

Chapter V

THE MACRO-ECONOMIC FRAMEWORK

A. The economic framework for decision-making in social housing

1. The economics of social housing studies the economic principles of efficient management of public resources allocated for meeting public housing needs by providing housing to eligible population groups on non-market terms. The economics of social housing is closely related to studies of the effects of various models of consumer subsidy in the housing sector (tax credits for home purchasers/mortgage borrowers, home purchase subsidies, housing allowances and so on). In fact social housing (associated with supply subsidies) and housing allowances (associated with demand subsidies) form the two pillars of public housing policies.
2. From an economic theory point of view, housing demand subsidy to a household is in general more efficient than equal supply subsidy which lowers housing cost. Even in a simplistic model, however, a household with a demand subsidy maximizes its utility function BUT as a rule consumes less housing than in the case of supply subsidies. The magnitude of socially acceptable variation in consumption of housing is usually less than in consumption of other goods. The need to ensure the minimum level of housing consumption in a society justifies the existence of a social housing sector in most of the countries under consideration. This does not allow an individual household to maximize its utility function but results in the maximization of benefit to the community or society as a whole.
3. Within this framework the economics of social housing studies:
 - Market failures justifying the need for social housing
 - Comparative effectiveness and efficiency of various models of subsidy
 - Redistributional aspects of social housing policies
 - Social housing externalities (such as neighbourhood effects, specific disease prevention)
 - Other aspects of the social value of housing inadequately reflected by its market value.
4. Most serious market failures are:
 - (a) Lack of housing investment as a result of lack of information about the risks and long-range effects of these investments versus the household's lifetime; income distribution patterns also often result in an inability on the part of a substantial share of the population to devote adequate resources to investment in housing;
 - (b) Factors making it difficult to respond adequately and in time to messages regarding market price;
 - (c) Risk of adverse externalities associated with housing sector development in a competitive environment (slums and homeless people) which may damage public community interests and require huge spending of public resources to mitigate them.
5. The most serious risks caused by housing market failures and by the relatively slow adjustment ability of the market, which constitute the rationale for a social housing sector development are:

- Shortage of housing supply (long-run risk)
- Sharp price variations (short-run risk)
- Negative side effects.

Housing shortages in post-World War II western Europe to a large extent fuelled decisions on the extension of the social housing sector from the 1950s.

6. National social housing policies (social housing sector size, subsidy, allocation and targeting models and so on) usually reflect national and regional characteristic features of market failures and “pricing” of risks associated with them.

7. Social housing is related to the general housing market in a number of aspects:

(a) At the stage of housing production it may contribute to growing competition in housing production and to the implementation of new standards and technologies. At some point, however, competition for limited resources may result in an increase in prices;

(b) At the stage of housing consumption, social housing increases supply, thus pushing prices in the private rental market down; at some point, again, oversupply of housing may discourage private investment;

(c) The setting of certain standards by social housing may stimulate private owners to push “substandard” housing out of the market faster.

As long as policy makers have a certain degree of flexibility, managing “social housing cycles” may alleviate some adverse effects of housing market cycles. For example, maximizing social housing construction during recession periods results in at least two positive outcomes: the construction industry is kept alive and social housing is built at a cheaper price (for example, the Finnish experience of counter-cycling).

8. Social housing is also related to a wider range of economic issues. The magnitude of the social housing sector is a considerable economic factor per se. Public expenditures on housing policies vary from 0.1-0.3 per cent GDP in southern European countries (Italy, Greece) to 1.2-1.4 per cent GDP in some northern European countries (Finland, Denmark) and Austria. These numbers comprise tax and interest rate deductions for private investment and direct support of social housing, and they reflect public expenditure, which benefits not only low-income citizens. Though there is a considerable downward bias in numbers due to methodological deficiencies (for example, only Germany and Portugal include revenue forgone), conservative generalization indicates that social housing-related expenditures comprise 0.1 per cent-1 per cent of EU countries’ GDP. In several transition economies, social housing constitutes an even bigger share of public expenditures. For example, in Russia in 2001 the subsidizing of only the operating costs of housing and utilities was assessed at 4 per cent of GDP (including subsidies to home owners). Overall public expenditure relating to housing in Russia may be appraised at 5-6 per cent of the GDP.

