

PART I.

Public Housing Policies:
Economic and
Social Perspectives

Local Government and Housing

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1. THEORETICAL FRAMEWORK

Housing is not a simple category that can be viewed from a single perspective. On one hand, housing is one of the basic human needs and the right to adequate housing has been classified as a basic social human right in most developed countries around the world. On the other hand, housing constitutes a special type of private property, traded on the market. Although trade-offs between the social and economic aspects of housing may have to be made, the purpose of both central and local housing policies lies in searching for a consensus that assures both the effective functioning of the housing market and the financial affordability of housing for all social groups within a society.

1.1 Economic Perspective

From a purely economic perspective, housing constitutes private property because it is not available in a non-competitive manner and does not have the same characteristics as public goods.¹ However, housing economics notes the following essential differences between housing and standard market commodities:

- 1) Housing is a very heterogeneous, complex and multidimensional good. Individual houses, and apartments or flats, differ in floor space, design, age, quality, standard, furnishings, tenure, size and number of additional spaces or buildings (garage, garden, etc.) location, quality of the environment, accessibility and so on. It is very difficult to measure the unit of output and the demand for housing in general because the rent paid for a small flat can be the same as for a larger family house, even under conditions of optimal distribution and market equilibrium. Therefore, housing economics have introduced a theoretical construct called housing service. It is assumed that, in a state of equilibrium,

the price per housing service unit will be the same in all types of dwelling units. Households or individuals thus demand housing services rather than housing on the market.

- 2) Housing is a durable good and as such it becomes subject to both consumption and investment. "There are two housing markets. In one, the consumer good, housing service, is exchanged and the price per unit of housing service is determined. In the other, the investment good, housing stock, is exchanged and the price per unit of housing stock is determined." [Fallis, 1985, 6]. In a perfect market, the price of a housing stock unit will equal the discounted present value of housing service flows (discounted by the interest rate and depreciation). However, housing consumption and investment motives may conflict: The consumer wishes to maximize utility but the investor chooses from all the options a housing unit with a maximum net present value of expected future returns. Moreover, a household willing to acquire housing must make an important decision: To rent or to buy. By choosing to rent a dwelling, the household is participating in the market of housing services only because, under standard conditions, rental housing is not an investment. The situation is slightly different in several CEE countries.
- 3) Housing is a spatially fixed good and cannot be moved from one location to another. To buy a dwelling means not only to buy a particular dwelling but also to buy the socio-economic status of a neighborhood and the level of accessibility to the place of employment. The price per unit of homogeneous housing services varies with distance: Near the center of employment the price will be higher than when farther away. The access-space trade-off model developed by Alonso (1964) explains why prices for the land production factor must decrease with the distance from the center of employment (meaning the center of the town).

Other specific features of housing include, in particular:

- High transaction costs of potential moving i.e. as finding and furnishing a new dwelling and moving involves considerable expenses (not only monetary expenditures but also time and emotions invested) that do not relate directly to the acquisition of a new dwelling. These constitute so-called transaction costs. The market adapts to changes in household income (the income effect) very slowly, compared to potential adaptations, if the transaction costs equal zero. "Such costs may range between 5 and 10 percent of the total price of a house, particularly where movement entails both selling and purchase costs." (Maclennan 1982: 61) The transaction costs are often so great (especially if intermediaries such as real estate agencies are included) that they, to a large extent, influence the selection of future housing itself. Stigler (1961) used his own model, for example, to prove that the greater the difference between

the highest and lowest prices offered for dwellings of the same standard (i.e. the greater the difference between the prices offered for relatively comparable housing) the greater the likelihood the buyer will spend more time looking and will go through more inspections, if we assume costs related to the inspection of each offered dwelling remain constant. Moreover, housing is a relatively illiquid good, at least in comparison to financial assets and at the same time a very expensive one. Therefore, people are extremely careful before they make the final decision to buy and it takes them far more time to make this decision than is the case with other consumer goods.

- The inability to attain perfect knowledge about the situation on the market. Neither the buyer nor the seller can acquire perfect knowledge about all the offers for the various housing services in such a dispersed market. As mentioned above, housing is a heterogeneous good and to behave rationally (to make a decision) it is necessary not only to know the price of a dwelling but also the price of particular housing attributes in various regions and locations where a potential client may look. It may even take real estate agents a long time before they notice changes in demand and supply on the market. The information is never free and this expense contributes to the high transaction costs related to moving mentioned above.

Due to its durability, housing represents a very expensive good traded on a market where supply adjusts very slowly to sharp changes in demand. Moreover, due to its special fixity, many externalities can appear on the housing market.

If a market is perfectly competitive, all the participants (buyers and sellers) consider the price to be a given and assume that their individual behavior cannot change it. In such a market, there must be a large number of sellers and buyers and none of them may control the market or a significant segment thereof. In such a case, the price equals the marginal utility of consumers and the marginal costs of producers and the market finds itself in a Pareto optimum. As Fallis postulates (1985: 148), even a market with a smaller number of actors on the supply side may obtain an equilibrium price and the optimum amount of exchange. Such a market must be “open to competition”. It must be a market where potential newcomers on the supply side may acquire complete information about its functioning, operate at the same cost and under the same production conditions as the existing producers and the entry to or the exit from the market must not be contingent upon any special costs. If the market is open to competition, even a market with only a few entities on the supply side may produce optimum output.

Although a perfect situation can never be attained, if we compare the efficiency of the functioning of the housing market with respect to the number of sellers and buyers on other markets, we will most likely come to the conclusion that on both sides of the market (supply and demand) there is a relatively large number of players. Even if we

examine the home-ownership market separately from the rental market, we will still find a great number of participants on the supply and demand sides. “It is sometimes popularly asserted that a few companies own a large fraction of the rental stock. This is simply untrue—the rental stock is widely held in Canadian cities.” [Fallis 1985: 149]. “In general, economists assume that the housing market is atomistically competitive. In the British context, assumptions of monopoly ownership have only been made by political commentators or Labour Party legislators in relation to private rental housing. Even in quite small areas of cities, the ownership of rented property is considerably dispersed and the development of new housing is also deconcentrated. Ironically, it is only really local public authorities whom are monopolists in a market sense and their monopoly may be reflected, not only in exploitative prices but also in poor practice, which, in some cases, may result in some tenants paying council rents in excess of probable market rentals.” [Maclennan, 1982: 155–6]. “The fact that house prices and rents can change substantially in the short run may cause equity problems, but it is neither non-competitive nor inefficient... Nevertheless, the supply of housing displays no major violations of the competitive assumptions.” [Barr, 1993: 386]. However, the adjustment of a market is relatively slow and even sharp price variations can appear on a non-regulated housing market in the short run. This “short-run price instability” is an implicit feature of the housing market.

Another case of market failure involves externalities. The indirect consumer externalities, externalities following from the housing stock reconstruction/regeneration and externalities following from land use are usually considered to be the most significant ones in the housing market. Indirect consumer externality arises when the consumption of one household influences the total utility of another household’s consumption indirectly, through another factor. For example, the housing consumption of one household (excessive number of people living in a flat as a result of the specific social situation of that household) may influence the crime rate in a given area (aggressive antisocial behavior). This, in turn, may influence the total utility of housing consumption of other households. Health problems (infections), vandalism, intentional destruction and sabotage of the environment may serve as other examples. State intervention (greater law enforcement in the case of criminal conduct, minimum housing standards, etc.) may result in the elimination of these externalities and lead to a Pareto optimum.

In addition to negative externalities, there are also positive externalities on the housing market due to housing stock renovation. When purchasing or renting a dwelling, people consider not only the quality of such a dwelling but also the quality of the surrounding environment. If an owner invests in repairs and the renovation of his/her house, then it is not only the owner but also everyone else living in the neighborhood that gain from the renovation (the neighborhood effect). There is a problem, though: If all owners renovated their houses, the profit would be much greater than if only one of them does so. Owners thus often must consider whether or not to go ahead with

renovation because they do not know whether the other owners will renovate their houses too. This results in the well-known “prisoner’s dilemma”. The active mediation role of public bodies may greatly contribute to the regenerative process.

1.2 Social Perspective

As mentioned at the beginning of the theoretical framework chapter, housing is also perceived as a basic social need of human beings and its standard greatly influences the standard of welfare of the whole society. Housing insecurity can have far reaching consequences for the labor market, as well as for the political stability in a particular country. In view of the increased acceptance of the concept of the *welfare state* after World War II (a concept which is being more clearly redefined today) the right to adequate housing has become one of the fundamental social rights in all economically developed countries and the responsibility for housing has gradually transferred from the consumer and family to public authorities and public finances.

The right to housing is a social right, and social rights constitute the third element of human rights (the other two being political and civil rights). The main principle of the right to housing is equal and non-discriminatory access to housing with respect to race, creed, and sex. In the Housing Policy Guidelines, approved by the UN European Economic Commission for Human Settlements and published in 1992, the right to housing is characterized as unenforceable and non-claimable. The guidelines express the obligation of governments to assume responsibility for this area and to ensure that a satisfactory level of housing is provided to citizens. In some countries, housing in general—as a field meriting the particular “attention” of the State—is included directly in the Constitution.²

The right to housing as one of the human rights is formulated in a number of international documents, the oldest being the Universal Declaration on Human Rights, which the UN General Assembly adopted in December 1948. Article 25 of this document states that “Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services...”. In Principle 4 of the Declaration on the Rights of the Child, adopted in November 1959, it is stated “the child shall have the right to adequate nutrition, housing, recreation and medical services...”. Part II, Article 10 of the Declaration on Social Progress and Development, adopted in December 1969, states that “the basic freedoms can be attained also by provision for all, particularly persons in low income groups and large families, of adequate housing and community services.” Article 11 of the International Covenant on Economic, Social and Cultural Rights adopted in 1966 states “the State Parties to the present Covenant recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food,

clothing and housing, and to the continuous improvement of living conditions”. To support the realization of the obligations under this International document, the UN Council for Human Rights worked out numerous recommendations, explanations and commentaries. The right “to adequate housing” is mostly understood as ensuring affordable housing (a housing price level that will ensure the fulfillment of basic needs in the field of housing, including the possibility of obtaining social support in cases when the family cannot ensure this fulfillment by its own means) and the availability of housing for disadvantaged and endangered social groups (seniors, children, physically handicapped individuals, victims of natural and other disasters etc).

