

HOUSING ALLOWANCES : ASSESSING THE POTENTIAL FOR SLOVAKIA

by

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Rental housing in Slovakia is currently owned and operated by municipalities which abide by a national law that sets fixed rent rates for units according to dwelling size. As a consequence, a low-income household pays exactly the same rent as a high-income family for a comparable rental unit. In addition, due to extremely strong tenant rights and a system of planned housing production, households in Slovakia cannot easily move from one unit to another. Because of this constraint on mobility, there is often no relationship among a household's size, the size of the unit it occupies, and the household's income. Furthermore, because of low and highly subsidized rents, the housing stock in Slovakia suffers from years of deferred maintenance. In addition, because of price liberalization, utilities or energy costs associated with housing now constitute the major share of housing costs and in some cases, severely impact on family budgets.

In order to right these inequities and inefficiencies in the housing sector and promote market-oriented housing production, a formula-based housing allowance is needed. In general, a formula-based housing allowance system requires participants to pay a fixed share of their income for rent. The allowance fills the gap between this share of income and the rent (including energy or utility costs) for an appropriately sized housing unit of good quality. Under this scheme, a household is free to rent private as well as public housing since the allowance payment is paid directly to the family and can be used to cover housing costs regardless of who owns the unit or tenure form. By implementing this type of housing allowance in conjunction with increasing rent for public units and decontrolling rents for private rentals, Slovakia will be able to initiate housing sector reforms while protecting poor members of society from having to pay an excessive amount of income for housing.

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The size of a housing allowance is determined by a household's income, the applicable maximum standard rent (or energy, utility, or other housing cost), and a predetermined maximum share of income devoted to housing costs. Analytically and administratively, formula-based allowances can be based on *total* housing costs, including utility payments. This type of allowance provides behavioral incentives for a more efficient and equitable distribution of housing based on market principals. The formula for computing the housing allowance (*A*) is given by:

$$A = MSR - (r * Y)$$

The right hand side of the equation determines the amount of the allowance. The maximum standard rent (cost) *MSR* is set according to social norm of housing need based on the size or characteristics of a family. Under this scheme, a floor space allowance could be set for families of different compositions and then multiplied by the different components of housing valued on a square meter basis (m²). The space allowance could be established according to family composition, taking into account the number, age, and family relationships. The *MSR* can be defined to include maintenance fees, rent, energy costs or some combination. The argument for including energy costs is that currently these make-up the larger share of housing expenditure for many owner and renter families.

In the above equation, *r* is the share of income a household can reasonably be expected to spend for housing. Currently, households renting in Slovakia spend about only 5 percent of their income towards base rent alone. According to the most recent Family Budget and Expenditure survey, households in Slovakia, overall, spend about 12 to 13 percent of their family budget on housing related expenditures. This compares to about 25 to 30 percent in Western Europe and America. The *r* in the housing allowance formula for Slovakia could be set according to information derived from surveys such as the Family Budget and Expenditure survey. Since few families live in units that are exactly the same size as the social norm, families rarely will pay exactly the percentage of their gross income chosen for *r*.

In the equation, *Y* is the households monthly income from all sources. Allowance payments equal the *MSR* when the household has no income and therefore the allowance payment declines as income rises. Thus allowances are phased out or discontinued when $Y = MSR/r$. This method of calculating a housing allowance payment is better than if it were based on whether a household's income is above or below some arbitrary income cutoff as is the case in the Czech Republic. Notice, the *MSR* is set according to norms for size of the unit and related housing costs and not according to the actual size or current housing related expenditures.

In market-based economies where formula-based allowances are utilized, the *MSR* is set according to market rents, and is set high enough to provide a household with the ability to lease a good quality unit. The household may lease a unit for more than the *MSR*, but the difference must be paid by the household. If the allowance exceeds the actual rent, the households can keep the difference. However, the household might be required to pay a minimum share of their income towards housing costs in order to participate in the program, thereby providing some incentive for households to choose a minimally adequate housing unit. The behavior incentives built into the formula motivate households to purchase or pay for the amount of housing or housing related goods such as energy, that is appropriate to its characteristics.

