OTHER COUNTRY EXPERIENCE WITH A CONSUMER-BASED HOUSING SUBSIDY

by

Maris Mikelsons

Background

The concept of a means-tested consumer-based housing subsidy is not unique to Eastern Europe. The first use of a consumer-based housing subsidy dates back to the early 1900s in Europe. Many countries in Latin America have offered grants to poor households for the purchase of new private sector housing. The United States' Department of Housing and Urban development has promoted the use of housing allowances for low-income renters. Today, means-tested consumer-based housing subsidies are increasingly used throughout the world because they have proven to be a relatively efficient and equitable way of providing housing subsidies.

The design of the subsidy can vary a great deal among countries. For example, central and local governments may combine resources to fund a subsidy program or they may separately administer programs. In all the countries, eligibility is determined by means-testing households using either their current income or a combination of income and assets. In some countries the subsidy does not vary in direct proportion with need nor is it available to all tenure groups. Finally, in some countries, the consumer-based subsidy is combined with other forms of housing subsidies such as housing production programs. Table A1 shows the countries that currently administer a means-tested consumer-based housing subsidy.[1]

[A]- This table shows only those countries that use a direct consumer based subsidy. By definition, this type of subsidy is payed directly to the household or in some cases to a landlord where the subsidy recipient resides. It is in contrast to production-based subsidies that are linked to the housing unit. We show countries that have documented their experience with a consumer-based housing subsidy.

Insert table a-1

Regional Experience with Consumer-Based Subsidies

Latin America. Housing assistance in Latin America has evolved along with the broader process of economic reform sweeping this region. Starting with Chile in the early 1980s, many Latin American governments have begun to redefine their role from a direct provider of housing to an enabler of the private sector housing market. Housing subsidy initiatives in Colombia, Costa Rica, El Salvador, Paraguay, and Uruguay follow the “Chilean model”.

The Chilean model involves three basic policies that: (1) discontinue direct government production of housing and shift that function to the private sector, (2) provide one-time government capital subsidies to households for the purchase of housing and limit other indirect or implicit government housing subsidies, and (3) institute transparent systems of selecting households that will benefit from government housing subsidies based on current income and a savings contribution. The Latin American programs use rationed (i.e., they are not an entitlement) resources from the central budget and are directed to needy households who do not own a house.

Western Europe.[2] Governments in this region of the world have effectively operated housing allowances for several decades with a wide variety of strategies. Most Western European countries introduced allowances following World War II. The Dutch were the first Western European country to introduce a housing allowance to renter households. In 1930, Sweden introduced an allowance for households with children with the intent of increasing the supply of housing for this group. Thereafter, another Scandinavian country--Finland--introduced a housing allowance. Again, the allowance was designed with the intent to provide adequate housing for large households. By the late 1950s and 1960s, most Western European countries incorporated some form of housing allowance into their national housing policies.

The introduction of allowances was motived by different factors in different countries. As noted above, in Scandinavian countries housing allowances were distributed to impoverished renter households with children. In other countries, governments designed the housing allowance so that it facilitates integration of new (high cost) housing with older (lower cost) rental housing creates enough effective demand to motivate housing developers to build multifamily rental housing. Another important motivation for introducing allowances in Western Europe was to promote labor mobility. This was accomplished because subsidies are paid directly to households allowing them to shop for housing and relocate where employment opportunities exist.

Other Country Experience. In North America, both the United States and Canada use a modified housing allowance to subsidize rental housing. This is also true in Australia. South Africa, on the other hand, recently adopted a Latin American style of housing subsidy to supplement the purchasing power of lower income households and stimulate the private sector to build housing.

The United States has two versions of a housing allowance--certificates and vouchers--that assist renter households. Neither program is an entitlement program, meaning the government funds only a portion of eligible households. For both programs, housing must pass an annual inspection to determine compliance with program quality standards, and the administrative agency must determine that the rent charged by the landlord is reasonable when compared to similar units in that area.

The certificate program, created in 1974, requires households to pay 30 percent of adjusted income toward their total housing costs and the program pays the difference between the total costs and the tenant's contribution. Adjusted income for this program is gross income less deductions for dependents, excessive medical costs, child care, handicapped person care, and elderly households. Overall, the family contribution represents about 27 percent of gross income. Households must select housing with gross rents at or below a standard set for each market area based upon periodic cost surveys. If the household chooses to lease housing costing less than the standard, less subsidy is required.