In November 1988, the UN General Assembly adopted a principal document concerning housing titled “Global Strategy for Shelter to the Year 2000” where it is stated: “The right to adequate housing is generally recognized by the International community. All nations without exception recognize some form of obligation in the housing sector, such as the establishment of ministries or other institutes for housing issues, allocation of funds to the housing sector and creation of housing policies, programs, and projects. All citizens of all states, including the poorest ones, have the right to expect that their governments will pay attention to their housing needs and will adopt fundamental measures leading to the protection and improvement of housing...”. Similarly, the European Social Chart of the Council of Europe, adopted in 1961, the revised version of which was adopted in 1996 by a number of member States of the Council of Europe, states in Part I that “Member States adopt as the objective of their policies the attaining of conditions under which the following rights and principles will be effectively fulfilled”. Under number 31 of the rights and principles it is stated that “Every person has a right to shelter”. In Part II, Article 31 the States pledge to “adopt measures with the aim to support accessibility of housing of adequate quality in order to prevent homelessness and to implement measures securing affordable cost of housing for those who do not have sufficient financial means”.

The continued efforts to ensure the greatest possible degree of general and financial affordability of housing is especially important in relation to groups of the population with little social power, i.e. those who cannot themselves ensure adequate housing on the free housing market. The traditional market-oriented housing policy has at its disposal a number of tools that make it possible to work toward the fulfillment of the general and financial affordability of housing. These legal, economic, and financial tools are used on both the demand and the supply sides; on one side, they serve to approximate the housing costs and, on the other, to approximate the disposable income of households. The approximation of the supply and demand sides must always respect the adequacy of housing with respect to the needs of an actual household and its financial options.

Housing as merit good. Financial affordability of housing.

In connection with the above-described social perspective, housing is also often labeled as a “*merit good*”. A good is a merit one, when there is a collective consensus on its consumption by the entire society. In other words, society collectively believes that its consumption is inherently desirable and, therefore, unlike the consumption of other goods, must be supported. Merit good does not mean public good because housing does not have the basic characteristics of a public good. Merit good is a standard, a private good whose consumption should be supported by public authorities. Education is a frequently mentioned example of a merit good too. As has been stated above, the basic imperative of housing policies adopted by public bodies, based on the perception of housing from the social perspective, is to ensure the general availability of housing and also to ensure that such housing is financially affordable for socially needy households.

The financial affordability of rental and ownership housing is gradually becoming the standard form for the operational assessment of the housing situation in most developed economies. During the 1980s this term was popular among housing policy makers. Throughout the 1990s, an increasing number of housing researchers became engaged in the study of the concept and its methodology [Bramley, 1991, 1994; Hallet, 1993; Whitehead, 1991; Hulchanski, 1995; Hills et al., 1990; Freeman et al., 1997; Linneman and Melbolugbe, 1992; Maclennan and Williams, 1990]. The frequently quoted definition of the financial affordability of housing states that “affordability relates to securing a certain standard of housing (or various standards) for a price or rent, that in the eyes of any third party (usually a government) does not represent an unreasonable burden for a household income.” [Maclennan and Williams, 1990]. The financial affordability of ownership and rental housing is most frequently measured by indicators—rent-to-income and/or housing expenditures-to-income ratios—relating the housing expenditures that a household must make to acquire and maintain adequate permanent housing to the net income of the household. Special indicators are also used to measure the affordability of ownership housing (number of years of savings in order to acquire adequate ownership housing, lending multiplier, affordability index of the National Association of Realtors in the USA based on median income and median price of appropriate ownership housing, etc.).

1.3 Synthesis

Public (both state and municipal) housing policies are usually led by

- 1) the effort to eliminate market failures and ensure that the housing market functions more efficiently (“optimalize”), and
- 2) the effort to redistribute housing consumption or, to put it more precisely, to ensure affordable housing for all groups of society.

Although both these objectives are far from complementary (and may sometimes be contradictory), public authorities—through their housing policies and other types of policies—strive to eliminate monopolies and “internalize” externalities following from the imperfect functioning of the market and, at the same time, they introduce various restrictions, regulations, licenses, plans and especially various fiscal subsidies or exemptions for selected groups of households which do indeed curb urban development of cities and help prevent sudden variations in housing prices. Such strategies, however, may lead—and in reality often lead—to the erection of other market barriers and an even more imperfect functioning of the housing market. The double role of the public authorities as *rational economists* and *understanding paternalists* [Lux, 2002] may be illustrated from the point of view of the welfare economy in Figure A1.1 (*Edgeworth box*), which is in Appendix I.

The role of a public authority as *rational economist* derives in particular from the well-known definition of the optimum developed by Italian sociologist and economist Wilhelm Pareto. According to this theory, the market finds itself in an optimum if there is no possible allocation of goods other than the existing one (another manner of production, other legislative environment, etc.) that could increase the utility of one of the participants without decreasing the utility of the other participants. If the situation on the market precludes any public inference that could increase the utility of one without decreasing the utility of another, we talk about a Pareto optimum (also the highest economic efficiency). If, on the other hand, the total utility could increase without decreasing the utility of any of the actors, then the process of “improvement” is called optimization, a Pareto improvement. Such an improvement involves, for example, the elimination of monopolies from the housing market or ensuring greater information dissemination among actors entering the market, i.e. interventions leading to the elimination of market failures.

The public entities, however, also enter the housing market as *understanding paternalists* and come with a certain concept of a welfare state. It is clear that the scope and type of public interventions depend largely upon which type of welfare concept the particular administration favors. In the case of libertarians and liberals (right-wing parties) it is more likely that they will consider housing to be primarily a private issue and will leave responsibility for ensuring housing to the individual citizen or his/her family. In the case of socialists and communists, on the other hand, it is more likely that they will consider housing to be a public matter and therefore the responsibility for ensuring housing will be placed on the shoulders of the State, municipalities, and public institutions. (The potential conduct of a public authority “headed” by libertarians, utilitarians, egalitarians, and socialists is briefly outlined in Appendix I). A majority of the politicians will most likely consider housing to be a matter of both public and private interests and, therefore, in any legal system of a developed Western country (even very liberal ones) we will find housing policies aimed at ensuring greater

equality in housing consumption (i.e. we will find public authorities in the role of the *understanding paternalists*). The dual role of public housing policy as *understanding paternalist* and *rational economist* is described in the Western expert literature on housing policies also as policies directed towards the *economic efficiency* of market functioning on the one hand, and towards the *social effectiveness (equity)* in market distribution of housing services on the other. Ensuring the economic efficiency of market functioning rests in the elimination of market barriers, in Pareto optimization; ensuring social effectiveness (equity) rests in the redistribution of consumption. “It is possible that a ‘*trade off*’ situation may arise between efficiency and equity” [Barr, 1993: 78] and in reality such a situation frequently occurs.

While efficiency is defined through the Pareto lens³, effectiveness is understood as the degree to which the originally defined goals of state intervention are met, i.e. whether the funds were actually spent where they were allocated and whether those to whom they were intended were actually helped. The question of the effectiveness is not left solely to the will of the policy-makers or the governments, who often do not define the intention of the intervention at all. *Welfare economics* distinguishes between “vertical” and “horizontal” effectiveness. Vertical effectiveness measures the extent to which the subsidies (a housing allowance, a social flat) are actually allocated to those who really need help (i.e. mostly to low-income households). Horizontal effectiveness measures whether any of the needy is excluded from the program. The reason that a social group is “left out” of a program may lie in the fact that the program has been set up badly or the potential claimants are badly informed (or may be afraid of potential social stigmatization).

“Almost any conceivable intervention in the economy will make some better off and others worse off. There are few pure Pareto improvements possible. However, there are likely many interventions after which those who are better off could compensate those who are worse off and still remain better off.” [Fallis, 1985: 123]. In connection with ensuring efficient market functioning (achievement of an optimum situation), many liberal economists recommend that the governments should define only the basic legislative framework for the exchange of goods, ensure the protection of ownership rights, and refrain from other types of interventions (Adam Smith’s *invisible hand of the market*). In such cases, however, it is presupposed that the markets are perfectly competitive (there are no monopolies, monopsonies, oligopolies), there are no externalities, no public goods, no insecurity (imperfect knowledge), and no macroeconomic problems related to inflation, unemployment, and economic growth. If a single one of these conditions is not met, the market is not able to achieve the optimum, and potential interventions may bring about Pareto optimization.