9. Some of the links to macroeconomic issues may be regarded as general characteristics of the housing sector; however, social housing has its specific features. Among these important links economic research has identified the following:

10. Housing and labour markets Housing clearly affects both labour costs and labour productivity. Social housing, by lowering the housing costs of consumers, alleviates pressure towards wage increases. There is reported evidence of this when policy decisions on social housing were to a large extent driven by the intention to stimulate the competitiveness of national export industries. Labour productivity in industries requiring less skilled labour is to a larger extent dependent on the accessibility (and affordability) of social housing.

11. Housing and employment Access to affordable housing (usually with adequately protected tenancy rights) provides an important safety element in cases of temporary job losses. Job loss followed by a need to move to different housing may often lead to problems caused by a lowering of a household's social status and the spectrum of opportunities available. As long as labour markets under the global economy become more and more fragile, the role of this advantage of social housing increases.

12. Housing and labour mobility Labour mobility enables the inhabitants of regions suffering from economic depression and increasing unemployment to move to find other work. In such cases mobility may be inhibited by a growing gap in housing prices between the run down region and other areas, which may result in the continuation of economic crisis and poverty in the region (lock-in effect) and growing Government spending on regional recovery programmes. Social housing may play an important role in lowering labour mobility-related barriers. In general, the mobility of social housing tenants tends to be higher than average. Estimates of labour mobility rates (percentage of the numbers of residential changes associated with the acceptance of new job) from a sample of households in the five largest EU countries during 1995-1997 supported this hypothesis – 1.2 per cent for social housing compared with an average of 0.8 per cent, 0.4 per cent for owners and 2.6 per cent for private tenants (cited from: Structural factors...).

13. Housing and health Inadequate and substandard housing provides an environment for the spread of a range of dangerous diseases. Social housing itself is associated with a certain socially acceptable level of sanitary standards and also by different means contributes to acceptance of such standards as uniform and compulsory. This allows a saving of public funds which would otherwise have to be channelled into public health programmes (for more details see chapter VIII).

14. Housing and economic stability Social housing may act as an anchor to decrease fluctuations in the housing market. Extreme fluctuations within the housing market may cause instability in other sectors of the economy. Stable housing costs in the social sector stabilize the demand for other goods and services. On the other hand, the need for more social housing rises in periods of economic crises when available resources are more limited and “competition” for those resources with other urgent public needs is higher.

15. European countries show a great variety in both their methods of defining those groups eligible for social housing and their methods of estimation of the percentage of such groups in the total population. As an illustration, today 15-20 per cent of Ukrainian and Russian citizens are recognized as being eligible for social housing, while in Bulgaria and Moldova this population group comprises only 0.5-2 per cent.

16. One of the key characteristics of social housing is that its entry point is determined by administrative processes rather than by price rationing, which makes it vulnerable to risk of administrative failure. The most serious risks associated with potential administrative failures are:

- A lack of incentive to manage resources efficiently
- Inclination of social housing organizations to serve their own interests rather than public interests or the interests of specific group
- Risk of higher management and maintenance costs due to monopolistic position of social housing organizations.
- Thus, in terms of housing economics one of the main tasks of a social housing policy is to alleviate any adverse effects of bureaucratic administrative rules and procedures (see also chapter VIII on the important role of competition within the social housing sector).

17. Reductions in the social housing sector may be seen as a common recent trend for both western and eastern European countries. For western Europe the reasons are:

- (a) The perception that there was a sufficient supply of housing and enforced health standards combined with a general improvement in welfare;
- (b) Population stability or even decline in several regions or countries, and a decrease in younger generation numbers which statistically constitute a higher proportion of social housing dwellers;
- (c) Improved public awareness, making the risk of market failures due to lack of information less serious;
- (d) Encouragement of home ownership by most countries of the region (urged by changes in ideological and political priorities, concerns about the long-term competitiveness of the European economy and the need to comply with rigid Maastricht budget deficit targets); this accordingly results in a fast shrinkage of the privately rented sector, which can even outpace reductions in the social rented sector.