[A]- This section of the Annex draws from Jay Howenstine, *Housing Vouchers - A Comparative International Analysis,* Rutgers University Press, New Brunswick, New Jersey, 1986

The voucher program, initially implemented in 1984, provides a subsidy that is the difference between the cost of standard housing in the area the household chooses to reside and 30 percent of adjusted household income. The household may choose housing that is more or less costly than the standard. If it chooses housing costing more than the standard, it must pay the difference between the subsidy and actual cost; if it chooses housing costing less than the standard cost, the household is allowed to keep the difference.

In recent years, there have been attempts to make the two programs more alike and to consolidate them into one program. In all, there are about 1.4 million households (out of a total 33.5 million renter households) receiving this assistance throughout the country. Another 1.4 million households live in municipally owned subsidized housing. However, the U.S. Department of Housing and Urban Development is considering doing away with most producer-based housing programs and relying on housing allowances as the dominant form of housing assistance in the United States.

Eastern Europe's Recent Experience With Consumer-Based Housing Subsidies

Currently nine Eastern European countries have implemented a consumer-based housing subsidy either on a nationwide or local basis. These include Estonia, Czech Republic, Hungary, Latvia, Lithuania, Poland, Ukraine, and Russia. Slovakia will soon be added to this list. In all cases, the primary motivation for implementing a means-tested housing allowance was to protect poor households from higher housing costs associated with rent increases that generated much needed revenue for the operation and maintenance of housing.

The Czech Republic.[3] The Czech Republic has been slow to initiate reform in the housing sector after the velvet revolution. As in Slovakia, the two cornerstones of socialist housing policy--rent control and strong tenant property rights--remained in place longer than in many Eastern European countries. Although rents for existing municipal units (25 percent of the total housing stock) increased by 100 percent in mid-1992, they still remained below levels needed to cover current operating expenses and support much needed renovation. Realizing that implicit subsidies through rent control were fast accruing in the rental housing stock, the Czech government instituted a rent allowance to compensate for planned rent increases in 1994. In 1996, the government went further with housing reform by implementing a means-tested housing allowance available to all households regardless of tenure.

Starting in 1994, a rent allowance was made available to all income-eligible households who lived in municipal rental or cooperative housing.[4] The rent supplement was intended to make up the difference between rent increases that took effect in 1994 and existing rent in municipal housing. In designing the rent allowance, the Czech government placed restrictions on participation in the program. Household income could not exceed 1.3 times the poverty line. In addition, a household had to prove it had payed space rent

---

[A]- This section of the Annex draws from published and unpublished material. Some of the information for this section came from *The Ten Commandments to the Contribution to Rent,* Ministry of Labor and Social Affairs, Czech Republic. In addition, this section draws upon conversations with Eva Holanova, Director of Income Policy, Ministry of Labor and Social Affairs for the Czech Republic.

[A]- The following discussion centers on renters since the primary purpose of the rent supplement (by definition) was to fill the gap between the rent increase that went into effect in 1994 and existing rent. Cooperative members do not in fact pay “rent” but pay the fixed amortization of the loan used to finance this type of housing. The ” rent supplement” for eligible households that live in cooperatives was a flat amount varying only by household size.

as well as costs for communal services for the previous six months. For the purpose of qualifying for the rent allowance, the average monthly income based on the previous six months was used. In addition to the rent supplement, limits were place on rent increases (40 percent, on average) from their 1993 levels. The rent allowance was also capped for all households (with a lower limit of Kc 50). The allowance was in force for a two-year period.

After one year of experimenting with the rent allowance, participation rates were extremely low due to a combination of factors. First, since the rent supplements were administered by the local social care office, they used the same income verification procedures as were in place for other social programs. This process was rather cumbersome. In addition, the rent supplement was designed so that it was last in the sequence of eligible income sources used to compute the eligibility threshold. Second, the new program was poorly advertised. Brochures were distributed to social care offices but little else was done to announce the new program. In addition, rent increases, and therefore the benefits, were too low for many eligible households to bother applying for the program. The low participation rates translated into low overall program costs. In 1994, out of the central budget allocation of Kc 1 billion for the rent supplement, only Kc 100 million was spent on actual housing expenditures (another Kc 400 million went to administration costs). In 1995, the payout for the supplement increased another Kc 100 million to reach Kc 200 million.

Starting in 1996, the Czech Republic implemented a housing allowance for owners and renters. In part, the government's motivation for introducing a housing allowance reflected the rapid price increases of utilities and rents relative to wages. Over the 1990 and 1994 period, space rents increased by about 180 percent while utilities increased by 420 percent. Wages, on the other hand, increased by only 76 percent. At the end of 1994, rent levels still needed to increase 100 to 600 percent to cover the cost of operating and maintaining public housing.