2. PUBLIC AUTHORITY AS AN UNDERSTANDING PATERNALIST

In addition to the sociological theory, there are several economical/political science explanations as to why public authorities behave not only as *rational economists*, eliminating market failures and externalities, but also as *understanding paternalists*. According to Downs [1957, in Barr 1993], “the poor”, acting either on behalf of themselves or in a coalition, take advantage of their right to vote to ensure a rational interest, i.e. to increase their wealth through a redistribution from “the wealthy” to “the poor”. According to Tullock and the presuppositions of the *rational choice* school of thought politicians behave selfishly and with the expectation of expanding their power, status, or income, they strive to maximize the number of potential electoral votes for themselves in the next elections. And because the income distribution is unequal in most countries (there are relatively few people with high incomes but many people with low incomes), politicians maximize the number of electoral votes by supporting the redistribution from the wealthy to the poor. Total property equality will not occur only because:

- there is a certain fear among politicians of the consequences of complete property equality on the efficiency of market functioning (e.g. nationalization of enterprises, high taxation);
- the minority of wealthy people usually concentrate relatively great influence on social and political events (theory of elites) and manage to defend themselves against certain pressures;
- many poor people also “want” a certain degree of property inequality to remain since they also wish to one day become lucky enough to be wealthier and more powerful than others. They never completely relinquish this possibility.

Another theory of the “redistribution imperative” is the *voluntary redistribution theory* proposed by Hochman and Rodgers [1969, in Barr 1993], that documents it is in the rational interest of every “rich” person to redistribute the wealth in the direction of “poorer” fellow citizens and therefore the “rich” do so—not under pressure from the State, but voluntarily. The theory is based on the assumption that there are always several externalities on the market (the housing market displays such characteristics, especially housing in blocks of flats) and, therefore, the consumption utility of each individual is significantly influenced by the consumption of others. Thus, the consumption utility of the “wealthy” is influenced by the degree or form of consumption of the “poor”. Moreover, redistribution is justifiable with respect to quasi-efficiency. Let us assume that there are only two citizens, wealthy W and poor P . In the simplest version their own utility functions (U) are only influenced by their own incomes (Y):

$$U_W = f(Y_W)$$

$$U_P = f(Y_P)$$

Now let us assume, though, that the amount of the utility of the wealthy citizen will depend not only on his own income but also on the income of the poor citizen:

$$U_w = f(Y_w, Y_p)$$

Then redistribution will follow from rational conduct of the wealthy person and will last until:

$$\frac{\partial U_w}{\partial Y_p} - \frac{\partial U_w}{\partial Y_w} > 0$$

i.e. the moment when an increase in the utility of the wealthy person's consumption following from the increase in the poor person's income by a unit equals the fall in the wealthy person's utility due to a decrease in his income by the same unit as a consequence of redistribution towards the poor person (∂ is the mark for partial derivation). The model is sometimes criticized, especially for neglecting the phenomenon of *free riders* who always appear if there are not only two, but n other, people. In addition to the theory presupposing the purely rational and "selfish" behavior of social actors, sociological theories of ethics and social solidarity also study the reasons for the redistributive aspects of public authorities' behavior. These theories emphasize the aspects of values, emotions and norms in individual and social lives that economists tend to neglect. Regardless of which social-economic theory the grain of truth can be found in, the fact is that the redistribution of housing consumption has become the axis of housing policies for most modern states and its goal is to ensure the affordability of housing for all social groups. There is no fundamental difference between central and local government housing policies from the theoretical point of view: Both elected entities behave as rational economists and understanding paternalists and both of them are influenced by the welfare concept accepted by leading political representation. Though some local governments in the CEE countries try to adapt such housing policy based purely on economic calculations (the quick privatization of all public housing) this will soon appear as an unsustainable approach due to the substantial decrease in housing affordability for the lowest income social groups in particular municipalities. The differences, however, appear when analyzing the particular housing policy instruments and power.

2.1 Public Housing Policy Instruments

In principle, there are two ways for public authorities as *understanding paternalists* to ensure (through the redistribution of wealth) greater equality on the housing market and, thus, ensure higher financial affordability of housing for low- and middle-income

groups of households: Income-tested cash allowance increasing the income of needy households (housing allowance), or action lowering the cost of housing, consequently decreasing the expenditures of needy households (social housing operation subsidies, rent regulation). With respect to the efficiency of both types of redistribution (Pareto lens and economic theory) it appears that the cash allowance is more efficient than an allowance aimed at decreasing the costs of housing. This comparison is shown Figure A1.2 (Appendix I) which captures the impact of both types of state intervention on a needy household.

In reality, however, the situation may not be quite as simple. Figure A1.2 captures a situation where one household makes a decision between two types of goods—in practice there are many heterogeneous households that make decisions among a wide range of goods (also work and leisure time). Moreover, the goal of wealth redistribution is usually not merely to achieve the highest possible efficiency of state intervention but also to achieve greater effectiveness of the intervention, i.e. the means allocated for increasing housing consumption must actually be used for housing. In the case of a public authority as *understanding paternalist*, effectiveness is often more important than efficiency and, therefore, we can imagine a situation in which the public authority opts for a less efficient solution but the aid really ends up where it should.

Notice, for example, that in the case of intervention directed toward decreasing the cost of housing, the household in Figure A1.2 would consume more units of housing services than if a cash allowance were provided, although the cash allowance would move the household to a qualitatively higher level of total consumption, a higher level of total utility. If the objective of public intervention is to increase housing consumption (e.g., improve the housing conditions) and not so much to increase the consumption of all other goods (to increase the living standard as such) and if the intervention is to be truly efficient, i.e. not to result in an increase in the consumption of other goods (let us presume housing as a merit good), then of the above-mentioned possibilities the public authority would tend to opt for an intervention decreasing the cost of housing (although a cash allowance may be made contingent upon various factors in order to prevent the “abuse” too).

In reality public interventions aimed at decreasing housing costs may, for political reasons, be preferred over a cash benefit as a minimum level of housing consumption is often easier to ensure and monitor by supply-side subsidies (construction of social flats) than through demand-side subsidies (housing allowance). Similarly in education, as well as being more transparent and politically acceptable, it is easier to ensure that the poor receive free basic education than to pay an allowance to the poor so that they may pay for their education. In order to support this fact using a formal analysis, let us expand the argument concerning the interweaving of utility functions of the rich and the poor which we have used above. Let us assume now that the amount of the total utility (U)

of wealthy citizen W is given by his income and the consumption (C) of his poor fellow citizen P . Let us presuppose this time that the utility of the rich person is influenced by the consumption of the poor person rather than by the poor person's income:

$$U_W = f(Y_W, C_P)$$

From the point of view of the wealthy citizen (i.e. based on his/her evaluation, his/her own values and norms), the consumption of poor citizen C_P may be broken down into "good" consumption ($C_{P_{good}}$) consisting of, for example, the consumption of quality housing, and "bad" consumption ($C_{P_{bad}}$) consisting of, for example, the consumption of alcohol, tobacco, etc. Thus, we would transcribe the utility function of the rich citizen in the following manner:

$$U_W = f(Y_W, C_{P_{good}}, C_{P_{bad}})$$

If the rich citizen decides to redistribute resources toward a poorer fellow citizen, the rich citizens will naturally strive to direct the resources exclusively to good consumption, which a simple cash benefit does not necessarily guarantee. In the case of a simple cash benefit, the poor citizen may support what the rich citizen may view as bad consumption, which, in turn, would decrease the total utility of the rich citizen. Therefore, redistribution through intervention aimed at decreasing housing costs (e.g. the support for the construction of social housing) that, from a purely economic point of view, is more expensive and less efficient, offers the rich citizen a better guarantee that his/her money will be used for good consumption by the poor fellow citizen and thus contribute to an increase in his/her own total utility. Similarly, even the poor citizen may, under certain conditions, favor supply-side support over a cash allowance because he/she will perceive such a situation as less stigmatizing than to stand in line for the payment of social benefits.

In conclusion, the following are fundamental public housing policy instruments aimed at securing greater financial affordability of housing:

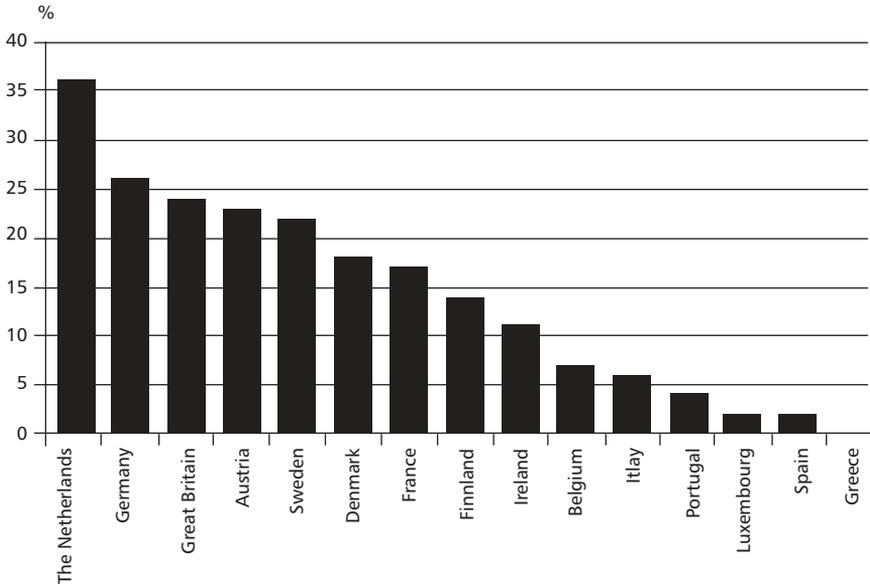
- 1) Rent regulation;
- 2) Allocation and rental policies in current social housing;
- 3) Support for the construction of new social flats provided by municipalities or non-profit housing associations;
- 4) Housing allowances;
- 5) Tax relief and interest subsidies for ownership housing;
- 6) Housing subsidies for special social groups (social care housing for elderly, barrier-free housing for the handicapped, shelter housing for the homeless).

