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# EFFICIENCY AND EFFECTIVENESS OF HOUSING POLICIES IN THE CENTRAL AND EASTERN EUROPE COUNTRIES<sup>1</sup>

*Martin Lux*

## ABSTRACT

The article provides the comparison of state housing policies in six selected Central and Eastern European countries. The description of the basic elements of policy approaches is followed by an analysis of both the efficiency and effectiveness of new supply- and demand-side subsidies. For this purpose the author set particular criteria allowing evaluation of subsidies. According to the results the most effective/efficient subsidies were implemented where general policy orientated towards the rental model was combined with decentralization/deregulation in the rental sector. The worst results appeared in countries where the same orientation of policy was not accompanied by decentralization/deregulation of rental housing. The factor of housing shortage may also influence the level of efficiency and effectiveness of public subsidies.

## KEYWORDS

Public subsidies, efficiency and effectiveness, social housing, housing allowances, housing privatization, comparative context

## 1. INTRODUCTION

Although few modern democratic governments have ever questioned the importance of the role of the public sector in ensuring greater equality in housing consumption, achieved especially through the use of instruments aimed at increasing the affordability of housing for low- and middle-income households, in several EU countries in the 1980s and 1990s we saw dynamic reforms of housing policies, significant cuts in public housing expenditure and a move away from the relatively expensive supply-side subsidies towards less costly support through income-tested housing allowances (i.e. demand-side subsidies). This is most visible in the United Kingdom, Netherlands and Sweden, that is those EU countries where social rented housing plays a major role (Boelhouwer and Van der Heijden 1997; MacLennan and More 1997; Priemus 1997; Garnett 2000).

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 many countries took part, there was a complete change in the understanding and perception of housing with respect to the responsibility of the government to citizens. Generally, we can summarize this shift in the motto: 'from housing supply to enablement'. The title of a World Bank document *Housing: Enabling Markets to Work* clearly reflects this trend (World Bank 1993).

If new public subsidies are introduced, they are usually accompanied by careful and continuous assessment of their *efficiency* and *effectiveness* made either by state administrations themselves or by special audit (control) institutions. While efficiency is traditionally viewed through the Pareto lens,<sup>2</sup> 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. However, the question of the effectiveness is not left solely to the will of the lawmakers or the governments. The *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. Horizontal effectiveness measures whether any of the needy are excluded from the programme (Barr 1993).

Trends in the European Union countries are generally well documented but the question is, what is the situation in the Central and Eastern European (CEE) countries in the field of efficiency and effectiveness of new housing policies? The objective of this article is to briefly describe the state housing policy approaches in the six selected CEE countries and to detect through the country comparison at least some of factors that may influence the degree of their efficiency and effectiveness. As efficiency and effectiveness of public subsidies is only scarcely monitored in those countries, we will define our own set of criteria that will be used for the evaluation. However, this may be done only after the general description of the state-of-the-art because we can use only those indicators that are available from statistics and housing research in those countries.

The following countries were selected for the comparison: Bulgaria, the Czech Republic, Estonia, Poland, Romania and Slovakia. Though the countries selected represent a range of housing systems, population size, economic structures and geographic location, the conclusions are not generalizable to all CEE countries.

## 2. DESCRIPTION OF HOUSING POLICIES

Table 1 shows the main differences in the basic socio-economic indicators among the selected CEE countries. With the exception of Slovakia, the total

Table 1 Socio-economic indicators in selected CEE countries

	Population (in thousands) (mid-2001) <sup>a</sup>	Population growth rate (in %) (2001) <sup>a</sup>	Share of urban population (in %) (mid-2001) <sup>a</sup>	Area (in km <sup>2</sup> ) <sup>a</sup>	GDP (PPP) per capita (USD)		Unemployment (in %) <sup>b</sup>
					2000 <sup>b</sup>	2000 <sup>c</sup>	
Bulgaria	7,867	-1.14	67.4	110,910	6,200	-	17.7 (2000)
Czech Republic	10,260	-0.07	74.5	78,866	12,900	14,285	8.7 (2000)
Estonia	1,377	-0.55	69.4	45,226	10,000	-	11.7 (1999)
Poland	38,577	-0.03	62.5	312,685	8,500	9,588	12.0 (1999)
Romania	22,388	-0.21	55.2	237,500	5,900	-	11.5 (1999)
Slovakia	5,403	0.13	57.6	48,845	10,200	11,643	17.0 (2000)

*Notes:*(a) United Nations, *World Urbanization Prospects, 2001 Revision*.(b) CIA, *World Factbook 2001*.(c) OECD statistics ([www.oecd.org](http://www.oecd.org)).

population is shrinking, particularly in those countries with the lowest GDP per capita (Bulgaria, Romania) and in Estonia. The Czech Republic has the highest percentage of its population living in urban areas, while Romania and Slovakia are among the countries with the lowest percentage. Bulgaria and Romania have the lowest GDP per capita and Bulgaria and Slovakia are struggling with a relatively high unemployment rate.

Tables 2 and 3 provide a summary about general housing conditions and tenure structure. The most significant changes in tenure structure appeared in Estonia, Slovakia and Romania; these are consequences of large-scale public housing privatization. In the Czech Republic and Poland, due to the slower speed of privatization, municipalities remained the largest landlords of rental housing in 2001. Unfortunately, the figure indicating the share of private rental housing of the total housing stock is very often not available, though this housing sector is present in all analysed countries. The highest share is probably in Estonia and the Czech Republic, where restitution of property to former owners was applied to a relatively large proportion of expropriated residential housing.

With the exception of Poland, there is no rental housing stock owned by non-profit independent housing landlords (other than housing cooperatives), the housing associations. On the other hand, housing cooperatives still own large numbers of dwellings in the Czech Republic, Poland and Slovakia even though the fact is that in the Czech Republic and Slovakia the free-of-charge transfer of cooperative dwellings to the full ownership of cooperative members was introduced by 1994. (Cooperative housing obtained more or less the status of homeownership in Slovakia and the Czech Republic.) In Poland two statutory forms have been introduced: ownership and rental cooperative housing (for more details see Lux 2001).