Historical Overview

The first use of the consumer-based housing subsidy, such as the housing allowance, dates back to the early 1900s in Europe. The Dutch first introduced a housing allowance to families displaced by slums during the first war. Some years later, Sweden introduced its first consumer-based subsidy to families with children as way of making more housing available to the poorer segment of society. Shortly thereafter, another Scandinavian country - Finland - introduced a housing allowance that was made available to large families only. By the late 1950s and 1960s, a housing allowance had been incorporated into national housing policy of the majority of Western European countries.

The introduction of housing allowances has been motivated by different factors in various countries. The earliest development of the housing allowance was motivated by the need to protect large families and the elderly from undue economic hardship (Scandinavia). In other cases the housing allowance was used in a pragmatic attempt to integrate new high cost housing with the older low cost rental housing, providing families with the incentive to move into new housing that might otherwise remain vacant or never built in the first place. Another important motivation for introducing the housing allowance in European countries was to promote labor mobility required by changing economic growth areas. (This especially true in Slovakia - a country undergoing major structural change during its transition from a command economy to one more orientated towards markets.)

More recently, housing allowances have become the dominate form of subsidizing housing because of cost considerations. Many countries are turning away from producer-based subsidies due to the systems high per-family cost relative to consumer-based subsidy such as the housing allowance. In France, Sweden, and Germany the dominate form of housing assistance is based on a housing allowance. Overall in Western Europe, the extent of housing allowance programs is large; in four countries approximately one-fifth or more of all households receive some form of a housing allowance and in three additional countries it is approximately one-tenth. The United States is currently considering collapsing its dominate producer-based housing programs into a single housing allowance program thereby expanding the coverage of its existing housing allowance to include even more families.

In Eastern Europe, six countries (Lithuania, Estonia, Latvia, Slovenia, Poland and the Czech Republic) use a modified housing allowance on a national scale to protect a growing pool of low-income households, increase revenues for operating and maintaining rental housing, and promote the production of new housing. In the Russian Federation, a housing allowance system has been successfully adopted by specific cities, such as Moscow. Since the joining of East and West Germany, the West Germany housing allowance scheme was adopted in the New Lander. There the program has been extremely successful in improving housing conditions and creating a good deal of economic activity associated with increases in demand for housing and related housing goods.

If implemented, similar to the experiences of other East European countries, a formula-based housing allowance scheme for Slovakia will address six main policy objectives:

- protect low-income households from paying an excessive share of their income for housing;
- integrate government-owned and private rental housing in such a manner that households are free to locate from one type of housing to another without incurring excessive costs;
- use the price mechanism as a signal to allocate housing and housing services

thereby, eventually, doing away with rent control and subsidies for utilities and energy costs;

- eliminate producer-based subsidies which have led to inefficient consumption of housing since in many cases housing unit size does not correspond with the size of the family;
- raise revenue for much needed building maintenance of the rental housing stock by allowing rent to increase without imposing undue hardship on low-income families; and
- stimulate the production of good quality housing by increasing the ability and willingness of households to pay for housing and utilities costs.

Rental Housing Subsidies

Revenues from rent payments for public housing have never fully covered operating, maintenance, and capital costs. In the past, the state made up the shortfall in rental revenues but the subsidy was often inadequate to cover the costs associated with public housing.² In 1990, the last year that the state subsidy fully covered the gap between operating costs and rental income, the total subsidy for Slovakia amounted to Kčs 1.6 billion. Since then, ownership of public housing has been given to the municipalities, and they are now responsible for the subsidy. Accurate figures on the total subsidy paid since then are not available but it is likely (given constraints on local revenues) that operating and maintenance outlays have fallen behind the inadequate levels of 1990.³

The extent of housing subsidies accruing to municipalities and attributed to operating and maintaining rental housing is best illustrated by an example drawn from a typical municipality. In Bratislava's District 4 there are about 3,500 municipal rental housing units as of mid-1993, managed by a (private) housing management company for a fixed fee of Sk 60 per unit per month. This management fee is paid directly out of the District's general operating revenues which, in turn, are supplemented by rent payments collected from the tenants on a monthly basis. If rent, on average, for these units is Sk 320 per month (based on an average size category I unit), then total rent, less actual arrears of 2 percent, is approximately Sk 1.1 million per month. The monthly fee for managing the units, based on Sk 60 per unit, is Sk 210,000. Assuming the true economic cost of managing and operating the units is equal to four times current rent revenues⁴, the implicit subsidy is about Sk 3.4 million per month. This sum represents the difference between what is needed and what is actually collected on a monthly basis. Given increasing losses from the municipal revenue base due to restructuring and the loss of state transfers to municipalities in 1993 for housing, the District's need for additional revenues for the