Social housing (representing the subsidies aimed at decreasing the costs of housing) and housing allowances (representing the subsidies aimed at increasing the income of households) form the pillars of public housing policies in most of the developed countries. Though central and local housing policies are very closely inter-related, social housing operations (construction, allocation, rent policy) form rather a portion of the local government housing policy while the main responsibility in the case of housing allowances lies generally within the central government housing policy.

In almost all Western European countries we can find a housing sector called *social housing*. Although there are great differences in the individual systems (the housing policy in the European Union falls under the jurisdiction of member States), social housing is generally understood as a sector of rental housing in which public bodies of the state or municipalities strive to ensure a general equilibrium in the rental housing market. They provide dignified and suitable housing to the needy households who cannot otherwise afford housing on the free market due to their low income or other reasons. The rents in social rental dwellings are usually lower than the market rents for similar dwellings while the construction and sometimes operation of social flats is supported financially by public authorities in one way or another, such as by creating various fiscal benefits for investors, providing grants, interest subsidies, qualified public loans, or guarantees for construction loans raised on a free financial market. Investors and operators of social housing may be municipalities represented in municipal housing associations, housing cooperatives, non-profit housing associations, or private owners (only in Germany). Figure 1.1 shows the share of social housing on total housing stock in the EU member States.

An income-tested rent/housing allowance is a very important instrument of housing and welfare policy in European Union countries. With respect to housing policy, this is a demand-oriented instrument that directly influences the demand for housing. Indirectly, it may affect the supply side of a housing market. Increasing the disposable income of the population, by providing an allowance, it stimulates demand based on purchasing power. The natural reaction to an increase in demand is a corresponding increase in the supply. Income-tested housing allowances were implemented in the developed Western countries beginning in the middle of the 1960s (Germany 1965), but especially during the 1970s (Great Britain 1972, France 1977). In the current EU, the income-tested housing allowance is used in all countries except Italy and Spain. The basic principle of housing allowances is to provide entitled households from the rental or ownership housing sectors a sum usually amounting to the difference between the actual and normatively settled level of household burden by rental/housing costs, defined as the share of housing expenditures from total household income. When calculating housing allowance, three factors in particular are taken into account: Income; housing expenditures; and the number of people in a household. Strict income testing guarantees high social effectiveness of a given program.

Figure 1.1
Share of Social Housing within Total Housing Stock, EU [%]

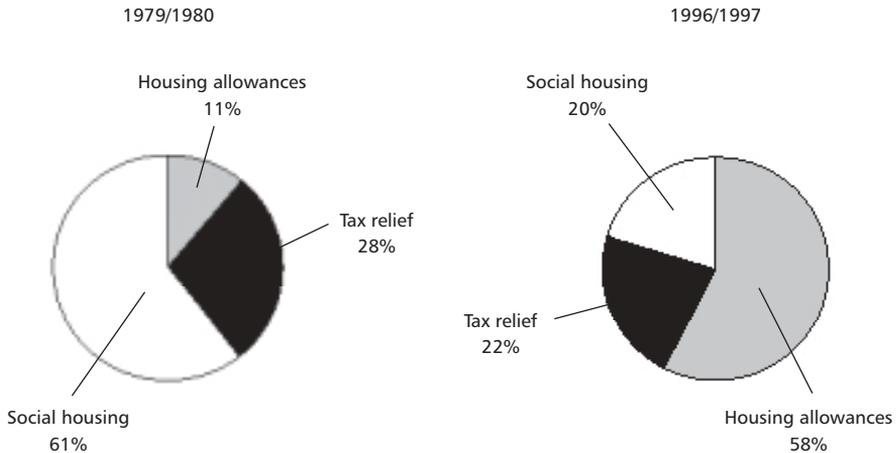


SOURCE: European Observation Unit for Social Housing, CECODHAS 1996.

2.2 Trends in Public Housing Policies in EU Countries

No government has ever questioned the important role of the public sector in ensuring greater equality in housing consumption (role of *understanding paternalist*), achieved especially through the use of instruments aimed at increasing the affordability of housing for low- and middle-income households. Even so, in most EU countries in the 1980s and 1990s, we saw dynamic reforms of housing policies, massive cuts in public housing expenditures and a move away from the relatively expensive social housing construction and operation support (also “supply-side subsidies” or “bricks-and-mortar subsidies”) toward less costly support through income-tested housing allowances (also “demand-side subsidies” or “subsidies per head”). This move away from supporting the supply towards supporting the demand is most visible in Great Britain, The Netherlands and Sweden, that is—and this is very important—in those EU countries with the highest share of social housing on total housing fund. The following Figure 1.2 shows clearly the change in the housing policy between the end of the 1970s and the end of the 1990s in Great Britain.

Figure 1.2
The Percentages of Individual Types of Support Out of
the Total Housing Policy Expenditures in Great Britain



SOURCE: Garnet (2000: 68)

Significant cuts in budget expenditures allocated for the construction and administration of social rental stock were caused by several factors:

- Public budget deficit and the need to decrease budget expenditures (support of demand is always less costly for public budgets than supply-side support);
- The need to comply with the strict Maastricht criteria, concerning the degree of the state budget deficit, upon entering the European Monetary Union;
- Low economic efficiency of the existing operators of social housing, unjustifiably high administrative costs, inflexibility, inefficient management;
- The attempt to return to ownership and rental housing construction private capital investors pushed out by post-war public housing construction;
- A crisis of the welfare state concept evident in the economic practice of the most “generous” countries by the brain drain, low private investments, growing unemployment, and inflation;
- Political will to give priority to ownership housing over rental housing;
- The conviction that the problem of post-war housing shortage is no longer a problem.

As is clearly apparent from a 1994 OECD report analyzing the trends in the management and functioning of public bodies in developed countries, more evident

efforts are being made to ensure public resources are used more efficiently since social objectives are no longer categorically superior to the calculation of the economic efficiency of public interventions. In other words, the instruments aimed at increasing the affordability of housing are subject to far more extensive economic criticism than before. In the period between the two *United Nations Conferences on Human Settlements HABITAT* in 1976 and *HABITAT II* in 1996, in which policy makers from almost the entire world took part, the perception of State responsibility in the field of housing completely changed. Generally, we can summarize this shift in the motto: “from housing supply to enablement”. The public authorities should no longer be seen as the providers but as the enablers. Civic society, the desired form of democratic countries, thus places far more emphasis on decentralized forms of self-administration as well as on non-governmental organizations, the private sector and civil movements. According to the *Global Strategy Until 2000* from 1988, the State should focus on the creation of legal and economic frameworks for citizens, non-governmental organizations, and the private sector so that they all can ensure housing and related services more efficiently than the State ever could. Changes during the 1980s and 1990s in the understanding of the housing policy and the role of individual actors on the housing market are often formulated as “from housing needs to housing rights”.

Public and independent audit institutions in many developed countries (Great Britain, the Netherlands and France) have developed sets of *performance indicators* measuring selected and comparable activities of municipalities and independent operators of social housing with the goal of perfecting the management in view of a more “market oriented” approach to social housing tenants. Some of these indicators in Great Britain are as follows:

- Coefficient giving the percentage of empty flats in the total housing stock per municipality (with the exception of flats intended for reconstruction or those where reconstruction is underway);
- Average rent loss due to vacant flats as a percentage of the potential rent roll of a given municipality;
- Ratio of average costs for flat maintenance to absolute costs and as a percentage of the total rent;
- Average loss resulting from rent arrears as a percentage of the potential rent roll in a given municipality;
- Average administrative costs per housing unit (and average number of people working in the housing stock management per housing unit);
- Average number of re-rented flats (turnover) and the average time before a flat is re-rented after vacancy (the turnover does not include flat exchanges but only “actual” new lease contracts);
- Average amount of time required to perform emergency, urgent and regular repairs;

- Satisfaction with the management and maintenance of dwellings among tenants based on regular obligatory sociological surveys conducted among tenants.

In Great Britain, municipalities are obliged to pool required information (in addition to this, they are also obliged to work out a detailed financial report on the use of allocated money and the debt) and to send the final calculations of the above-mentioned indicators to the *Audit Commission*, a state control body that has the power to inspect and verify the accuracy of such data. When making decisions on the allocation of state budget resources to municipalities for the next year, poor efficiency results lead to significant subsidy cuts. Similarly, British independent operators of social dwellings, the housing associations, must work out an annual general report containing all of the above-mentioned performance indicators. This report then serves as an important basis for decisions made on the allocation of capital grants intended for the rehabilitation or construction of social dwellings from the resources of the *Housing Corporation*.

Over the past few decades, the absolute scope of public finances allocated for the construction of social housing has decreased significantly and the monitoring of economic efficiency has become stricter. Furthermore, in many countries, newly adopted legislation has given a dominant position in the sphere of new social rental construction to independent operators of social dwellings (housing associations) that up to this point had played only a marginal role. These operators function as non-profit, yet financially independent and fully responsible, private legal entities that must carefully consider the costs and yields of potential projects. In the Netherlands (the EU country with the highest percentage of social housing), where these operators have basically become the exclusive operators of social dwellings, housing associations were completely cut off from state resources in the mid-1990s. In the future, housing associations are to cover the costs of their “noble” activities solely from private capital. Housing associations in Great Britain are also increasingly forced to make use of private capital. In the 1990s, they became the exclusive developers of new social flats (although a majority of social housing in Great Britain is still managed by municipalities). The share of total expenditures for new social housing construction covered by grants from the Housing Corporation funds (the state budget, in fact) fell in the course of the 1990s from 90% to 50% of total construction costs.