The number of dwellings per 1,000 inhabitants is relatively high in Estonia, Bulgaria and the Czech Republic. From this point of view, it would seem that these countries are characterized by housing sufficiency. However, in practice many other factors enter the equation: rent regulation, high costs of acquiring new housing, low quality of prefab housing and relatively low dwelling area per person. Poland has the lowest number of dwellings per 1,000 inhabitants and as the only country in our comparison probably suffers from a real shortage of housing units.

The change in housing policy from an almost wholly state-controlled and state-financed system to one based on private ownership and market financing could not be expected to have been realized immediately after the change of the political regime. Together with the politicians' implicit fear of rapid changes to the conditions related to the functioning of the housing market meant that reform in the sphere of housing was realized only partially. The reforms were often characterized by an amalgam of liberal and conservative approaches. These hybrid strategies led to the complete withdrawal of public subsidies but they did not pull down the

Table 2 Tenure structure and its change between 1991 and 2001 (% of total housing stock)

	<i>Bulgaria</i>		<i>CR</i>		<i>Estonia</i>		<i>Poland</i>		<i>Romania</i>		<i>Slovakia</i>	
	1992 <sup>a</sup>	2000 <sup>a</sup>	1991	2001 <sup>b</sup>	1992 <sup>c</sup>	2000 <sup>c</sup>	1991 <sup>d</sup>	2000 <sup>d</sup>	1990 <sup>e</sup>	1998 <sup>e</sup>	1991	2001 <sup>f</sup>
State rental housing	1.8	1.8	39.0	–	25.8	0.7	–	–	21.4	4.0	–	1.1
Municipal rental housing	2.0	2.2	–	24.0	34.7	3.3	17.97 <sup>g</sup>	11.57 <sup>g</sup>	–	–	21.2 7 <sup>g</sup>	5.4
Enterprise rental housing <sup>i</sup>	2.9	3.2	–	–	–	–	13.7	4.6	–	–	6.5	–
Cooperative housing	0.2	0.3	20.4	20.0	5.0	3.9	25.4	28.6	1.5	–	22.1	15.6
Private rental housing	0.5	0.8	–	7.0	n.a.	n.a. <sup>h</sup>	n.a.	n.a.	1.0	3.0	–	4.1
Rental stock of housing associations	–	–	–	–	–	–	–	0.01	–	–	–	–
Homeownership	91.0	92.5	40.5	49.0	34.5	85.9	43.0	55.3	76.1	93.0	50.2	73.8

*Notes:*

(a) Statistical Office of Bulgaria.

(b) Housing Policy Strategy, Ministry for Regional Development of the Czech Republic.

(c) Statistical Office of Estonia; in 2000: 1.1% of housing stock is owned by other owners and the owner of 5.1% is unknown.

(d) Statistical Office of Poland.

(e) UN/ECE – CHF Practical Workshop on Housing Privatization, Krakow 1999.

(f) Preliminary results of Census 2001; Slovakian Statistical Office.

(g) Including state rental housing.

(h) The share is estimated at a level of 10% of total housing stock (Kährlik *et al.* 2003).

(i) The enterprise housing consists of the stock of rental housing owned by former state enterprises allocated among employees. The majority of housing was privatized or transferred into the ownership of municipalities at the beginning of the transition.

Table 3 Housing condition indicators (1991–2001)

	Bulgaria <sup>a</sup>		Czech Republic <sup>b</sup>		Estonia <sup>c</sup>		Poland <sup>d</sup>		Romania <sup>e</sup>		Slovakia <sup>f</sup>	
	1992	2000	1991	2001	1992	2001	1991	2000	1992	1999	1991	2001
Number of dwellings per 1,000 inhabitants	400	424	396	424	407	434	289	306	336	352	336	350
Average floor area of dwelling (in m <sup>2</sup> )	63.5	63.9	70.5	49.3 <sup>g</sup>	53.5	54.0	59.6	61.5	33.7 <sup>g</sup>	34.4 <sup>g</sup>	48.3 <sup>g</sup>	56.1 <sup>g</sup>
Average floor area per person (in m <sup>2</sup> )	25.4	27.1	25.4	18.6 <sup>g</sup>	21.8	23.4	17.5	19.2	11.3 <sup>g</sup>	12.1 <sup>g</sup>	14.6 <sup>g</sup>	17.5 <sup>g</sup>
Average number of rooms per dwelling	2.92	2.89	2.66	2.71	2.9 <sup>h</sup>	2.6 <sup>h</sup> (1999)	3.41	3.48	2.46	2.50	2.86	3.21
Average number of rooms per person	0.86	0.82	n.a.	n.a.	1.2 <sup>h</sup>	1.1 <sup>h</sup> (1999)	1.00	1.09	0.80	0.88	0.88	1.00

*Notes:* Dwelling is defined as a room or set of rooms and facilities that serve or are assigned to permanent housing and create one structural/technical unit. (In Bulgaria: has one or more exits to commonly accessible area. In Romania: with separate entrance from the staircase, hall, yard or street which has been built, transformed or arranged with a view to be used, in principle, by a single household.) The indicator is calculated from the total number of dwellings (including both inhabited and vacant dwellings) if it is not stated otherwise. Room means habitable room that has the possibility of daylight, ventilation and heating, including kitchen when it is only a one-room flat and with minimum area of 8 m<sup>2</sup>. (In Bulgaria: minimum area of 7.5 m<sup>2</sup>. In Poland: minimum area of 4 m<sup>2</sup>. In Romania: minimum area of 4 m<sup>2</sup> with at least 2 metres high at its tallest point, excluding kitchen. In Estonia: kitchen and other supplementary spaces are excluded.) The floor area is defined as total floor area of the dwellings if it is not stated otherwise.

(a) Statistical Office of Bulgaria.

(b) Czech Statistical Office.

(c) Statistical Office of Estonia.

(d) *Housing Economy in 2000*, Central Statistical Office.

(e) National Commission for Statistics (2001).

(f) With the exception of the first figure (number of dwellings per 1,000 inhabitants) all other figures are for only inhabited housing stock. *Source:* Slovakian Statistical Office.

