

HOUSING POLICY: A WORK IN PROGRESS

by

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There is a surprising degree of unanimity in the world today with respect to the necessity of a market-driven economy for economic growth. However, there is a great deal of divergence in practice about how to move from a state-driven system to a market one. Not coincidentally, the same situation prevails in the area of housing policy.

As long ago as 1988, the members of the United Nations, in stating a "Global Shelter Strategy for the Year 2000," agreed that the most important contribution that a government housing policy can make is to "enable" the efficient workings of the private sector. Before arriving at this remarkable consensus, most governments, including those in all of the most advanced countries, had previously experimented with ambitious programs of public construction or government subsidized finance. In fact, many of the countries went through similar evolutions in policy, for similar reasons.

It was in the 1950s that the U.S. and many Western European countries experienced great support for public production of housing. By the mid-1960s, it was clear that (1) such production was far more expensive than privately-organized production and (2) the private sector was more responsive to the wishes of the consumer and more effective with respect to management. Steadily since then, these countries have shifted the focus of their efforts to assist housing towards assisting the private sector. First, the incentives went to the producers, with subsidized finance or tax advantages or cheap land. Gradually, most of these countries have shifted to directly assisting needy households with cash assistance in order to buy or rent housing provided by the private sector.

The developing countries have largely followed in these footsteps, but with a lag of 10-20 years. Following independence, former colonies proudly set forth programs to build huge numbers of better quality houses for their urban populace, many of whom lived in little more than ragged shacks. It was only after some of these efforts literally bankrupted the countries that these governments have moved along the policy evolution curve. In the 1980s, policies often focused on simply subsidizing site development, but in the 1990s, in keeping with the new consensus, most countries are working towards developing more effective systems for unsubsidized finance and encouragement to private sector development efforts of all sorts, and towards targeting subsidies directly only to the neediest.

THE MYTHOLOGY OF TRANSITION

Part of the mythology of transition in the former centrally-planned economies is that these countries can skip over the "mistakes" of the developing and developed worlds and move directly towards contemporary "best practices." But this view ignores the reasons why it has taken these other countries 30-40 years to arrive at the position they now hold on these matters. It was not simply ignorance by experts of the theories of market efficiency that caused policymakers to follow the routes they did. In any political system, generally the leaders can only take the public where it is somewhat willing to go. In a democratic system, the leaders that get elected, for good or bad, are usually those most in tune with the public perceptions.

Thus, it is the pace of evolution in the thinking of the public, as well as of the technocrats, that most affects housing policy. In the prosperity in the U.S. in the 1950s, it was felt that the government should clear away the slums and build large tracts of new housing for the poor. In war-ravaged Western Europe, it was felt that direct public intervention was needed to rebuild the rental stock without price gouging by private owners. In post-colonial countries, public construction was a good way to quickly expand employment opportunities (and political patronage) and show visible proof of progress.

These views were held not just by the general public, but also by many opinion leaders in the media and universities. What generally caused these views to change was actual experience. Not experience in other continents or even nearby countries, but immediately at hand, in the form of ballooning budgets, dissatisfied consumers, or frustrated would-be beneficiaries. Only then did views change, and, with a lag, so did policies.

The transition countries may be able to accelerate this policy evolution, but it will be difficult to do so without some first-hand experience on which to base it. In fact, it is hard to overestimate this difficulty in countries where, until recently, most urban households either received their housing unit directly from the government or received a major subsidy towards it; where private landlords have not been seen for 40 years; and where no one paid a true market rate for financing. In such an environment, the notion that housing is best left to an unfettered and unsubsidized free market is foreign to most people, both literally and figuratively.

POLICY EVOLUTION IN SLOVAKIA

Slovakia initially moved quickly away from government intervention. In some ways, the government may have gone further along on the policy evolution curve than the public was prepared. Starting in 1991, Slovakia devolved the responsibility for state rental housing to municipalities. Then a law was passed to "individualize" co-operative housing with the intent of hastening their privatization. Once Slovakia became an independent nation, it quickly moved to privatize its municipal housing stock by passing a comprehensive privatization law, with a provision for forming condominium associations.

In this process, explicit state subsidies for rental housing were terminated in 1994 and utility costs for all tenure forms were liberalized to reach nearer the cost (with exception of heating and hot water). On the finance side, subsidized lending for home construction ended in early 1992. Housing finance largely ceased to exist as a means to acquire housing with long-term lending, though two government-backed building savings societies (the first in East Europe) were allowed to operate.

However, the components of an "enabling" policy environment are not in place yet. Any institution lending for housing knows that it has no assured means of recovering its funds, despite the presence of a mortgage. Rents are still not regulated by the market and private landlords are not able to evict those who do not pay. The co-

op apartments are still not privatized. Thus, in general, the forces of the market, both for "good" (encouraging more construction and maintenance) and "bad" (limiting housing choices to what can be afforded), are absent.

One major step towards blending market forces with social welfare policy is still under consideration. As early as 1993, the government formulated the implementation of a means-tested housing allowance scheme. Such a scheme has been recognized as a necessary and vital means to correct price distortions and target subsidies. It would make up the difference between what a household can afford to pay for housing and the cost of standard housing adjusted for household size. This type of allowance is envisioned for all tenure forms including owners since utility costs will also be included.

Implementation of the housing allowance is in the hands of the Ministry of Labor and Social Affairs since the allowance is to be incorporated into the existing safety-net structure.