To save on administrative costs and distribute the benefits equitably--free from local political influence--the housing allowance program was integrated into the existing social safety net. Both renters and owners are eligible for housing allowances, provided their income does not exceed 1.4 multiple of the poverty line. Similar to the rent supplements, renters are eligible if they have paid their previous six months rent while owners are liable for paying property taxes. Household income, including all social benefits received during the previous quarter, is used to determine eligibility.

A complex formula is used to determine the amount of the housing allowance. It uses three parameters to determine eligibility: actual housing costs, the subsistence minimum, and household income.

$$HA = ZM(h) - \frac{ZM(h) * Y}{ZM * 1.4}$$

Where HA represents the housing allowance; ZM(h) represents the housing cost component of the subsistence minimum; ZM represents the entire subsistence minimum, including housing costs and costs for food and clothing; and Y represents gross household income.

It is useful to rewrite the formula to better interpret its underpinnings. Simply by collecting the terms we arrive at:

$$HA = ZM(h) * [1 - ((1/1.4)*(Y/ZM))]$$

The formula shows that the benefit varies from a maximum equal to the household component of the subsistence minimum (ZM (h)), when income is zero; and a minimum of zero when income is equal to 1.4 times the subsistence minimum. Written in another way, HA = ZM(h) - ß * Y, where ß is equal to [ZM(h) / 1.4 * ZM], the formula resembles the proposed housing allowance for Slovakia, with two major deviations. First, the MSR is now simply the household component of the subsistence minimum, which varies by household size. Second, the benefit reduction rate (in the traditional formula it is the "r") is no longer fixed, rather it varies across households according to their composition, since the subsistence minimum varies according to household size and composition. Based upon this reformulation, the value of ß decreases as the size of the subsistence minimum increases. It ranges from over 0.20 for a single adult to less than 0.10 for large households.

This benefit formula is rather unusual. The most typical design of income-tested benefit programs involves two parameters, the "guarantee" (which in our case would be the MSR), that is, the level of benefits that is guaranteed when income is equal to zero; and the "benefit reduction rate", the rate at which benefits are reduced as income increases (which in the traditional housing allowance formula is the "r"). Together, these two parameters determine the third parameter, the "break-even point"--that is, the level of income at which the household stops being eligible for benefits.

The approach adopted by the Czech Republic reverses this logic, in that the break even point is fixed at a certain multiple of the subsistence minimum, and thus the benefit reduction rate can no longer be fixed. One of the disadvantages of this approach is to render the working of the program less understandable to the public.

Russia.[5] Russia's starting point for housing reform was different from the majority of Eastern European countries with about 70 percent of the housing in state ownership. Accompanying this type of tenure pattern were command-economy practices that contributed to the poor quality and distribution of housing, including centralized construction methods and maintenance practices. Strict rent control applied to all public housing. Similar to other Eastern European countries, Russia quickly divested itself from its housing stock by transferring ownership of housing to municipalities. Secondly, Russia was one of the first countries to pass privatization laws that transferred title to sitting tenants in public housing at little or no cost. Housing privatization was later accompanied by institutional changes that effected the management of multi-family housing units. Following these reforms, municipalities that raised rent were required to implement a housing allowance.

In Russia a system of housing allowances was seen as a way to allow housing service price liberalization while protecting the poorer population from undue economic hardship caused by increases in housing costs. It was also viewed as a means to integrate state rental and the growing private rental sector that was not subject to rent control. With rent decontrol taking place in the public sector, rents would eventually reach parity between to two sectors causing ques for access to public housing to disappear. The magnitude of these reforms were significant since net rent in public housing had not increased since 1928. It was estimated in 1992, that revenue from net rent only covered about 25 to 30 percent of estimated maintenance needs (exclusive of deferred capital costs). In late 1992, the central government authorized municipalities to raise rents and implement a housing allowance program.

[A]- Information about Russia's housing allowance system is found in Ray Struyk and Alexander Puzanov, *Monitoring Russia's Early Experience with Housing Allowances,* The Urban Institute, Moscow, March 1996.

Rent liberalization was to take place over five year period allowing for implementation of a housing allowance. This program was the first means-tested program in Russia with program parameters determined at the central level though funding was the responsibility of local governments. The allowance was designed so that it would cover the gap between what a household could afford for housing and what it cost for an appropriately large standard unit. In other words, the Russian housing allowance used the formula (currently under consideration in Slovakia) HA = MSR - r * (Y). The letters MSR in this formula denote the maximum standard rent or housing costs associated with normative floor space standards. While the "r" is a coefficient that determines what a reasonable share of total household income (Y) should be attributed toward housing costs.