(g) Average living floor area of dwelling (floor of habitable rooms and part of kitchen area, over 12 m<sup>2</sup> for Czech Republic, Slovakia; floor of habitable rooms for Romania).

(h) The figures are calculated only from inhabited housing stock.

barriers preventing their compensation by voluntary not-for-profit activities or private investment. The housing sector belongs often among the least efficient in the economy because many relics from the past still remain in place (strong legal tenant protection, impossible or long eviction process, rent regulation, bureaucratic barriers to private investments, slow legal proceedings, etc.).

The main consequences of more restrictive public housing financing and liberalization of construction and utility prices at the first stage of transition were that housing affordability decreased, as did the amount of new housing construction. In some countries, the state refused to subsidize new housing construction but decided to maintain strong tenant protection and rent control in rental flats. Decreased availability of dwellings with controlled rents meant that the doors were closed to newly established households looking for affordable housing and there has been a rapid growth of black market rental contracts.

Though the basic legislation for a market housing finance has often been approved, its slow development with a continued perception of housing shortage has led to the re-creation of new, but often untargeted housing subsidies designated mainly for new housing construction in the second half of the 1990s (see below). These subsidies combined with the regressive character of tax incentives often helped only the higher-income groups, who did not need such assistance, although it did help them to construct/buy larger dwellings than they would have otherwise been able to afford. Housing privatization, often recommended by international organizations, was shown to have many drawbacks and intensified the social tensions between those who were able to take advantage of house-purchase subsidies and those who were not.

#### **a. Housing privatization**

The rules and scale of privatization were very different in the individual countries. In Estonia, Romania and Slovakia, large-scale privatization of former public housing took place mainly because of the application of the tenants' right to buy. (In Slovakia only a limited form of this was applied.) The central legislation defined the general terms for privatization (right to buy for tenants, calculation of sale prices, condominium registration and sometimes public-loan conditions) and municipalities had only limited possibilities to influence the scale or the most fundamental conditions of privatization. In Poland and the Czech Republic the scale and speed of privatization were much more modest. Tenants in public rental housing did not receive the unrestricted right to buy and municipalities could decide for themselves the scale as well as the terms for privatization. Bulgaria has a special status in this context, as the privatization of public rental housing was also common practice during the Communist regime. We can thus



distinguish three groups among the selected CEE countries: fast privatizers, slow privatizers and the special status of Bulgaria.

*i. Fast privatizers*

In Romania, all tenants who could make the down payment and receive a qualified mortgage loan were eligible to buy the public rental housing they occupied. The qualified loan from the Savings and Deposits Bank, with a 25-year maturity and 4% nominal annual interest rate (for married couples under 35 years of age, the maturity was 30 years with a 2% interest rate) was offered to all households willing to buy their dwelling. The price was very low, dependent on the date of construction.

All adult persons permanently living and working in Estonia received 'privatization vouchers' (according to the length of time they had worked in Estonia since 1945) and the purchase of apartments was realized mostly through such vouchers. All public tenants had a right to buy public rental housing, that they occupied, for very low prices and using the vouchers. Direct financial costs consisted of only the legal fees for the transaction, not exceeding 1% of the total price. Owing to these very soft terms, no particular financial programmes had to be introduced to help cope with paying the costs. However, part of the housing stock was restituted into the hands of former owners, which resulted in profound social tensions between those who could benefit from privatization and those who could not, due to the restitution of property. Municipalities are thus obliged to provide tenants in restituted buildings with flats close to their previous residence and having the same quality standard and size as their former residence. These flats may be privatized under the same preferential conditions originally applicable to tenants in public housing.

The Act on Privatization of Municipal Flats was one of the first Acts of the independent Slovak Republic; in 1995 and 1998 amendments were introduced that strengthened the power of tenants applying to purchase their flats. The first amendment introduced the rule that municipalities were obliged to privatize the flats within two years if at least 50% of the households in a particular block of flats requested their flats to be privatized. The prices, regulated by the central law, were very low.

*ii. Slow privatizers*

In the Czech Republic and Poland, the right to buy was applied only to tenants in cooperative housing. The Act on Ownership of Apartments and Non-residential Premises (1994) with later amendments, enabled the privatization of public rental stock in the Czech Republic (condominium legislation), but the tenants' right to buy has not been introduced, nor has the regulation of privatization prices been applied. A look at the Polish

situation gives us the same picture: dwellings were privatized generally at market prices although various discounts were granted. The extent of the discount, as well as the selection of the stock to be privatized, remained under the competence of the individual municipalities.

### *iii. Bulgaria*

Unlike other transitional countries, Bulgaria started its democratic development with a high percentage of homeownership, consisting of 91% of the total housing stock. The privatization and restitution processes did not cause significant changes in tenure structures. During Communism housing, which was initially built to be state or municipally owned, was later sold to the tenants. Each tenant had a right to buy the dwelling after occupying it for two years and could benefit from soft loans from the State Savings Bank with a 2% nominal annual interest rate. Moreover, the construction of public housing was subsidized by the state and the prices were thus widely affordable. A new regulation was adopted in 1994, supposedly to prevent further privatization of municipal housing stock and introduce more stringent criteria for its allocation, but this moratorium was cancelled in 1996.

### **b. Supply-side subsidies**

Supply-side subsidies directed towards new social/affordable rental housing construction are low in all the CEE countries analysed and, with the exception of Poland, municipalities are the only providers of rental housing for low-income households. Legal definitions of social housing are found only in Estonia, Poland and Romania. In all cases it includes some kind of municipal shelter for the most needy households. The residual character of the social housing definition is found mainly in the Southern European EU member countries (and in Belgium); in an overwhelming majority of the EU countries a much wider concept of social housing system is used. The understanding of the term 'social', in connection with housing, is thus different in the CEE region than in the countries of Western Europe, and it is probably closer to the perception of social housing in the USA.