Between the years 1964 and 1991, rents (with the exception of cooperatives) did not change despite the fact that operation and management losses accumulated. Today, government estimates of neglected housing maintenance amount to Sk 40 billion or Sk 90,000 per unit.

In January 1992, service charges for municipal units were increased by about 200 percent. Combined with the base rent for a municipal unit, this represented an increase of about 80 percent over the previous level (concurrently, rent discounts based on the number of children were abolished). In July 1992, base rents for municipal housing were doubled.

The Association of Housing Management Companies estimates that rents would need to rise by anywhere between 400 to 600 percent to cover the costs of operating and maintaining housing units.

operation and maintenance of housing accumulates over time causing the condition of the buildings to deteriorate.

Since rents are still regulated while subsidies for energy costs have almost been eliminated, utility charges constitute a significant share of total housing costs. Along with the general price liberalization initiated in 1991, subsidies for utilities have been gradually relaxed. Starting in 1992 price controls for electricity, heat, and other fuels (mainly used for heating and cooking) were partially lifted. At the beginning of 1993, price controls for electricity, gas, and other fuels for residential housing were all but lifted. This left heating as the only commodity still explicitly subsidized by the state budget. In 1993, the Republic's budget allocated Sk 2.24 billion as a subsidy for heating costs, mainly going to producers of heating. Today, utility or energy payments make up well over 50 percent of housing costs for renter and owner households. As a result, there is strong need to evaluate whether a housing allowance should include utility or energy costs as part of the formula.

The second group of renters are represented by the affordable rent curve which is above the vertical line based on the average rent-to-income ratio. These households or about 63 percent of all municipal renters, pay less than their affordable rent. For them, their income would allow them to pay more but since rents are strictly controlled, they accrue a windfall at the expense of those who pay more than their affordable rent. With rent control, revenues from rents fall short of the costs to operate and maintain buildings. However, according to the affordable rent curve there is a group of renters who could pay more but instead receive a subsidy. Combined this subsidy accrues to renters at about Sk 40 mil. per month or almost Sk. 500 bil. a year.

There are indications that income disparities among households in Slovakia are growing. The affordable rent curve in Figure 1 shows conditions in early 1993. If truly the poor are growing poorer and the rich are getting richer, the amount of subsidy accruing to those renters falling above the average rent-to-income line would increase. Graphically, this would cause our affordable rent curve to rotate on its axis where it touches the rent line (assuming rent control was still in place). The negative gap for those households below the rent line would also widen.

This illustration shows that a good portion of renters receive a subsidy through imposition of rent control at the expense of other lower income renters. Because of rent control municipalities are forced to subsidize the operation and maintenance of their housing. The current policy of fixed rent for housing irrespective of the ability of the household to afford this their monthly payment clearly is inequitable. The solution to a policy that allows tenants who in fact have the ability to pay more for housing to accrue a subsidy and does not afford protection to those households who need assistance with their housing costs is implementation of a housing allowance.

Slovakia's Social Safety Net

Similar to other Eastern European countries, Slovakia has an extensive system of government cash transfers designed to aid needy individuals and households. Slovakia's safety net is currently divided into three major categories: (1) social security, (2) social welfare, and (3) unemployment. Combined, these programs offer a wide array of benefits. Today, the government is reforming the social benefits programs to function better in a market-based economy. The proposed housing allowance could replace the housing component of the current social welfare benefit.

In response to the changing fiscal demands placed on the social safety net in a country

undergoing major structural change, Slovakia's Ministry of Labor and Social Affairs began to modify the benefits program in 1992. The Ministry streamlined the funding mechanisms of various programs and attempted to target benefits more efficiently. In addition, the National Insurance Company was established to manage three social security funds: health care; sickness insurance; and pensions. A fourth fund was also established to manage unemployment benefits.