Even in Sweden the conservative government launched a tax reform in the 1990s related to a sharp cut in public subsidies for social housing that forced public operators of social dwellings (municipalities) to transfer the burden to the tenants, thus making housing less affordable. Housing expenditures-to-income ratio in Sweden is the highest among EU countries and it grew the fastest in the 1990s. Social housing reform in France has led to an expansion of the semi-public/semi-private legal form of housing associations called OPAC (to the detriment of the completely public form) that have, on one hand, obtained greater power because of their position as a private company but, on

the other hand, now receive fewer public funds. All these changes have been propelled by a single objective: Increase the efficiency of public expenditures while preserving the same basic goals of the housing policy. These housing policy goals are still dominated by that of ensuring the affordability of housing for all groups of citizens.

If the public authority is involved at all in the field of social housing, it is usually only after a critical analysis of the *efficiency* and *effectiveness* of potential subsidies. The main research questions used for the evaluation of the effectiveness and efficiency of different housing policy instruments are listed in Appendix II.

3. THE ROLE OF LOCAL GOVERNMENTS IN HOUSING POLICY IN EU COUNTRIES

The trend toward a decentralization of responsibilities in the sphere of housing policy has been apparent in many EU countries during the past two decades. Generally, decentralization of power from central to regional/local government has two forms: absolute and relative [Sýkora, 2000]. The absolute form consists of a direct transfer of competence from the central to the local level and includes the strengthening of the power of local government in the sphere of existing social housing (allocation rules, rent setting/pooling), new rental housing construction, land policy, regional planning, etc. The relative form is closely connected with the objective of decreasing the overall public supply side subsidies, leading to lower public authority interference with free housing market relations. This “deregulation of the public sector” concerns mainly central government policies. By weakening the role of the central government, the position of local/regional levels of public administration grows proportionately. “Housing ceases to be perceived as a problem of national significance. It is perceived rather as a local or specific problem.” [Sýkora, 2000, 11].

In EU countries, local governments are usually responsible for securing affordable housing for households that would not be able to acquire housing on the free market. In some countries (Great Britain, Sweden, Germany, Ireland), local governments are directly involved in social rental housing construction and operation (public housing). Yet in some cases, (the Netherlands, Great Britain, France, Ireland) countries cooperate with independent social landlords (housing associations/corporations, housing cooperatives, and in Germany also private investors) to find a consensual approach to social housing allocation and rent setting. Although independent housing associations are currently the main developers of social housing in Great Britain, municipalities must approve housing association projects—otherwise the chance of obtaining a grant from the Housing Corporation is very low. In Denmark, municipalities hold a majority on the boards of non-profit housing corporations and have the right to approve and audit budgets of housing cooperatives, both of them operating in the sphere of social housing.

In France, representatives of local authorities are guaranteed a position on the boards of OPHLM (main providers of the French social housing) by law and thus have direct executive authority. In Germany, municipalities may conclude different forms of public-private partnerships for new social housing construction and through them are directly involved in social housing operation (used mostly in the Eastern Lands).

In almost all EU countries, municipalities provide land for new social housing construction; municipal land zoning/policy influences not only the scale of social housing construction in a particular municipality, but also the competence in allocation and management of social housing. If land is provided for free, independent social landlords must generally meet specific conditions set by municipalities in the agreement.

Concerning the competence in the sphere of social dwelling allocation policy, Ghékiere (1992) distinguishes three types of competence distribution between central and local government apparent in EU countries:

- 1) The criteria for claiming social housing are set at the national or regional levels and individual operators of social housing (municipalities, non-profit organizations, housing associations, and private investors) are left with a rather small space for the application of these criteria in their own allocation policy. Municipalities, like the other social landlords, must strictly observe the centrally defined criteria. In countries with this relatively centrist form of competence distribution, the law defines the maximum income ceiling for those wishing to qualify for a social dwelling claim. The “centrist” approach is typical of Luxembourg, Germany, Belgium (regional act), France, and Italy, for example.
- 2) Municipalities are given the freedom to formulate their own allocation policies, which, however, must comply with the more general provisions set by the central government. These central rules are limited to defining general priorities, such as the target groups (the hierarchy of social neediness). The form of allocation and more “precise” criteria (income ceilings) are not defined at the central level and individual municipalities must clearly formulate and publish their allocation policy both for their own rental sector and in cooperation with independent housing associations for the remaining social housing stock. This allocation policy usually reflects the specific social problems in a given area (e.g. in allocation, preference is given to the unemployed or to single mothers with children, etc.). This approach is typical of the UK or Ireland.
- 3) With respect to the allocation of competencies, the Netherlands occupies a somewhat exceptional position. In the course of the 1990s the most important social housing operators in the Netherlands, housing associations, gained great autonomy. The rules for managing the social sector are defined in the *Housing Act* adopted in 1993. The binding conduct of housing associations is defined “rather vaguely” [Priemus, 1999] and is based only on the requirement of hous-

ing allocation to the socially needy portion of households, defined in 1990 as the 40% of households whose income is lower than the average Dutch household income. The allocation policy is either the result of partnership agreements between a municipality and housing association, or falls strictly within the power of housing association. If municipalities want to influence the allocation policy of housing associations, they have to “offer something” in exchange, e.g. must offer land for construction free-of-charge.

In most EU countries (with the exception of the Netherlands) municipalities have the right to allocate either all the new social dwellings within their territory (in Germany three candidates can be nominated by the municipality, of which one must be chosen by a particular social landlord) or to allocate a significant part thereof (even though they are constructed and operated by the independent social landlords). This right (or reservation quota) is set out by legislative acts in France, Germany, Sweden, Denmark, Great Britain and all other countries where municipalities are not exclusive social landlords. Allocation occurs in this case, either in the form of a direct allocation of a flat by the municipality (Denmark, France, and Italy) or in the form of a nomination of candidates (Great Britain, Germany, and the Netherlands). In Denmark, for example, the law reserves a quota of 25% of vacated or newly constructed social dwellings owned by other than municipal social landlords for municipalities; in Italy 15%, in Great Britain 50%, and in France 30%, is reserved for the State (represented by the Prefect in a given department) and 20% for municipalities. The reservation quota can always be extended through a mutual agreement following cooperation between municipalities and housing associations (municipalities can offer land free-of-charge for social rental housing construction to housing associations). This is obligatory in the Netherlands if municipalities wish to influence the allocation policy of social dwellings at all.

Municipalities usually administer the waiting list of applicants and use different point systems to evaluate the social needs of applicants (with the exception of Sweden where applicants are ranked chronologically according to the date of application). In some countries, municipalities provide additional subsidies or guarantees for social housing construction to independent social landlords (Germany, France). They also influence local housing conditions through generally applied activities such as territorial/urban planning, issuance of housing construction permits, land zoning and different forms of support for private housing construction (infrastructure, in Germany support for private rental housing serving for social purposes, etc.). The construction and provision of temporary shelters (for homeless people) or special housing (for the handicapped, elderly, etc.) also ranks among common basic municipal activities in the sphere of housing.

In CEE countries, new social housing legislation has been developing very slowly at the central level (with the exception of Poland) and, in most cases, all the responsibilities have simply been transferred to the municipal level, mostly in connection with

the transfer of dwellings from state to municipal ownership at the beginning of the transition. Therefore, local authorities faced the problem of housing being financially less affordable on their own and could only rely on partial financial assistance from the State. In turn, they very often obtained full competence in the sphere of public housing allocation, setting rent prices in vacant public dwellings, the scale and method of the privatization of public housing, the use of rental income and new social housing construction. The combination of old anachronisms (central legislation on non-targeted rent regulation and high level of tenant protection, “quasi-ownership” character of public rental housing, interference of central government with municipal housing privatization through centrally defined “right to buy”) and unrestricted freedom (allocation rules, rent setting in vacant dwellings, use of privatization income, etc.), combined with sharp cuts in state subsidies for new social housing construction, has created a situation in which municipalities have very limited space for an active local housing policy. At the same time, they have very different and individual approaches to housing policy that, in turn, differ significantly from municipality to municipality within a single country and even within a single district.

4. THE LOCAL GOVERNMENT AND HOUSING PROJECT

The *Local Government Policy Partnership Program* is a cooperation between the *Department for International Development* (DFID), the UK and the *Open Society Institute Local Government Initiative* for the period of 2000–2003. The objectives of this donor cooperation is to produce comparative policy studies on selected local government issues. Our goal is to respond to country needs and to make available reform experiences of Central European countries for the broader region. Beneficiaries of the project are national government ministries, local government associations, research and training institutions and individual local authorities. The partner countries are the Czech Republic, Hungary, Poland and Slovakia. The project invites experts who form country teams with an appointed manager. The project manager and editor is responsible for the preparation of comparative policy studies. Three comparative studies are published annually.

In 2000–2001, the selected policy areas were: Regulation and competition of local utility services; education finance and management; public perception of local governments. In the second year of the project the Program focused on the relationship between decentralization and regional development.

The following countries were selected for the purpose of the *Local Government and Housing Project*, under which this publication has been prepared: Bulgaria, the Czech Republic, Estonia, Poland, Romania and Slovakia. Each country team prepared the report on the situation in their country and the content of the reports has been standardized. Attention was paid to the comparison of different local government solutions

regarding the issue of a decrease in housing affordability for low- and middle-income households and to their critical evaluation from the point of view of economic efficiency and social effectiveness. The reports, thus, do not offer only simple descriptions of current situations but also an evaluation (though sometimes limited) of activities and programs, conclusions and policy recommendations on the background of the concept of social effectiveness and economic efficiency. The first part of the reports provides a brief description and evaluation of state housing policies. The second, most important part, deals with local government housing policies and assessment from the point of view of efficiency and effectiveness. The conclusion and policy recommendations always form the final part of each country report. The text of reports is accompanied by case studies of excellent practices that could serve as inspiration for both the local and central policy makers (in framed text boxes).