In any event (even if social housing is not legally defined) the public housing stock is considered to be the only affordable housing for households in need of social assistance. This relates mainly to those countries ranked among the group of fast privatizers and Bulgaria where municipal housing stock became residualized. With the exception of Estonia and Bulgaria, rents in municipal/state dwellings are regulated by the state. The process of rent deregulation was progressing very slowly, mainly in Slovakia, Bulgaria and Romania.

One of the most important contributions to rental housing reform in

Poland concerns the introduction of a new type of social housing operator: social housing associations (*Towarzystwa Budownictwa Społecznego*, TBS). A TBS cannot make a profit. The main activity is designed for new 'social' rental housing construction, which is partially subsidized through the preferential loans extended by the State Housing Fund (70% of total costs). The rents in new TBS housing are set by the Municipal Councils; they, however, cannot exceed 4% of the replacement value of a dwelling set by the *voivoda* (head of the Regional Council) in its quarterly edicts. The explicit rules for allocating new rental flats and income ceilings were introduced by a special Act. Moreover, once every two years the tenant households must present the TBS with a declaration of the average monthly household income for the past year. If the declared household income exceeds the ceiling, the association may charge a free market rent. TBS housing has been constructed in Poland since 1996.

However, no similar process for the creation of non-profit independent social landlords cooperating with local authorities in new social/affordable rental housing construction can be found in the other selected CEE countries. In some of them state housing funds were also established but they channelled the budget contributions mainly to support home-ownership construction/purchase (Slovakia, Estonia). Though target groups of the population were sometimes defined, means testing has not been applied or has been applied only partially. The guarantees and preferential loans were extended by the Estonian Housing Fund (before its abolition in 2001) to young families with children and tenants in restituted housing; the new *KredEx* fund provides loan guarantees to young and employed 'specialists'. In both cases means testing was not used. The Slovakian State Housing Development Fund offered qualified loans (up to 80% of purchase/construction price) and grants (up to 50% of purchase/construction price). After its establishment (1996) the Fund soon fell into deficit as many households were eligible for the support. During later years the conditions for the subsidy allocations changed but the incomes of applicant households influence only the level of interest rate. Generally any household is still eligible for some kind of support regardless of its income.

In Romania the National Housing Agency was established and acts both as a developer and loan-funding institution. The agency, a public interest institution, approves contractors, supervises the construction process and, finally, sells the units to eligible households. The sale is made in cooperation with commercial banks that issue a 'solvency certificate' for each applicant showing that he/she is able to repay a loan. There are arrangements that enable agency dwelling prices to be kept lower than market prices (land is provided free of charge by municipalities, the occupier is exempt from property tax and building permit issue costs are covered by the agency). However, no means testing is applied.

Special subsidy programmes for new 'quasi-rental' municipal housing

construction appeared in the Czech Republic in 1995. The programme is susceptible to abuse as ownership of the 'rental' flats will be often transferred from municipalities to the occupants after a period of twenty years free of charge. The state supports a construction with a subsidy of CZK 350,000 (€12,000) for each new flat (about one-fifth of the construction costs). However, there are no limitations concerning the maximum cost per square metre or the maximum area of the dwelling and no means testing is applied in the allocation of flats. The programme therefore serves in some cases as financial support for higher-income households to construct comfortable dwellings that will later fall under their full ownership.

Since the beginning of the new century, supply-side subsidies started to be more targeted and efficient in some of the selected countries. The programme on new social rental housing designed for young people on low incomes appeared in cooperation with the Central European Development Bank in Romania (7,000 municipal dwellings). In Slovakia a programme for new municipal 'social' rental housing construction was introduced in 2000. Although it is too early for an evaluation, the conditions of the programme are promising: the construction costs per square metre are limited, rents are limited to 5% of the replacement value and means testing is applied. The problems, from the point of view of economic efficiency, are mainly that the potential developers are limited to municipalities (no housing association legislation has been passed up to now) and, from the point of view of social effectiveness, there is a lack of regular income inspections. In Bulgaria no important supply-side subsidies were introduced until the end of 2001.

### c. Demand-side subsidies

Housing allowances were introduced in Poland, the Czech Republic, Slovakia and Estonia (now part of the subsistence benefit). In Bulgaria, only a special type of energy allowance has been introduced (extended during the winter and covering part of heating expenditure). In all countries both renters and homeowners are eligible for an allowance.

A common feature of the housing allowance in all the countries surveyed is its marginal significance. Its role is limited to income maintenance for the lowest-income families, rather than being an effective demand-side housing policy instrument. The many restrictive conditions that apply (income ceilings) demonstrate this. Two types of income ceilings can be distinguished: implicit and explicit. Implicit ceilings arise from the formula used for calculating the housing allowance, whereas explicit ceilings are strictly set in the Act. Housing allowances in all selected CEE countries include either implicit or explicit income ceilings. Such limits appear also in standard models of allowances in the EU countries. However, if limits are

too low and taper (rate of withdrawal) too high, this may negatively affect the household members' work incentives and lead to a poverty trap.

With the exception of Poland and Estonia, explicit housing expenditure *normatives* (notional expenditures or tariff costs) are also applied in housing allowance models. The notional costs are set often at a low level, reflecting the situation in the 'privileged' regulated rental sector (Czech Republic, Slovakia). Households living in the free market rental sector are thus almost completely excluded from any effective help through the allowance. Moreover, as the only criterion remains household income the allowances are allocated among both households with high actual housing expenditure-to-income ratio and low actual housing expenditure-to-income ratio. In Estonia, *actual* housing costs are taken into account though they are limited by ceilings (maximum values). The ceilings are not set centrally but by the municipalities. In Poland *actual* housing costs are included in the calculation with only indirectly set ceilings (comparable costs in municipal housing).<sup>3</sup>

Another problem of the analysed housing allowance models concerns the determination of so-called *normative rate of burden*. The normative rate of burden is defined as the normative share of household income that a household must spend on housing (always based on a formula involving a coefficient). In other words, it sets the minimum financial contributions of a household to its housing expenditures not directly (in absolute values) but indirectly in a form of a percentage of the total household income. In the Czech and Estonian models the normative rate of burden varies according to the income, size and composition of the household (due to their connection to the concept of a subsistence level). In the Polish model the coefficient varies according to income level. However, in all analysed CEE models, the rate does not increase with housing costs (assuming constant income). In the standard continental models of the EU countries the rate usually increases with the level of housing costs. For example, moving to better located or equipped housing would be connected with a rise in the normative rate of burden; the household covers the higher costs with a higher share of its income, compared to before the move.