The government has proposed other modifications to the social safety net. It seeks to consolidate many overlapping programs while redefining others to be more inclusive of individual and family needs. There are three main components to the new system of benefits: (1) social insurance, including health insurance and pensions; (2) state social support, including child allowances, parenthood allowances, and housing allowances; and (3) state social assistance, including programs to benefit the poorest citizens. (While the unemployment benefit will be retained, this program is distinct from the three managed by the Ministry.)

While the three proposed categories of assistance retain many of the current programs, a major distinction from the current system is found in the newly proposed social support category. The social support programs will become means-tested with an income eligibility threshold of either 1.5 or 2 times the established poverty level. The new proposed social support package also includes such programs as; child allowances, payments for incomplete families, parenthood allowance, birth grant, personal assistance for disabled, disability payments, and housing allowances.

Currently, the structure of the housing allowance component of the newly proposed state social support category is being debated. One issue centers around whether to make owners and renters eligible for housing assistance. Another issue focuses on whether utilities should be included in the calculation of the housing allowance and whether or not to base the allowance on a housing quality standard similar to the one used by the *MSR* in formula-based housing allowances. The proposals calls for housing allowances to be income based, though whether the payment is directed to the manager of the housing, the owner, or tenant is still being debated. Furthermore, local governments have been proposed as the administrators of the allowance, though program parameters such as the *MSR* or *r* would be set at the national level.

Conclusions and Recommendations

Political acceptance of rent increases large enough to approximate market levels and provide resources for adequate housing operation and maintenance is unlikely without a formula-based housing program. A housing allowance program undermines the argument that the poor cannot afford to pay such high rents. Under the housing allowance system, low-income households would be protected since no one would have to pay more than a fixed share of their income for rent. Only middle-income and high-income tenants of communal housing (and there are many of these) would have to pay substantially more out of their own pockets than they are paying at present. A housing allowance program is, therefore, the key to political acceptance of rent increases which, in turn, will be essential if an adequately maintained and managed housing stock is ever to be a reality in Slovakia.

With the technical assistance of USAID the Ministry of Labor and Social Affairs has used the housing allowance and income support (HAIS) model to simulate the impact of a housing allowance scheme in Slovakia. This model was designed specifically for Slovakia so that the number and type of eligible beneficiaries could be estimated under different program designs and parameters. The HAIS model also estimates the amount of the housing allowance (Sk) payable to household. The data the model uses is based on an updated MikroCensus file statistically matched with the Family Budget and Expenditure survey supplied by the National Statistics Office.

According to the simulation results from the HAIS model, the estimated annual housing allowance outlay required to protect the poor in cooperatives as well as in rental housing, associated with a 100 percent rent increase and a maximum 20 percent share of income devoted to housing (r in the formula) expenditures in 1993, was only Sk 64 million per month. This is less than half of the actual state subsidy paid for state rental housing in 1990. For municipal unit renters only, the HAIS model estimated that monthly allowance outlays would total Sk 34 million or Sk 408 million a year. Even with a 400 percent rent increase, only 50 percent of all municipal and cooperative tenants with an average Sk 562 per month allowance would be eligible for the program. Under this scenario, base rent levels four times higher than they are today would approximate true cost of operating and maintaining apartment units.

The housing allowance concept is already built into the social support component of the draft social safety net proposals being reviewed by the Ministry of Labor and Social Affairs. What has worked in other countries is housing allowance program that is a separate and clearly identifiable component of social support, rather than being buried in an indistinguishable general payment. The type of housing allowance appropriate to the conditions of Slovakia needs to be evaluated but from all indications from other country experience the allowance should be based on the difference between the household's ability to pay a reasonable share of its total gross income towards housing costs (including utilities or energy costs) and what it costs to rent a good quality unit appropriate to the size of the household. The allowance would not have to be limited to renter households but they should be paid directly to the households since this will allow households to "shop" for housing appropriate to their particular circumstances and allow for much needed labor mobility. The political support necessary for base rent increases will only be forthcoming if a formula-based housing allowance is implemented.