Central government officials designed provisions in the housing allowance that allowed for households who were overhoused to have access to smaller units with the assistance of the local governments. Given that the housing allowance formula provides a strong motivation to consume the "right" amount of housing for a given household size (because the MSR varies by household size), drafters of law were concerned that households who live in large units would be relegated to live in housing they could not afford if other (more appropriately sized) housing was unavailable. Therefore, the law mandated that local governments provide "overhoused" households with smaller units should they request to move and exempt these households from paying excess housing costs until another unit was located.

Program administration is done at the local level while some aspects of program design is dictated by the central government. This type of arrangement leads to a great deal of design variation across municipalities. For example, Gorodetz, a city of about 30,000 persons, introduced a design modification to the housing allowance that allowed the parameter "r" in the formula to vary with household income. That is, the lower the income the lower the "r" in the housing allowance formula, starting with 10 percent in the maximum case. This resulted in an increase in the number of households eligible for housing allowances. In another city, Vladimir--a city of about 350,000 people--the housing allowance formula was altered so that it could deduct "special benefits" attributed to invalids, veterans, Chernobyl victims, etc. from the MSR while keeping the benefit reduction rate or "r" in the formula constant at 10 percent. This resulted in reducing the number of households eligible for a housing allowance.

Germany.[6] Shortly, after the integration of East Germany with West Germany a housing allowance was implemented in the former socialist state. This allowance was based on the design of the allowance already in place in West Germany since 1955. East Germany had suffered the same housing problems of other countries with transitional economies including rent control, monopolistic building practices, and highly subsidized state-run management enterprises. The former state housing stock suffered from years of deferred maintenance and housing shortages associated with an arbitrary housing allocation process. Housing services were so inefficient that unsubsidized heating costs were twice as high in former East Germany than on average in West Germany. In addition, compared to West Germany, East Germany used a remarkably higher number of employees to manage and administer comparable multi-family rental housing.

Eligibility for the German housing allowance is determined by a set of tables that take into account income and household size. There is no single formula for calculating the amount of the housing allowance but in theory it is intended to cover the cost of housing that might be socially acceptable. This socially acceptable level is defined by a housing costs to income ratio that on average never exceeds 28 percent.

[A]- Material for this section came from *Wohngeld and Mietenbericht, 1993*, Bundesministerium fur Raumordnung, Bauwesen und Stadtebau, 1994 and personal conversation with Dr. Dick and Dr. Volker.

The allowance is based on rent exclusive of utilities and is limited by statutory rent ceilings. The rent ceilings vary due to: family size, local rent level, date of construction, and apartment amenities. The housing allowance is paid directly to the tenant.

By the end of 1992, about 3.8 million household in Germany were receiving a housing allowance. Approximately 1.8 million of these households lived in West Germany, or about 6 percent of all West German households. In former East Germany, approximately 2 million households or 30 percent of all households received housing allowances. By the end of 1993, the number of assisted households in former East Germany dropped to about 1.4 million due to general rise in real incomes associated with the integration process. The cost of the program in 1992 was about DM 6.8 billion, of which about DM 3.1 billion was funded by county governments; the remaining DM 3.7 billion was paid by the federal government. About 10 percent of these costs went to administering the program. In former East Germany, the housing allowance payment represented about 50 percent of all social allowances payments.

In conjunction with the introduction of the housing allowance, rent and utilities in former East Germany increased by 400 percent from 1991 to 1992. Without the allowance, this rent increase would have caused households with low incomes to pay about 30 percent of their income towards housing costs. But with the allowance in place, the average housing cost-to-income ratio dropped to about 20 percent. By 1992, about 31 percent of all tenants were receiving a housing allowance with an average payment of DM 105 per month. The average share of income devoted to housing costs for housing allowance recipients in former East Germany was 18.3 percent while for non-recipients--even with a 400 percent increase in housing costs--the share was only 16.7 percent.

The introduction of a housing allowance combined with other reforms has had a positive impact on afford ability, levels of investment, and household mobility in former East Germany. As early as 1992, the level of investment in the housing sector started to increase, especially among renter households who chose to rehabilitate their housing. In 1993, the number of building permits for rehabilitation increased by about 70 percent over the previous year. Over this same period, new housing starts increased by about 31 percent causing residential construction to be the fastest growing sector in former East Germany. Heating costs (excluded from the housing allowance) have also decreased due to a program of metering individual apartments. Whereas household mobility was stifled in the communist era, survey results show that, in 1993, about 11 percent of all households planned to move within two years while another 9 percent considered it very likely that they would relocate.