The danger of creating a poverty trap can also be evaluated (in EU countries this is discussed often in connection with the housing allowance in the United Kingdom). This could be measured by the so-called taper (rate of withdrawal), showing the amount of decrease in housing allowance when the income of a household increases by one currency unit. In most of the analysed countries, the taper is relatively gentle (about 30%) and only the Estonian model with a 100% taper is an exception. The Estonian allowance leads to a substantial poverty trap.

With the exception of Poland, housing allowances are paid from the state budget. In Poland *gminas* (municipalities) are mainly responsible for

Table 4 The comparison of selected CEE housing allowance models

	<i>Housing allowance is a separate benefit in social system designed particularly to cover housing costs</i>	<i>All tenures are eligible for the housing allowance</i>	<i>Explicit or implicit income ceilings for housing allowance application</i>	<i>What kind of income (net or gross) is used for the eligibility test or for the housing allowance calculation? Are other social benefits included?</i>	<i>What housing expenditures are taken into account for housing allowance calculation?</i>	<i>Who provides financial sources for housing allowance payments?</i>	<i>Proportion of all households receiving housing allowance</i>
Czech Republic	Yes	Yes	Yes, explicit (as a multiple of household's subsistence level)	Net income, including illness and retirement benefits, unemployment benefits, parents' benefits, care benefits, child benefits	Notional housing costs (part of a subsistence level) differentiated by size of household	State	7.6% (December 2000)
Estonia	No (a common subsistence benefit was introduced for covering all primary needs)	Yes	Yes, implicit (household income after payment of limited housing expenditures must remain below the subsistence level)	Net income, including social benefits with a few exceptions: one-time benefits, certain benefits to disabled persons, child benefits	Actual housing costs to the extent of the standard allotted living space and to the limits established by local authorities	State	12% (in 2001)
Poland	Yes	Yes (but there are important limits in cases when household is not living in municipal rental housing)	Yes, explicit (as a percentage of the lowest retirement pension)	Net income, including social benefits, with a few exceptions: one-time benefits and social transfers for orphans	Actual housing costs to the extent of the standard allotted living space (limits are applied mainly for households living in market rental sector)	Both State and municipalities	7.6% (in 2000)
Slovak Republic	Yes	Yes	Yes, implicit (emerging from the formula used for housing allowance calculation)	Net income, including other social benefits with a few exceptions: one-time benefits, social assistance	Notional housing costs calculated on the basis of allotted living space for the household multiplied by average rent, maintenance and energy fees (per m <sup>2</sup> )	State	4.2% (December 2001)

covering housing allowance expenses, but they obtain a grant from the state budget, calculated according to two possible relatively complex formulas. On average, they receive a subsidy equal to 50% of the total payment duty. The brief comparison of models is contained in Table 4 (Bulgarian energy allowances are not included).

People in the former Communist states are very sensitive to state subsidies. State intervention in the free market generally evokes reactions among the population, though such reactions are always delayed. Several countries thus introduced interest subsidies on mortgage loans (Czech Republic, Poland, Slovakia), tax credits on housing savings (Poland), tax deductions for interest on housing loans (Czech Republic) and tax deductions for costs of unit purchase/construction (lump-sum deduction in Poland). In many cases these subsidies are limited to new housing construction; some of them were later redesigned. All those fiscal subsidies are untargeted and regressive, though the rate of regression is lower in case of tax credits and if lump-sum deduction is only allowed than in case of simple interest deductibility. Bulgaria, Romania and Estonia did not introduce any fiscal subsidies for housing loans.

### 3. ANALYSIS AND CRITERIA USED FOR COMPARISON OF SUBSIDIES

The general typology of all the selected CEE countries, according to the applied state housing policy, is scarcely possible as they are characterized by very particular approaches. Though there are some uniform features the development of policies varied largely among those countries and led to the creation of very diversified systems.

The selected countries have already been grouped into three types according to the housing privatization strategies: (1) Fast privatizers (Romania, Estonia and Slovakia); (2) Slow privatizers (Czech Republic and Poland); (3) Bulgaria. Only a weak association between a country's per capita GDP and its privatization approach can be detected and certainly such relation cannot be supported. These are, very probably, different political factors (including the impact of international organization activities, such as those of the World Bank) and pre-communistic traditions (existence of pre-war rental housing sector) that may have higher influence. The comparison of privatization approaches with decentralization/deregulation approaches in the rental housing sector is shown in Figure 1. Higher deregulation/decentralization in rental housing, measuring on axis  $x$  of Figure 1, is assumed to be connected with:

- higher freedom in rent-setting and dwelling allocation for both private and public landlords (abolition or substantial limitation of state rent control and/or central public dwelling allocation criteria);

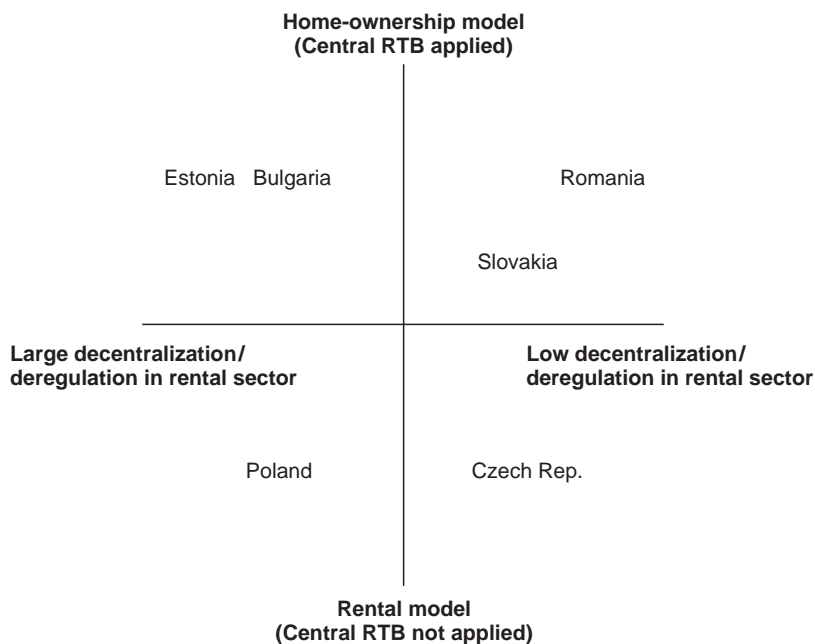


Figure 1 Comparison of state housing policies

- lower legal tenant protection in both private and public rental housing; and
- larger competence of local authorities in shaping of/paying for housing allowances.

