândia, and Cidade Tiradentes, which underpinned the regularization efforts there. This technical assistance project was followed by a second one, whose implementation began in December 2005, and which focuses on strengthening the capacity of the MSP Housing Department to design and implement low income housing policies and programs.

IV. Cooperation and Partnerships

26. **The MRSP and particularly its core, the Municipality of São Paulo, has not been able to consistently make use of policy and institutional instruments that would guide metropolitan governance and the implementation of basic municipal development policies, plans, and interventions.** In addition, constant political changes have signified interruptions to implementation by prior administrations. As a result, private actors have lost trust in sustained and long-term approaches to structural local problems, reinforcing individualist and short-term behavior. A notable exception is the World Bank-financed Guarapiranga Project in which horizontal and vertical investments to tackle water pollution and social exclusion were undertaken by successive administrations, at both the municipal and the state levels. This happened over a period of eight years, despite changes in administrations and political differences between administrations.

27. **In the context of fiscal constraint and increasing public service demand pressures, coordination with other public agents is crucial.** A confusing institutional framework with overlapping responsibilities and the lack of coordination across government levels adds to the difficulties in metropolitan areas. There is a need of coordination both vertically (across levels of government: federal, state, municipal) and horizontally (across municipalities), particularly in the education, health, housing, water supply and sanitation (WSS), and transportation sectors, where municipalities play a key role in service provision. PPPs are particularly relevant considering fiscal constraints of the different federative entities, lack of incentives for private sector investments, and a pressing need to invest in infrastructure. The WSS sector provides a good example of these vertical and horizontal challenges. WSS service provision in the MRSP is widely provided by the state water company (SABESP), which is responsible for the macro, metropolitan water supply, and wastewater infrastructure.⁸ However, for a number of years, a group of key MRSP municipal administrations have been responsible for taking SABESP's bulk water, distributing it, and charging for it at the municipal level – without reimbursing SABESP for the bulk water at the rate that the latter deems appropriate. The same scenario has developed for wastewater, with municipal sewage continuing to flow into rivers while SABESP's wastewater treatment works are underutilized because municipal governments cannot agree on how much they should be paying SABESP for the services of collecting sewage and treating it centrally.

28. **The land-use/urban informality/environmental protection nexus encountered in the city's *mananciais* is one of MRSP's critical development challenges that requires integrated interventions through vertical and horizontal cooperation.** There are almost 2 million people, mostly low-income, currently residing in the MRSP's two main *mananciais* basins (Guarapiranga and Billings). These informal and slum settlements cause direct pollution of the reservoirs through wastewater and garbage discharge, storm run-off and silting, thus threatening their future use as raw water bodies for potable supplies. To tackle this problem, horizontal and vertical government interventions are essential in order to bring together key urban upgrading interventions locally with metropolitan-wide initiatives in wastewater collection and treatment, drainage and solid waste management. The recently-approved Guarapiranga land-use/water pollution control law needs to have its implementation arrangements operationalized to ensure that future land development and urban upgrading are consistent with the sensitive nature of the reservoir basins.⁹ World Bank support in this area begun in the 1990s and kept evolving over time (Box 4).

29. **The urban transport sector is another area in which cooperation and partnerships are key and where good examples on this can be found.** The history of institutional coordination among entities running different components of the urban transportation system is centenarian. Initially, there was a problem of coordination of public companies within the same mode of transportation. But dispersion of government agencies responsible for overseeing and planning developed over time, leading to tensions between state and municipal agencies. Nowadays, the system is still complex, including buses, the subway, and trains being operated by public and private agents under a wide variety of contractual arrangements. The state and the municipality of São Paulo share the responsibility of the functioning of this system, which is

⁸ The balance of water supply and demand in MRSP is a critical issue for the city's competitiveness and economic growth. MRSP's extremely low per capita water availability is comparable to that prevailing in the driest areas of the Northeast. Half of the MSP's potable water supply is imported from neighboring river basins, which is contentious given the demands of other large urban conurbations vying for the same water. The remainder comes from headwater-reservoir systems (*manancias*) within the MRSP itself.