Ukraine.[7] Since the Ukraine was part of the former Soviet Union, it housing stock suffered from the same problems associated with socialist provision of housing. Price liberalization has proceeded at a slower pace than in the rest of Eastern Europe. By 1994 housing subsidies amounted to about three-quarters of the national budget deficit. In order to qualify for financial assistance from international agencies, the government agreed to cut subsidies to reduce the budget deficit which had grown to about 20 percent of all government expenditures in 1994. Rapid increases of the price of housing services, including utilities, were necessary to reduce the deficit and increase revenue for much needed housing maintenance and repair.

The design of the Ukraine housing allowance was extremely simple, reflecting the need to implement the program quickly. The housing allowance paid subsidies to households if their total monthly housing payments exceeded 15 percent of their average gross income during the preceding three months. The subsidy was based on a payment structure that allowed 21 square meters per person as a norm in order to avoid paying disproportionately large subsidies to households that lived in apartments larger than the norm. To facilitate income verification, the housing allowance was only paid to those households in which all adults were either working or looking after disabled household members, or were registered as an unemployed worker or student.

[A]- Information for this section on the Ukrainian system of housing allowances came from Roger Vaughan, *A History and Overview of Ukraine's Housing Subsidy Program,* PADCO, Kiev, Ukraine, November 1995.

With a housing allowance program in place, the government of Ukraine was able to increase prices of housing and utilities to cover about 40 percent of their costs. With lower incomes than generally found elsewhere in Eastern Europe (average of $50 per month), Ukraine households were particularly vulnerable to increases in expenditures for rent and utilities. Without the housing allowances, one half of all households would have had to pay more that 50 percent of their income towards housing costs.

Since the allowance program had to be implemented quickly, the government (assisted by USAID) spent a great deal of resources to set up the apparatus to administer the new social program. About 4,000 new employees were hired and trained over a three-month period using training materials that included a manual and a video. Copies of these materials were distributed to 750 housing allowance offices throughout the Ukraine. In May 1995, these new offices began taking applications for housing allowances and verifying the income of applicants. Office staff used custom computer software to assist with intake and monitoring. In addition, a wide-scale public information campaign was launched using television advertisements, radio commercials, and printed poster boards.

By the fall of 1995, about 800,000 Ukrainian households were receiving housing allowances. This represented about 5 percent of all households; about 6 percent of all households applied for the benefits. About 81 percent of these applicants were from urban portions of the country. The total cost of the program was much less than the government anticipated since its projections were based on 100 percent participation rates among eligible households. The total cost of the program in the first year was $28 million while the budget deficit was reduced by about $600 million due to reductions in subsidies resulting directly from the program of housing allowances.

Other Eastern European Countries. Less information is available about other housing allowance programs in Eastern Europe. Estonia and Lithuania, at one time, utilized a housing allowance that takes into consideration the number of household members and income. The allowable share of income spent on housing is higher for higher income households. Rent liberalization has been particularly rapid in these countries despite the fact that their incomes are somewhat lower, on average, than most of the other Eastern European countries.

Poland introduced a housing allowance in 1995. Survey data there show that a large share of the richest urban households occupy rent-controlled housing. New rental legislation will allow rents to rise to cover the full cost of operating and maintaining housing. As of 1995, rents only covered about 35 percent of operation and maintenance costs. Public and private housing renters and cooperative owners are eligible for allowances. Income eligibility for the new allowance is set at the pension level and the maximum share of income devoted to housing varies by household size (i.e., 15 percent for single person households, 12 percent for 2 to 4 person households, and 10 percent for all other households).

Although Hungary does not have a nationwide housing allowance program, localities implement housing allowance programs. With USAID technical assistance, the city of Szolnok implemented a housing allowance program. The city increased rents, introduced housing allowances, and reformed its municipal housing management practices. The design of the housing allowance was based on the same formula proposed for Slovakia, that is, the allowance covered the gap between what a household could afford and the normative cost of standard quality housing. The city set the maximum share of income devoted toward housing cost at 35 percent of gross income. For renters, the maximum standard rent included space rent and utility costs. For homeowners, there was a separate utility allowance with an additional subsidy to cover mortgage payments. Less than half of all eligible households participate in the housing allowance program. About 42 percent of all eligible households participated in the program during the first two years.