The application of right to buy represents axis  $y$  of Figure 1. The main factors that influence the position of a particular country in Figure 1 can be outlined as follows. In Romania the rents are regulated by the state and allocation of vacant public dwellings is also limited by central criteria. In Slovakia and the Czech Republic rent regulation and tenant protection have been maintained although municipalities are free to allocate vacant or new dwellings. In Estonia, at the opposite end of the spectrum, rent regulation was abolished at a state level and only half of municipalities apply some kind of rent regulation on their territories. Estonian municipalities can also substantially shape housing allowances by setting the expenditure ceilings. Though rents are controlled in Poland, the ceiling set in the Act is relatively high to allow municipalities to implement greater rent deregulation, with rents reflecting a dwelling property value. The Polish municipalities are responsible for housing allowances payments. Slovakia applied only a partial right to buy.

There is one clear logical implication of homeownership policy



approach. The policy orientated towards the homeownership model, combined with too low privatization prices (Estonia, Bulgaria, Romania) leads to rapid residualization of public housing. This is connected with social segregation (only the lowest-income households or pensioners do not use their right to purchase a dwelling) and usually a strengthening of tensions between tenants in public and private (restituted) housing sectors. In all countries that belong to fast privatizers and offered very advantageous right to buy, the problem with tenants in restituted houses appeared. This is gradually solved by giving priority in municipal housing allocations in Romania and Bulgaria (Pascariu and Stanculescu 2003; Yoveva *et al.* 2003) and 'privatization voucher' loans in Estonia (Kährik *et al.* 2003). At the opposite end of the scale, tenants in restituted houses in Poland and the Czech Republic did not obtain any preferential conditions in the housing market.

The 'legislative' deregulation does not have to be (and in practice is not) accompanied by real rent price deregulation. In countries with a more modest scale and speed of privatization, municipal housing did not become residualized and the deregulation of rents went much quicker than in countries with right-to-buy policies. According to the results of a special survey among local authorities with population higher than 5,000 (in Poland higher than 20,000) of inhabitants conducted in 2002 in the six CEE countries, only 17.8% of municipalities would agree that total rental revenue covers the full costs of housing maintenance in Bulgaria (resp. 23.5% in Estonia), while in the Czech Republic the proportion exceeds 50% of municipalities (Lux 2003: 441).

The policy orientated towards the rental model, which is not accompanied by the decentralization/deregulation process, may be connected with relatively passive municipal housing policy and the establishment of a black market with rent-regulated municipal dwellings. This practice is almost unknown in most of the countries, while it is very common in the Czech Republic (Sýkora 1996, 2003; Lux 2002). The black market takes basically two forms: illegal subletting of rent-regulated municipal apartments and illegal 'sale' of rental contracts on rent-regulated municipal apartments via fictitious dwelling exchange. Owing to the continuous strong tenant protection, rent regulation and slow performance of the Czech courts, landlords often have very little power to eliminate these practices.

No policy model can be theoretically evaluated as purely bad from the point of view of economic efficiency. Large-scale privatization (homeownership model) is the speediest way to deal with the burden of 'socialistic' heritage, to cut public subsidies substantially and to support the housing market. Though it leads to tensions between different groups of society due to its very low social effectiveness, it is sometimes the best way to start the future housing policy based on targeted housing allowances helping those who really need help. On the other hand, policy orientated

towards the rental model helps to maintain a significant rental sector (possibly allowing higher labour mobility in the future), guards against social segregation and spatial residualization and allows more substantial rent price deregulation. Existing rental housing can also be used to assist socially needy households with lower incomes in the future and this may produce substantial public savings (there is no need to subsidize needy households in other ways like support for new social housing construction or downpayment subsidies for housing purchase). However, the housing market is not supported by the additional supply following from privatization, and a quasi-ownership character of ongoing rental contracts is often preserved in such cases.

If we want to compare the countries/models according to the economic efficiency and social effectiveness of their current supply- and demand-side state subsidies we need to set the list of main indicators used for such evaluation.

Let us assume *demand-side subsidies* as *socially effective* if:

- the housing allowance model does not use *notional* housing costs (tariffs) and instead *actual* costs and expenditure ceilings are included into the equation;
- the housing allowance model applies ‘optimal’ taper which has only a modest poverty trap effect.

The effect of using notional instead of actual costs in housing allowance computation has already been discussed above. The notional costs are set at a low level and households living in the free market rental sector (paying often much higher rents) are almost completely excluded from any effective help. Moreover, the reliance of such allowance models on income as the only criterion and not taking into account actual housing costs leads to the situation when substantial share of household with low actual housing expenditure-to-income ratio (mostly homeowners) are also eligible for benefit. In other words, the allowance helps those who do not need help and, on the opposite, refuses effective help to those who need it. High taper in the housing allowance model is also not very effective as it may lead to a poverty trap when beneficiaries prefer unemployment and benefit dependency as a better option to looking for new employment.

Let us assume *supply-side subsidies* as *socially effective* if:

- there is a clear definition of social housing in a particular country;
- subsidy programmes are targeted to households in social need (means testing is applied);
- subsidy programmes are designed for rental housing and not for homeownership;
- ‘old’ non-targeted rent regulation is abolished or, at least, transferred into the competence of municipalities.