⁹ Law No. 12,233 of January 16, 2006.

undertaken by their respective Transport Secretariats. In May 2006, all institutions involved in urban transportation signed an agreement creating the CDTI (Integrated Transport Administration Committee), whose executive board heads the metropolitan transportation system. Although there has been some degree of coordination, this agreement defines the new the CDTI as: (a) a tool to strengthen partnerships between the state and the municipal Transport Secretariat, (b) the aligner of urban transport planning, administration, and overseeing, (c) the promoter of efficiency by setting operation standards and investment priorities, and (d) an advocate of an integrated vision of passengers' accessibility through unified analysis and tariffs. It avoids creating a separate public entity and establishes the creation of legal mechanisms that give the CDTI authority for decision making, along with legal definitions to secure investment backups from State and Municipal governments.

Box 4. Water and Sanitation and the World Bank in São Paulo

The World Bank-financed "Water Quality and Pollution Control Project" was a pioneering US\$802 million operation (US\$390 million loan)^a designed to preserve and improve water quality in densely occupied urban settings in some of Brazil's most important cities, which broke with conventional project approaches by blending water quality and pollution control initiatives with those of social inclusion. Under this umbrella, the US\$340 million "São Paulo Water Quality and Pollution Control operation (Programa Guarapiranga)" was designed to assist the government of the state and the municipality of São Paulo in setting up institutional capacity to manage the Guarapiranga basin in an environmentally sustainable manner and to improve the quality of life of residents of slums and illegal settlements in the basin. The lessons learned from its implementation (1992-2000) will be presented in a forthcoming World Bank publication (*Série Água Brasil 8: Poluição Hídrica de Grandes Centros Urbanos*).

Since the "Guarapiranga Project" closed, the state of São Paulo obtained a PHRD grant from the Japanese Government for the preparation of a follow-up operation ("Programa Mananciais") intended to roll-out vertical and horizontal integrated approaches to water pollution control in all of MRSP's *mananciais*. As part of this preparation, a study was undertaken into the issue of metropolitan water balance, and its interfaces with water supply and demand, wastewater management, irrigation, drainage, and solid waste management. The study *Recursos Hídricos e Saneamento na Região Metropolitana de São Paulo: Um Desafio do Tamanho da Cidade* was published in 2003 as one of the World Bank's *Série Água Brasil*.

^a Cost and loan figures of the umbrella operation include the complementary loans in the states of São Paulo, Paraná, Minas Gerais, and in the federal government.

The MRSP needs constancy of programs and policies. The engagement of the private sector in the MSP's city planning, the reinvention of institutions, and the cooperation through partnerships with other public agents could help on this continuity. Strategic actions should focus on progressively engaging the key political, economic, and social actors in a consultative process, which could lead to a metropolitan development pact. It is not possible to expect quick results and success from this process, as it will take time for these actors to build consensus. Furthermore, policy coordination between the federal and state levels and within the metropolitan area plays a critical role.

Volume II of this report details both the diagnostics and policy recommendations for the two main areas of this study (i.e., the investment climate and the housing sector, one of the key areas of service delivery in São Paulo). It also brings more in-depth analysis of the fiscal context and partnerships, two of the main tools for achieving a sustained growth recovery.

REFERENCES

- Cities Alliance (2004). "Integrating the poor: Urban Upgrading and Land Tenure - Regularization in the City of São Paulo," December 2004.
- Glaeser, E.L. (2005a) "Urban colossus: Why is New York America's largest city?" NBER Working Paper Series 11398.
- Glaeser, E.L. (2005b) "Reinventing Boston:1630-2003." *Journal of Economic Geography* 5, pp 119-153.
- Imparato, I. and J. Ruster (2003) *Slum Upgrading and Participation: Lessons from Latin America*. World Bank Directions in Development Policy.
- Le Blanc, D. and E. Rottmann (2006) "Analysis of Housing Programs in São Paulo." Mimeo.
- Spink, P., M.A. Texeira. R. Clemente (2005) "Metropolitan Governance in Brazil: institutional push or organization pull." Initial country study prepared for the Metropolitan Governance in the Americas Study coordinated by Robert T Wilson and Peter Ward: LDJ School of Public Affairs, University of Texas, Austin.
- World Bank (2004) "Water Quality and Pollution Control Project." Report No. 28962.
- World Bank (2005a) "Brazil: Program Document for a Programmatic Loan for Sustainable and Equitable Growth: Housing Sector Reform." Report No. 31756.
- World Bank (2005b) *Doing Business Report*. Washington D.C.: The World Bank.
- World Bank (2005c) "Brazil Investment Climate Assessment, Vol. II." Mimeo.
- World Bank (2006a) "Crime, Violence and Economic Development in Brazil: Elements for Effective Public Policy." Mimeo.
- World Bank (2006b) *Doing Business in Brazil*. Washington D.C.: The World Bank.