Some information is based on results from the questionnaire research *Local Government and Housing Survey* (LGHS) conducted in the selected CEE countries especially in connection with this project. All municipalities with populations higher than 5,000 inhabitants (in Poland, higher than 20,000) in each country were asked to fill out a short questionnaire on municipal housing policy objectives and management of municipal housing (rent arrears, voids, re-lets, etc.). Besides the need of obtaining basic information about local housing policies, we were inspired to measure the amount of social landlord housing activities using performance indicators. The full version of the questionnaire module used in all of the selected CEE countries is in Appendix III. The questionnaires were filled in either by the Mayors, the Deputy Mayors, those members of the Municipal Councils who were responsible for municipal housing policy or heads of special departments responsible for preparation of housing policy in a particular municipality. Table 1.1 shows the total rate of return of survey questionnaires in all the selected CEE countries.

Table 1.1
Local Government and Housing Survey
—Rate of Return

	Bulgaria	CR	Estonia	Poland	Romania	Slovakia
Rate of return	30.7	33.6	46.0	24.5	28.8	54.7
N (number of municipalities in sample)	43	89	17	56	76	77

The municipalities were asked to fill in the questionnaire even after the deadline (if the rate of return was lower than 50%). Slovakian experts attained the best results. As an under-representation of small municipalities occurred in almost all countries, the

data was, for the purpose of comparison, weighted to assure a realistic representation of municipalities according to their size.

Moreover, another weighting of results was applied for the purpose of public housing management comparison (performance indicators). When we discussed the topic during the project, we realized the simple weighting of data would not provide us with a real picture in a particular country because it showed just the weighted average “per municipality” (e.g. what was the average number of re-lets in municipal housing per one municipality). However, municipalities have different size populations and numbers of re-lets in a municipality with only 5,000 of inhabitants cannot be properly compared with the same number in a municipality of 300,000 of inhabitants. Therefore, we decided to also calculate a weighted country average “per inhabitant” using the following equation:

$$\frac{\sum_{i=1...N} i \times pop}{\sum_{i=1...N} pop}$$

Here, i means particular performance indicator for a particular municipality, pop means number of inhabitants (population) in a particular municipality and N means number of municipalities in the LGHS data sample. Results of the survey could now be presented in the country reports in three forms: As *simple average “per municipality”* (on non-weighted data file); *weighted average “per municipality”* (on weighted data file after basic weighting); *weighted average “per inhabitant”* (as calculated according to the above-mentioned equation). The authors could decide individually which of the above-mentioned forms of results presentation they will use in their country reports (based on particular results in their country). In the summary chapter, the complete and comprehensive comparison is provided for all the selected CEE countries.

The final chapter of this book summarizes main information and conclusions raised from the country reports, provides general comparisons of the situation in all the selected CEE countries and offers general housing policy recommendations. Here the reader will find the main information gathered from the project.

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APPENDIX I

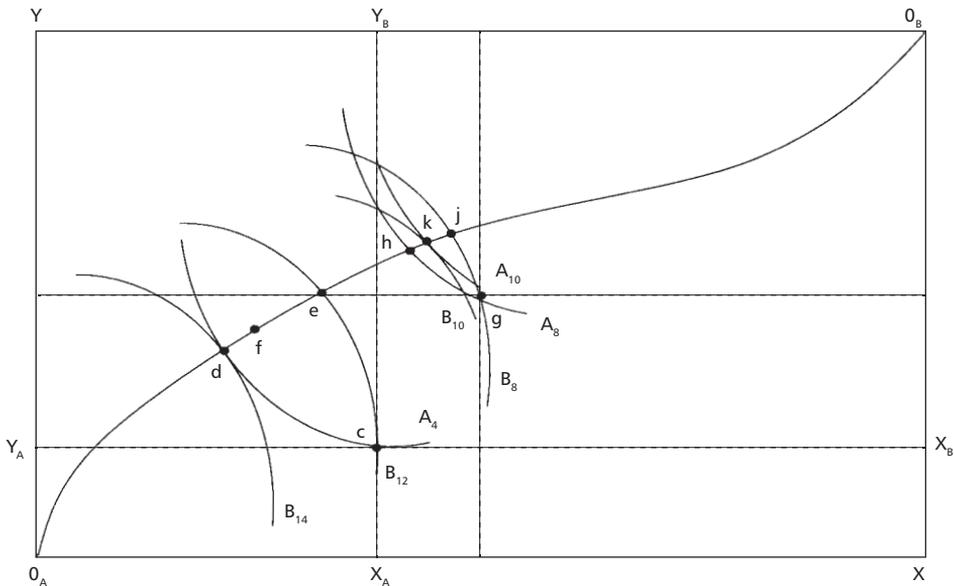
Public housing policy

The double role of the public authorities as *rational economists* and *understanding paternalists* may be illustrated from the point of view of the welfare economy in Figure A1.1 (*Edgeworth box*), which is based on the analysis of the welfare function W :

$$W = W [U_1 (x_{11}, x_{12}, \dots, x_{1m}), U_2 (x_{21}, x_{22}, \dots, x_{2m}), \dots, U_n (x_{n1}, x_{n2}, \dots, x_{nm})]$$

where U_1 through U_n indicate the level of total utility given by consumption x_1, \dots, x_m of goods by individual n citizens. Figure A1.1 shows a situation in which there are only two consumers in society (A and B) and two consumer goods (X and Y); the consumption of good X by consumer A is captured on axis $O_A X$ and by consumer B on axis $O_B X$, and the consumption of good Y by consumer A on axis $O_A Y$ and by consumer B on axis $O_B Y$. The total consumption of consumer A is then measured from the starting point O_A and the total

Figure A1.1
Distribution of Consumption of Two Goods
between Consumers A and B



SOURCE: Barr (1993, 74)

consumption of consumer B from the opposite starting point O_B . Curves A_n create indifference curves of consumer A (i.e. the combination of goods X and Y bringing consumer A the same utility), curves B_n create indifference curves of consumer B . The “contraction curve”, connecting points O_A and O_B , indicates all combinations of consumption of X and Y where the value of the marginal substitution in consumption of goods X and Y is the same for both consumers (i.e. it connects points where the indifference curves of both consumers meet and any movement outside this curve means a worsening of the situation for at least one of the consumers).

Let us assume, for example, that the initial division of consumption of goods X and Y is located at point c in Figure A1.1 where consumer A consumes X_A units of good X and Y_A units of good Y and consumer B consumes X_B units of good X and Y_B units of good Y . It is obvious that consumer B is far richer than A , since he may consume far more goods X and Y than consumer A . If, through market improvement (intervention of public authorities), the division of consumption moves from point c to point d , consumer B becomes “better off” (he moves up to a higher indifference curve from B_{12} to B_{14}) and consumer A does not become “worse off” (since he remains on the same indifference curve A_4 , i.e. he achieves the same total utility). The shift from point c to point d constitutes a Pareto improvement. Similarly, a shift from point c to point e also constitutes a Pareto improvement and, this time, the poor consumer A becomes “better off”; consumer A arrives at a higher indifference curve and consumer B remains on the same indifference curve B_{12} . Shifts from point c to points d and e always lead to greater allocation efficiency, a more optimal division of goods, while points d and e are equal with respect to pure efficiency (i.e. from the point of view of a public authority as *rational economist*). If public authority performed only the role of *rational economist*, its role would end by improving the efficiency of market functioning (e.g. elimination of a monopoly) leading from point c to point d or e .

The public entities, however, also enter the housing market as *understanding paternalists* and come with a certain concept of a welfare state. Since there are several concepts of the welfare state, let us outline briefly the potential conduct of a public authority “headed” by libertarians, utilitarians, egalitarians, and socialists.

Libertarianism: For libertarians the only way to improve social welfare is a Pareto improvement, i.e. a shift from point c to any point on the contraction curve (but not shifts along the contraction curve as such). Any pressure or policy leading to a further redistribution of wealth (e.g. a shift from point d to point k) is not desirable from a traditional liberal point of view (English political economy of the 18th century) or from the neo-liberal point of view represented by Hayek and Friedman in the second half of the 20th century.

Utilitarianism: The objective of utilitarians is to maximize the total utility of everyone. Thus, like libertarians, utilitarians would support the shift from point c to any point on the contraction curve. Unlike libertarians, however, some utilitarians consider

the utility to be a cardinally measurable variable (i.e. one that can be expressed in monetary or other measurable units). If both consumers A and B have an identical marginal utility of income functions (i.e. an income growth by an unit brings both of them the same growth in utility) the starting point for seeking the optimal distribution of goods is point g where both consumers consume the same amount of goods X and Y . A Pareto improvement is possible from point g , to point k , where the two consumers would be located on the same level of measurable utility functions (indifference curves A_{10}, B_{10} , i.e. each of them would achieve 10 units of measurable utility); consumption distribution corresponding to point k on the contraction curve would, thus, according to their perception of the welfare state, correspond to the ideal. If, however, the marginal utility of the income functions differed among individual consumers, the optimum allocation point would be different.