Precise definition of policy goals (provision of social housing) certainly helps to increase the social effectiveness of potential subsidies (or, at least, to its better evaluation). Targeting of new supply-side subsidies as well as allocating existing public flats with controlled rents among needy households (application of means testing) is a basic condition of any really effective help. Moreover, only regular income inspections of beneficiaries can prevent the situation where higher-income households profit from 'social' rents. If the income of a household exceeds the ceiling set by the Act or the subsidy programme then landlords should have a right for appropriate rent adaptation.

The preference of rental housing programmes over the subsidization of homeownership (via downpayment subsidies) is justified because in the latter case the targeting is less strict. This is a natural consequence of high house prices and a sharp decrease in financial affordability of ownership housing in the region. It can be assumed that the majority of households in the selected CEE countries would need to cover the whole costs of house purchase through such a subsidy because they are not eligible for any mortgage loan to cover the residual costs. Moreover, the downpayment subsidies can be abused later on (speculative sales by future homeowners) even if the law forbids it. We can also expect that political representatives themselves will abolish possible restrictions on house sales just because it will be as popular as housing privatization is now. If allocation of new 'social' rented dwellings is really based on means testing and if regular income inspections are applied (as in case of the Polish TBS model), then households noticing increases in their incomes will be forced to move out of the sector and vacant flats will serve another needy household. This is, however, not possible in case of downpayment subsidies for house purchase or construction.

The criterion based on abolition or substantial change of the 'old' central rent regulation rules applied on existing rental housing (often both public and restituted private rental stock) is also crucial, because such regulation benefits a substantial share of higher-income households (Lux 2001). The untargeted 'first generation' rent control not only distorts the housing market but it is also connected with a large social injustice.

The economic efficiency can be evaluated via calculation of the net present value of particular subsidies. In some cases a preferential loan may be 'more expensive' than a lower direct grant when counting opportunity costs for public financing of new supply-side subsidies. However, this needs to be based on very precise information on particular programmes that vary a lot even in one country. The detailed comparison of the selected countries is hardly possible and we assumed therefore only a few basic principles.

Let us assume *demand-side subsidies as economically efficient* if:

- the model of housing allowance takes account of regional and area price differences when setting the expenditure ceilings (maximum housing costs);
- the model of housing allowance applies a *normative rate of burden* rising with housing costs and income of applicant households;
- there is co-financing of housing allowance payments both from municipal and state budgets.

Regional differentiation in maximum costs that are taken into calculation of allowance may lead to public expenditure savings as there may be (and in reality are) huge house price and income differences between regions in one country. If prices (resp. rents) are lower in some regions, the ceiling can also be lower, and vice versa. The shape of the normative rate of burden has been discussed above. This criterion means, in other words, that households moving to a more expensive dwelling (with better equipment and/or in a better location) are expected to meet a higher proportion of housing costs. Public spending can be lower than in a case when such a condition is not applied.

Co-financing of allowance payments decreases state expenditure by making municipal rent policies more careful and efficient. Municipalities partially responsible for paying the allowance due will increase the rents in their housing stock only if it does not lead to substantial increase in allowance payments. We can assume that total public expenditure on housing allowances may be thus lower than if municipalities are free to set the rents and the state budget will solely cover the costs of rising rents.

Let us assume *supply-side subsidies* as *economically effective* if:

- subsidy programmes for rental housing construction are allocated among private not-for-profit housing associations;
- subsidy programmes presuppose the participation of private capital; and
- subsidy programmes are 'sustainable' in the long term (i.e. the state budget has enough sources to cover the demand of applicants).

Though municipalities may also be efficient developers of new social housing the general trend based mainly on past experience in EU countries is to strengthen the role of private not-for-profit entities (housing association, cooperatives) in this field (Maclennan and More 2001). Though it has not been confirmed by the empirical research, it is assumed that housing associations are more efficient in planning and housing management than public authorities, simply because they are responsible for their losses. This form of new social housing development also allows for higher participation of private capital and further cuts in potential housing subsidies.

Though some of the programmes (mostly subsidies for young people) are targeted at people in housing need, they are often prepared in such a way that does not allow their long-run sustainability (limited resources, too

many applicants, long waiting period etc.). These not very well designed programmes are rather expressions of political populism than efficient housing policy instruments.

There may be and there are, in fact, several trade-offs between the requirements of economic efficiency and social effectiveness. One example can be private capital participation which is always assumed in the case of homeownership purchase/construction programmes, but is less present in programmes for new social rental housing construction. In such instances, the decisive influence in our analysis would have been assigned to social effectiveness as targeting of public support is the main purpose of public intervention; economic efficiency should only assure the costs of the intervention are as low as possible.

#### 4. RESULTS AND CONCLUSIONS

Figure 2 summarizes the comparison of state housing policies in the selected CEE countries. Based on the criteria outlined above, Poland is the only country with a relatively high level of efficiency/effectiveness of both demand- and supply-side subsidies. It has a legal definition of social housing, housing association legislation and subsidies are allocated mainly