In eastern Europe and the former Soviet countries, the reduction of the social housing sector resulted from a general reduction of Governments' involvement in national economies, and the liquidation of many of their social obligations during transition, together with an acute deficit of public funds. As a consequence, some former Soviet Union countries (Armenia, Kazakhstan) have divested themselves of almost all social housing, while in Russia and Ukraine – where historically it overwhelmingly dominated – social housing now accounts for somewhat less than in some countries of western Europe.

18. These trends result both in decreasing public funds devoted to social housing policies and in a change of proportion between demand and supply subsidies. For example, in Great Britain expenditures associated with social housing dropped between 1980 and 1997 from 61 per cent to 20 per cent of total housing policy expenditure, while those relating to housing allowances grew from 11 per cent to 58 per cent (Garner 2000).

19. However, the economic and social problems addressed by social housing did not diminish. To perform its functions efficiently in a changing economic and political environment,

social housing should be modernized. There are several trends which may contribute to its ability to respond to challenges of contemporary society.

20. First, during the past decade countries of the region went ahead in using more efficient (“quasi-market”) mechanisms for improvement of stakeholders’ motivation:

- competitive selection of private contractors for municipal housing management
- introduction of performance measurement instruments into the practice of social housing management (for more details see chapter VIII).

21. Secondly, while in some countries social housing still includes only State or municipally-owned housing (former Soviet Union countries), the general trend is to more variation of institutional forms of social housing which embraces non-profit or limited-profit housing associations, housing cooperatives (Austria, Poland, Sweden) or even privately-owned housing, the landlords of which enter into agreements with municipalities or regions (Germany, Switzerland and the United Kingdom).

22. Thirdly, there is evident success in the coordination of policies relating to social housing - with local territorial planning and zoning. Social housing, which may risk contributing to more segregation in society, now more and more contributes to effective social mix and social cohesion (see also chapters VII and VIII).

23. Transitional economies are also more exposed to the risk of market failures caused mostly by a systematic deficiency of private investment into the housing sector resulting in a growing deterioration of the sector’s physical and engineering infrastructure. Factors responsible for this are:

(a) New homeowners lack knowledge and skills in efficient decision-making as well as necessary information support. Of particular interest is the fact that the regional housing markets are composed mostly of multifamily estates, the management of which by co-owners is rather difficult (see: Guidelines on Condominium Ownership of Housing for Countries in Transition, UNECE 2003);

(b) Failure to establish a strict division between State/municipal and homeowners’ obligations relating to housing, due to which many homeowners continue to wait for local government assistance when a situation becomes dangerous or critical. This is now common practice, primarily because these relations are not properly formalized;

(c) Low income makes housing repairs and maintenance unaffordable for most households. In fact, this is a consequence of a more general problem of the inadequacy of traditional consumer choices and available economic capacities, typical of many countries of the region.

24. The combination of these factors in transitional economies has given rise to a practice usually described as “owner-occupied social housing”, which may be a reasonable response to transitional economy challenges. However, this practice can be treated only as an interim remedy incapable of solving the problem of a deficiency of investments in housing stock maintenance.

25. In terms of housing economics, any privately-owned residential property that is lacking a reliable financial mechanism for maintenance is a source of imminent social problems which

local communities and the public in general will have to face, thus creating the necessity for Governments to apply social housing policies to this sector as well.

26. The trend of levelling out differences between social housing and other types of tenure implies a matching, first of all, of total rent and other contract terms offered to tenants of social and private rental dwellings. This matching is a result of the real growth in social rents (curtailment of direct subsidy). In consequence of such equalization of social and market rental payments, Governments in several countries have launched or extended programmes of housing allowances in an effort to subsidize tenants of both social and privately-owned housing. In addition to the recognized benefits of housing allowance programmes, as they are treated by economists (unit cost of beneficiary's welfare improvement), they also make it easier to solve the problem of local concentrations of socially vulnerable households. The main disadvantage of housing allowance programmes – they cannot prop up the supply in the housing market – is currently mitigated by the high level of supply achieved in the housing market in several countries.