Rawls's egalitarianism: According to Rawls (1995), goods should be distributed based on a rational social justice while assuming the existence of a "veil of ignorance" concerning the future position of all society members on the market. Distribution of goods should be adjusted as long as each new structure improves the total utility of the poorest member on the market. Rawls's theory of social justice is based on the imperative to improve the situation of the most disadvantaged person in the market (therefore, a shift from point c to point d would not be desirable, although it does constitute a Pareto improvement). The shift from point d to point k is desirable from the point of view of Rawls's theory, although it does not constitute a Pareto improvement because the "poorer" consumer A benefits to the detriment of the "richer" consumer B . Like some utilitarians, egalitarians would consider the distribution corresponding to point k to be ideal.

Socialism: According to the basic thesis of socialism, all goods should be allocated completely equally. Like Rawls, socialists consider any shift towards point k to be desirable although it does not constitute a Pareto improvement and the situation of one may improve to the detriment of another.

Housing Policy Instruments

Let us assume that the preference of a needy household is reflected in indifference curves U_1 , U_2 and U_3 which connect all combinations of the consumption of housing and other goods that bring the household the same utility. Curve AB indicates the income limit curve of the household, mathematically speaking:

$$y = p_1x_1 + p_2x_2$$

Here y is the income of the household and p_1, p_2 are prices of both the goods and x_1, x_2 are the consumed amounts of both the goods (x_2 represents the amount of consumed housing services, housing). The household that desires to maximize its utility will opt

for a consumption combination that will correspond to point C_1 , where the income limit curve touches the highest possible indifference curve. Let us now presume that state intervention will result in a decrease of the cost of housing to p_2' . The income limit curve will then, thanks to the decreased cost of housing, move from AB to AC . The new income limit curve AC can be mathematically captured thusly:

$$y = p_1x_1 + p_2'x_2$$

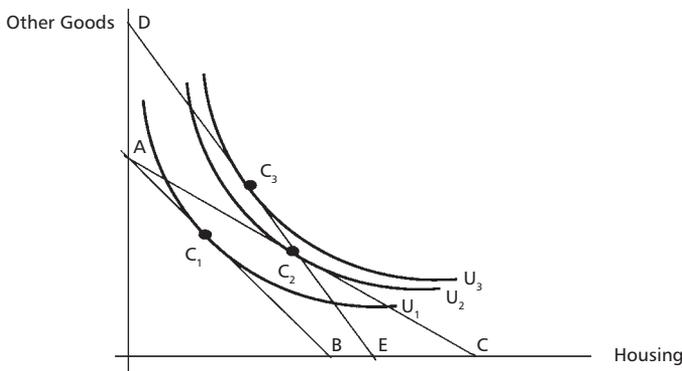
Because it is only the cost of housing that decreases, point A remains the starting point of the income limit curve on the axis measuring the consumption of other goods. In such a case, a rationally thinking household will opt for a combination of consumption in point C_2 on the higher indifference curve U_2 ; it will spend more on housing ($x_{2,2}$) and may consume more of the other goods (though what happens depends on the shape of the indifference curve). Let us now presume that the public authority, instead of decreasing the cost of housing, gives the needy household an income-tested cash allowance, the payment of which is as costly for public budgets as the original intervention consisting in decreasing the market prices of housing. Then the income limit curve moves from AB to DE , and mathematically we can describe curve DE thus:

$$y + (p_2 - p_2')x_{2,2} = p_1x_1 + p_2x_2$$

Since point C_2 is the point where income limit curve AC touches indifference curve U_2 and since the indifference curves are usually convex toward the beginning, part of the income limit curve DE must be above the level of indifference curve U_2 . Consequently, the household receiving an equally costly cash allowance is able to achieve a greater indifference curve (U_3) than it could if the intervention were to result in a decrease in the cost of housing, and opts for a combination of consumption corresponding to point C_3 in Figure A1.2.

Figure A1.2

Comparison of the Efficiency of Cash Allowance versus Price Regulation



SOURCE: Fallis (1985, 131)

APPENDIX II

Programs to Meet the Social Objectives of Housing Policies

Following is the list of the main possible social objectives of local or national housing policies:

- Higher affordability of housing for middle- and low-income households;
- Higher quality of housing;
- Social mix;
- Higher labor/tenant mobility;
- Sustainable development of housing conditions;
- Specific shortages (housing care, sheltered and supervised housing for disabled, handicapped, elderly, homeless people and children without parents);
- Tenant participation.

Greater Affordability of Housing for Middle- and Low-income Households

The examples of possible local/national housing programs are:

a) *Housing allowances (HA)*

Effectiveness: Has the program fulfilled the objectives of its “creators” (the decrease in the average rent-to-income ratio? Is the percentage of households receiving HA high enough to have a decisive influence on higher affordability of housing for middle- and low-income households? Are some households excluded from HA due to the formula or other restrictive provisions (e.g. needy households living in market rental sector)? What is the share of households that apply for HA out of the total number of households that are eligible for HA? If the share is low, why don’t households want to apply for HA? Do HA really help those who are expected to be helped (low income households) or does the insufficient targeting lead to the relatively high share of higher income households among the HA beneficiaries?

Efficiency: What is the share of HA expenditures on total state/local housing expenditures? Is there an empirical test of the correlation between the introduction of HA and rent price growth in an uncontrolled (market) rental sector? What is the estimate of the impact of HA introduction on rent price inflation? What other state/local expenditures rose due to the inflation caused by the HA introduction? Is there any econometric analysis comparing the overall demand side expenditures (HA) with the situation when the same amount of sources is used for supply side subsidies (e.g. new construction of social housing, improvement of current housing stock, etc.)? What are the main conclusions of the study? Does a higher HA (in association with higher rents), when factored according to the particular formula of HA applied in a particular country, raise the probability that the household will choose not to work instead of pursuing economic activity? Is there clear evidence of de-motivation from a particular HA model (poverty trap)? Is this problem quantified in some way?

b) *Rent regulation/setting/pooling*

Effectiveness: Is the rent regulation/setting/pooling really targeted to socially needy populations? Are some socially needy groups of households excluded from the sector where rents are controlled by public authorities (by excess demand or insufficient monitoring of rent controlled housing stock)? Are there provisions allowing for the rise in regulated rents when income of household living in the

controlled sector is rising? Do rent deregulation processes reflect the different level of social needs of the different households?

Efficiency: What is the effect of rent control on labor mobility? What is the amount of reconstruction/improvement investments in the controlled sector compared to the market sector? What is the average difference between rents in controlled and uncontrolled housing sectors for the same kind of dwellings in the same locations (or, at least, same size residence)? Do rents reflect the property values of dwellings in a controlled sector? Is there any evidence of underoccupation/overconsumption in the rent-controlled sector? How much do households from old dwellings subsidize the households living in new dwellings in the case of rent-pooling? Is there any evidence of the reduction of private market rental offers due to the national/local rent policy?

c) *Allocation policy*

Effectiveness: Are dwellings with lower rents allocated among households with lower income and *vice versa*? Is the maximum income limit applied in the allocation of social housing (means-testing)? Are there any groups of households excluded from allocation of current social housing? Do municipalities require a period of permanent residence in the area of local authority when households apply for social housing? Is there a stigma of social housing leading to the situation that other needy households decline to apply for social housing? Does the point system reflect the real social needs in different localities?

Efficiency: If the rent-setting mechanism is based on income, what are the incentives made to encourage members of the household to begin or continue to work instead of being unemployed? How is the difference between the housing costs of social landlords and income flowing from the rent handled? Is there any econometric analysis comparing the expenditures of a specific allocation policy to expenditures on HA when the same level of rent-to-income ratio is assured?

d) *New social housing construction (provided by different management forms)*

Effectiveness: Has the program fulfilled the objectives of its “authors” (e.g. housing for low- and middle-income households)? Is the maximum income limit applied in allocation of new social housing (means-testing)? Does the program lead to the filtration process? Can the program be abused (or was it abused) for other purposes due to bad legislation, rules or insufficient control (e.g. quasi-ownership housing instead of rental housing, housing for higher income households instead of housing for low- or middle-income households, etc.)? Are there effective provisions to prevent this situation? Are some target groups of population excluded from new social housing allocation and why?

Efficiency: What are the construction costs per square meter of new social housing compared to the construction costs of other private or public developers? Are there construction cost limits applied when public subsidies are allocated? Do rents in new social dwellings cover the total costs connected with maintenance, administration, repairs and construction after the deduction of subsidies, low or zero land price, tax advantages, etc.? Do rents reflect the property value of dwellings (location, quality, and services)? What is the average rent price of new social housing for different sized dwellings in comparison to the rents in new rental dwellings in other controlled or uncontrolled rental sectors in the same location? What is the average net present value (NPV) of new social housing investment (counting grants, interest subsidies, etc.) compared to the NPV of investments in the construction of new private rental dwellings? Are there any studies quantifying the scale of the crowding out effect of social housing construction? Are there any econometric tests comparing the overall expenditures of demand side subsidies (HA) with the same level of supply side subsidies (social housing construction)? Does private capital participate in the new social housing construction (e.g. in the case of new social housing management forms)? How many dwellings would be constructed if no private money were engaged, comparing with the situation of private-public joint investment?

e) *Privatization of rental dwellings (higher affordability of ownership housing)*

Effectiveness: Did lower- and middle-income households privatize their dwellings? Were they interested in the privatization process? What incentives were created by the State or local authorities to encourage lower- and middle-income households to privatize their dwellings?

Efficiency: What was the average difference between the market price of dwellings and the price of dwellings used for privatization, broken down by size of residence or location? Do new owners take care of their properties (i.e. pay enough to the repair funds to assure the maintenance and improvement of the dwellings)? What percent of privatized dwellings were sold immediately after privatization? What are the measures applied to prevent speculation or the dilapidation of buildings being privatized?