Privatization of municipal rental housing is proceeding while condominium associations are being formed for those multi-unit buildings that have been fully privatized. Even a few subsidy-free "mortgages" are being issued by the State Savings banks under terms that are somewhat more generous than commercial loans. Mortgage banks are expected to also start making loans for housing, but are relying on progress in making such mortgages enforceable.

Meanwhile, the public is getting restless in wanting more housing to be built, whether supported by state intervention or not. State intervention is certainly the most direct way of responding, even though undermining of the development of market processes.

SHORTENING THE POLICY EVOLUTION CURVE

If one adopts the view that political systems evolve housing policy based on local experience, and that Slovakia will eventually want to move towards an "enabling" strategy, there may be a way of shortening the policy evolution curve. That method is to move ahead with several different policy approaches at the same time and learn from all of them.

We can start with the policies that Slovaks are very familiar with. State-sponsored construction, ownership, and management of large scale housing projects is presumably as thoroughly discredited as in the advanced Western countries. Even the casual visitor to Bratislava soon becomes aware of the distaste that many feel for areas such as Petreszelka. However, there seems to be the same evolution in thinking as occurred elsewhere towards the idea that local governments might execute these better. The experience elsewhere confirms this view, but only if the projects are managed by private, competing firms.

The steep downside of this approach is the unsustainably high cost to the government, and the severe inequity between the lucky few recipients and the unlucky, unless rents are set at levels commensurate with normal burdens on household budgets elsewhere, 20-30 percent of income. Even so, experience everywhere has

confirmed the political difficulty of government bodies to adjust rents over time with inflation and to sustain the flow of funds available for maintenance.

But the government and the public may need to learn these lessons again before being ready to abandon public housing construction entirely. Moreover, there are few signs of an environment supportive of the development of a private rental market (e.g., reasonable eviction procedures, market-determined rents), so there are few other options at the moment for directly addressing the housing needs of those unable to buy.

Just as shifting public housing to local governments is a small step along the rental housing policy learning curve, so is a shift from low fixed-interest rates for housing loans towards a large subsidy from the market rate. It is even a bigger step if the buydown is paid for fully up-front (e.g., the rate is bought down by a specific amount for each year in the future and the present value of that cost is paid to the lender up-front.) In that case, the government faces the full cost of its subsidy commitment, rather than putting off much of it into the future. The downside of this is the cost burden of making this support very widespread, a burden which usually leads to the next steps along the policy curve, shrinking the subsidy and targeting it more tightly. And doing everything possible to encourage unsubsidized finance by private institutions.

SOME PRACTICAL SUGGESTIONS

Policymakers in Slovakia are focused on immediate issues, including increasing employment through construction projects and in utilizing the partially completed housing projects. On the other hand, it is really necessary to make some progress along the policy evolution curve. One practical approach would be to auction off the unfinished projects to private developers. The new owners would be entitled to apply to any bank for a loan at market rates, the funds for which would come from the government and the government would bear up to 80 percent of the risk (but not 100 percent!).

Such a program moves in the right direction, with private developers gaining expertise in evaluating, executing, and marketing, banks gaining experience in loan assessment and recovery, and the government finding out which projects are worth salvaging. The loss on the previous investment in the projects would be written-off rather than be expanded through subsidized completion and then being essentially given away at rents that are less than maintenance costs.

A similar step in the area of finance could be the creation of a mortgage subsidy program, whereby the government pays the lender upfront an amount equal to 20 percent or so of the loan and in return the lender reduces the interest rate by 5 percent the first year, 4 the second, 3 the third, and 2 the fourth year, all from the regular market rate. This leaves all the risks with the lender, where they belong, while increasing housing affordability and establishing the precedent of slowly rising payments by the borrower, something that is appropriate in an economy with a certain degree of inflation. Most importantly, the exposure of the government to uncertainty about future subsidy requirements is reduced.

Such an initiative towards expanding mortgage lending will also require progress

in limiting the legal and procedural rights of borrowers to avoid having to sell their home if they do not repay the loan. It must be recognized that banks cannot simply subsidize the continuing consumption of more housing than people can afford. The state may choose to do so through a housing allowance program, in which case those judged to be truly needy could benefit from assistance in meeting their loan repayments.

KEEPING AN EYE ON THE DESTINATION

As noted above, the end point of the policy evolution curve in Slovakia is likely to be a market-oriented financial system supporting a largely owner-occupied and unsubsidized housing sector, with a rental sector composed of small-scale landlords (each with a few units) and perhaps some mildly subsidized "social housing." Subsidies will likely be channeled through a housing allowance scheme, which is based on measurable need and varies over time as the need changes.

Getting there reasonably quickly will take more than simply pursuing flawed policies that eventually fail from their own weight. It must include actively developing the legal and financial premises of such a system, including reasonable foreclosure and eviction, a stronger banking system, encouragement of housing savings, and so on. Another step that is inevitable is either raising rents significantly in public housing or privatizing it, in order to provide for its maintenance and lay the foundations of a more active resale market and a private rental market of small scale landlords.

Thus, it is important that movement be maintained towards these conditions even as the government pursues construction and financial subsidy policies that may match the mood (and institutional capabilities) of the moment but will need to be supplanted with more advanced policies, hopefully sooner rather than later. The suggestion here is also for the policies that are pursued today for reasons of expediency to have the seeds of improved policies in the future, by promoting activities such as private development and lending that are necessary ingredients in the full-fledged market-based housing system of the future.