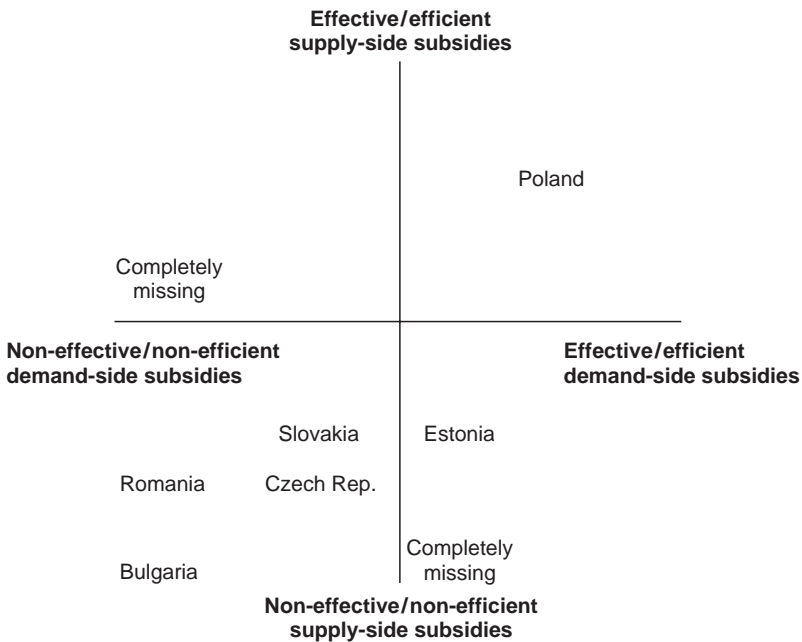


Figure 2 Comparison of public subsidies

for new social rental housing construction among not-for-profit associations. Subsidy takes the form of a qualified loan and covers only part of total construction costs. The allocation of new social flats is subject to means testing (income ceilings are set by the Act and are amended annually) and associations make regular income inspections of beneficiaries (every two years). 'Old' rent regulation is relatively slight and the housing allowance model uses actual housing costs limited by indirectly set ceilings (reflecting the regional differentiation in rents), applies normative rate of burden increasing with income level while a gentle taper avoids the creation of a poverty trap. The total payment due is co-financed from both state and municipal budgets.

Similarly, the Estonian housing allowance (subsistence benefit) model does not use notional costs and housing-cost ceilings are set at a local level (reflecting regional differentiation in housing costs); therefore, it provides more effective help to those in need than the Czech or Slovakian models. However, the high taper and exclusive state financing disadvantage the model in comparison with the Polish housing allowance model. On one side Estonia has already abolished the central system of 'old' rent regulation and introduced the legal definition of social housing; on the other side the government supports only homeownership purchase/construction regardless of income of the applicant and did not introduce any type of non-profit housing associations.

Romania and Slovakia introduced the programmes for new 'social' rental housing construction (means testing will be applied during the dwellings' allocation) but both countries did not introduce housing associations, regular income inspections and they did not abolish 'old' rent control. The Slovakian model of housing allowances does not reflect regional rent differentiation and programmes supporting homeownership purchase/construction were not always sustainable in the long term (many applicants and long waiting period). Romania does not have any significant demand-side subsidy and Bulgaria is the only country where no decisive supply- and demand-side subsidies (with the exception of seasonal energy allowances that are reviewed yearly) are implemented.

The relative position of the Czech Republic is surprising. The Czech housing allowance model uses only notional housing costs. These costs have no regard for regional differentiation in prices/rents and do not reflect the higher level of market rents. Allowances are paid solely from the state budget. There is no legal definition of social housing, no legislation on housing associations and an 'old' system of untargeted central rent control is maintained both in the public and private rental sector. Though the current programme for new 'municipal' rental housing construction allows for private capital participation, it often leads to some kind of 'quasi-rental, quasi-ownership' tenure. As it does not include means testing, the social effectiveness of this subsidy is very low. No other municipal social housing

development programme following the rules of the Slovakian case is introduced.

When comparing Figure 1 with Figure 2, we can reach a relatively important conclusion. The most effective/efficient subsidies were implemented where general policy orientated towards the rental model was combined with decentralization/deregulation in the rental sector of housing (Poland). If we exclude Bulgaria and Romania from the comparison (as some types of subsidy are missing), the least effective/efficient subsidies appeared in a country, where policy orientated towards the rental model was combined with a low level of decentralization/deregulation in the rental sector (the Czech Republic).

However, this is not just because higher deregulation/decentralization itself leads to higher efficiency/effectiveness of subsidies according to our criteria (co-financing of allowances, abolition of 'old' central state rent regulation). This may also be due to the fact that if some old inefficient practices are simply decentralized to the local level or indirectly abolished (e.g. through housing privatization) the central administration has, very probably, ceased to be lobbied by different interest groups wanting to retain these practices. This might allow the central government to prepare new and much more efficient/effective subsidy programmes with no need to look for some kind of hybrid solutions between past relics and new needs. Deregulation/decentralization thus may help central governments to clear the table and start afresh. However, so long as the government is occupied by problems connected with paternalistic old practices, it does not have either the political will or the time to prepare and introduce new, more effective/efficient subsidies.

From the comparison of housing conditions in particular countries we can find out another empirical implication. The relative housing sufficiency (Czech Republic, Slovakia, Estonia) leads to lower effectiveness/efficiency of housing subsidies while relative housing insufficiency (Poland) leads to the opposite. The factor of housing need (resp. housing shortage) may have some influence on actual efficiency and effectiveness of state subsidies because a country in an acute need of new housing supply cannot afford to experiment with hybrids of new and old practices. However, further empirical work including a large sample of transitional countries would be needed to confirm such a conclusion. The general macroeconomic situation influences only the fact if any policy instrument is introduced at all. Bulgaria and Romania, the poorest countries in our comparison, have only limited public and private resources to help effectively and efficiently those who need support.

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## NOTES

- <sup>1</sup> This article summarizes the research on housing policies in the selected CEE countries realized under the project Local Government and Housing supported by the Local Government Initiative, Open Society Institute, Budapest. Country reports were prepared by national experts, namely: L. Sýkora (Czech Republic), R. Uchman, J. Adamski (Poland), A. Kährlik, J. Kore, M. Hendrikson, I. Allsaar (Estonia), S. Pascariu, M. Stanculescu (Romania), J. Zapletalova, M. Antalikova, E. Smatanova (Slovakia), A. Yoveva, D. Dimitrov and R. Dimitrova (Bulgaria).
- <sup>2</sup> Pareto optimum is such a state of allocation of goods when nobody can be better off without being someone else worse off. In other words, the public subsidies are allocated in an efficient way if potential alternative uses of the same amount of subsidies would not produce better satisfaction of stated social goal. 'Generally speaking, economic efficiency lies in the fact how to take best advantage of the limited resources to satisfy human needs' (Barr 1993: 72).
- <sup>3</sup> The notional housing expenditures are rarely applied in EU housing allowance models. Instead, the ceiling (maximum costs) is often used while actual costs are taken into the calculation of benefit. Above the level of the ceiling the household must meet all other expenditures from its own sources.

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