Higher Quality of Housing

The examples of possible local/national housing programs are:

a) *Refurbishment/reconstruction of dwellings*

Effectiveness: Has the program fulfilled the objectives of its “creators” (e.g. improvement in the locations where it was expected, the expected scale of improvement works, etc.)? Do tenants (or other people directly influenced by the program) participate in the design and practical application of the program? Further questions arise in context with Social Mix and Tenant Participation social objectives.

Efficiency: Are costs of refurbishment/reconstruction lower than the costs of demolition and new housing construction (including direct costs plus higher maintenance costs and risk premiums in the case of refurbishment/reconstruction of low-quality dwellings)? Were the costs of the program covered by private capital or at least partially funded by private capital? In the event homeowners benefit, do or will they cover a substantial part of the improvement costs? In the event tenants benefit, are or will the costs of improvements to the dwellings be covered (at least partially) through higher rents in the improved dwellings?

b) *Regeneration of the neighborhood*

Effectiveness and *efficiency* can be evaluated by answering the same questions as in the case of refurbishment/regeneration of dwellings.

c) *New social housing construction*

Effectiveness: Are there explicit requirements concerning the quality of new social housing dwellings (e.g. the size of dwelling, materials used, and insulation standards)? Could the developers avoid meeting these provisions? How are the developers encouraged to increase the quality of housing?

Efficiency: see above

Social Mix

The examples of possible local/national housing programs are:

a) *Allocation policy*

Effectiveness: Does the allocation policy in current and/or new municipal housing assure the maintenance or recovery of social mix in different locations/blocks of flats? How? Is the housing stock of

municipalities or other social landlords occupied by different income/racial/social groups of society due to the allocation policy of landlords or due to the inefficiencies of the housing market? Are there any survey results that would prove the answer? When analyzing the time series, is the effect of allocation policy on the maintenance of social mix only short-term or can it be expected to remain long term?

Efficiency: see above

b) *Rent setting/regulation/pooling*

Effectiveness: Is the rent-setting mechanism or rent regulation designed in a way that leads to a social mix of population and prevents social exclusion? Is the effect of rent policy on the maintenance of social mix only short-term or it can be expected to last?

Efficiency: see above

c) *Refurbishment/reconstruction of dwellings and regeneration of dwellings*

Effectiveness: Are there any social survey results confirming that improvement programs helped to maintain the social mix in particular districts or blocks of flats? Are the inhabitants living in areas or dwellings chosen for improvement participating in the project design and application? Do social landlords conduct regular tenant satisfaction surveys? Is the effect of refurbishment projects on the maintenance of social mix short-term or it can be expected to last? Is there any trend raised from time series analysis that could serve as evidence for the answer of the previous question?

Efficiency: see above

APPENDIX III

Questionnaire for the Local Government and Housing Survey (LGHS)

Local Government and Housing Survey

The Open Society Institute, Local Government Initiative, Budapest and would greatly appreciate it if you would be willing to participate in an International comparative survey on local government housing policies by filling in the following brief questionnaire. The survey forms a part of the International research project and the collected information will be used to provide a comparison of the policies in six Central and Eastern European countries. If any questions arise, do not hesitate to contact.....or the International coordinator of the project: Martin Lux, Institute of Sociology of Academy of Sciences, Jilská 1, 110 00, Prague 1, tel: (4202) 2222 1655, fax: (4202) 2222 1658, e-mail: lux@soc.cas.cz. The questions should be answered by the person responsible for housing policy in your local government. We thank you very much for your willingness to assist.

1. Does your local government have its own housing policy concept?

Yes, approved by the council	1
Yes, but not approved by the council	2
No	3

2. If yes, does it contain clearly defined main housing policy objectives to be achieved?

Yes	1
No	2

There is no housing policy	99
----------------------------	----

3. If yes to number 2, please list these objectives and rank them according to their importance.

- 1
- 2
- 3
- 4
- 5
- 6

No objectives have been defined	99
---------------------------------	----

4. Whether your local government has its own objectives or not, would you please, according to your own opinion, rank the following objectives according to their importance when particular housing problems in the area of your local authority are taken into account. Write 1 for the most important objective and 9 for the least important objective.

	Higher affordability of housing for middle- and low-income households
	Improvement of housing conditions, higher quality of housing (including higher energy savings)
	Maintenance or creation of social mix to prevent social segregation
	Higher labor mobility
	To meet the shortage of housing for disabled, handicapped people
	To meet the shortage of housing for elderly people
	To accommodate homeless people
	Tenant participation in housing management
	Support for home ownership and/or private housing construction

5. Would you briefly indicate what policies/programs/activities are being prepared or are already used by your local government (even from the range of national housing programs) to meet the three most important social objectives stated in question No. 3. If no objectives are defined, please indicate what policies/programs/activities are being prepared or used by your local government (even from the range of national housing programs) to meet the objectives that were evaluated from the list in question No. 4 as the three most important social objectives.

Note: Among programs/policies the following may be included: New rental housing construction subsidies, land policy, housing allowances, rent setting system in local government housing, allocation policy in local government housing, new management forms (public private partnership, housing associations), etc.

Objective 1:

.....

Objective 2:

.....

Objective 3:

.....

6. Which of these programs would or will, in your opinion, lead to the fulfillment of the objectives in the most effective way?

Objective 1:
 Objective 2:
 Objective 3:

The next few questions concern your local government housing. Please exclude the sheltered housing or housing services for special purposes (housing for pensioners, children without parents, handicapped people, bread-and-breakfast housing, etc.) from your responses to the following.

7. How many rental dwellings does your local authority own?

.....dwellings

8. What is the percentage of local authority housing out of the total number of dwellings in your municipality. If no precise figures are available, please estimate.

.....%

9. What is the average residential size of your local authority dwelling in square meters? If no precise figures are available, please estimate.

.....square meters

10. What is the average number of rooms per local authority dwelling? ? If no precise figures are available, please estimate.

.....rooms

11. What is the number of vacancies in your local authority housing now?

Note: Housing that is vacant and available for let should include: a) all dwellings where the previous tenant is no longer being charged rent and no repairs are required before a new tenant can move in; b) all dwellings which have been newly acquired in a satisfactory condition for letting; c) all dwellings which have been handed over for new letting or re-letting after the reconstruction/improvement; d) all dwellings to be let after minor repairs (simple maintenance between tenants moving out and new tenants moving in).

.....dwellings

12. What was the average rent loss through vacancies as a percentage of gross rent roll last year?

Note: The rent loss through vacancies is the total amount of rent that was not collectable during the financial year because dwellings were vacant (though available for letting). Rent roll is the total amount of potential rent collectable for the financial year for all inhabitable stock owned by local authorities, whether occupied or not. Exclude any rent losses arising from long term vacancies that arise because a property is designated for major repairs.

.....%

13. What was the sum of rent arrears as a percentage of the gross rent roll last year?

Note: The rent arrears should include any arrears carried forward from previous years.

.....%

14. What is the expected sum of rent arrears as a percentage of the gross rent roll in 2001?

.....%

15. What was the number of re-lets as a percentage of the total municipal housing stock last year?

Note: The number of "true" re-lets as a proportion of the number of dwellings in municipal ownership should be calculated. The transfers (flat exchanges) are excluded from "true" re-lets!

.....%

16. What is the average time from application to allocation of a municipal dwelling for a household of two adults and one child (just born) where only one adult person is earning a national average salary? Please indicate in months.

.....months

17. Does your local authority use different rent setting approaches in municipal housing?

Yes	1
No	2

THE FOLLOWING QUESTIONS ON RENT SETTINGS WERE PREPARED BY COUNTRY TEAMS AS THERE ARE BIG DIFFERENCES AMONG COUNTRIES.

18. Do total rent revenues cover the full costs connected with housing maintenance, necessary repairs and administration of local authority housing? Please do not take into account reconstruction/improvement/modernization costs.

Yes	1
No	2

19. Do you provide a waiting list of applicants for local government dwellings?

Yes	1
No	2

20. Do you use a clearly defined point system of social need measurement when municipal housing dwellings are allocated?

Yes	1
No	2

21. Does your local authority use different allocation policies?

Yes	1
No	2

22. If yes, what are the percentages of dwellings allocated by different allocation policies out of the total amount of dwellings allocated in the last year? Please give a percentage for each separate allocation policy.

.....

23. Who manages and maintains your local authority housing (or the majority of the stock)?

Municipal administration	1
Budgetary organization	2
Municipal maintenance company	3
Private maintenance company	4
Private real estate agency	5

24. What most efficient tool do you use or did you use to solve the problem of rent arrears?

.....

25. What most efficient tool do you use or did you use to solve the problem of vacancies?

.....

26. Could you please, briefly describe the housing policy initiative of your local government that improved the conditions of housing or met the most acute housing problems and that, in your opinion, could serve as an inspiration for other local governments in your country?

Note: Different programs such as alternative management forms, public-private partnership management, special allocation or rent policies, control systems or tenant participation management, etc..

.....

Name of municipality:

Region:

Thank you for your answers.

ENDNOTES

- ¹ 'A public good is a good or service that provides benefits which cannot be limited to those who directly pay for it' [Truett and Truett, 1987: 41].
- ² Portugal has defined the right to housing in great detail. They specify that the right to housing includes accommodations of sufficient size, hygienic standard and a rent proportionate to income.
- ³ "Generally speaking, economic efficiency lies in the fact how to take best advantage of the limited resources to satisfy human needs." [Barr, 1993, 72].