27. A reduction of explicit subsidizing of social tenants does not cancel the need to make an inventory of hidden subsidies that are apparently still provided in most countries. Hidden or indirect subsidies include the provision of land or tax exemptions to developers or to individual households. Such policies may eventually favour higher-income households rather than the poor (who pay little or no income tax). At the same time, overall public expenditures on housing are lower and more transparent in countries (such as Austria) where subsidies are given in a direct form.

28. In most eastern European countries, and in particular in the countries of the former Soviet Union, rents for social rental dwellings are set at rates covering only operating costs, with capital costs remaining uncovered. As a result, payments associated with housing constitute only from 1/5 to 1/3 of household expenditures – the balance being covered by utility charges. Thus, the task of making an inventory of all indirect and hidden subsidies is particularly important for transitional economies, since a large portion of these resources goes to targets other than those established by the social housing policy.

29. Price setting at below market levels is a key feature of social housing. Housing economics suggests that rent differentials should still reflect the relative value of (and hence demand for) the property. However, in almost all countries mechanisms of rent pooling (flat rents) or cost-rental systems (rents set on the basis of actual costs) are used. This often results in adverse distributional implications with better-off tenants in better and more attractive properties paying lower rents than poorer tenants living in less popular estates. This gives wrong signals to both tenants and landlords (particularly in the case of decisions about the use/demolition of various properties). It also imposes additional difficulties in setting efficient and transparent allocation procedures.

B. Conclusions

30. Social housing is related to a wider range of economic issues. The magnitude of a social housing sector is a considerable economic factor per se. Social housing-related expenditure comprises from 0.1 per cent-1.5 per cent GDP in western Europe to 4-6 per cent GDP in the

former Soviet Union countries. Some of the links to macroeconomic issues may be regarded as general characteristics of the housing sector; however, social housing has its specific features. Among these important links are:

- Housing, labour market and employment,
- Housing and labour mobility,
- Housing, public health and social behaviour,
- Housing and economic stability.

31. Social housing has many important links with the general housing market. Efficient policy should result in using social housing as a tool to balance or stabilize the situation of the whole housing market. However, mismanagement in this sector may result in an unbalanced housing market.

32. The economic behaviour of large population groups may be seriously influenced by messages given to them in the course of development of the social housing policy, in the fields of labour, migration and so on.

33. The most important of such messages is the official registration of a citizen's need for social housing, commonly known as waiting list registration. In this context it is particularly important to follow the principle of transparency in order to avoid the emergence of false messages in the course of framing social housing policy targets. This principle is particularly important for eastern European countries and for the countries of the former Soviet Union where public expectations of social housing are traditionally very high and new systems setup by the transitional economy are still immature.

34. Today, a significant change can be observed caused by various market failures and risks creating the necessity to maintain social housing. As there is potential damage to society associated with such risks, constant public attention is required to issues associated with social housing.

35. At present the world economy is characterized by controversial factors which may either enhance or alternatively reduce the significance of social housing. On the one hand, economic globalization and the growing reliance on welfare, due to the situation in regional and world markets and to acute fluctuations in income and employment rates, call for the necessity to provide better protection of citizens' interests in the housing sector. On the other hand, the inert and localized nature of social housing makes it difficult to keep pace with the general economic development. Under these circumstances more extensive use of consumer subsidies (housing allowances) as an instrument for servicing fluctuating needs is observed.

36. These trends may result in the marginalization of the social housing sector and the stigmatization of its inhabitants. Marginalization of social housing may in turn have a negative influence on private business motivation in getting involved in public-private partnerships. Subsequently this may increase the burden of the public sector and especially of municipalities as key decision makers and administrators of social housing, which implies a possible growth in risks associated with inefficiency of bureaucratic procedures.

37. Various social housing sectors in the region have demonstrated their ability to cope with the new challenges observed; the efficiency of sector management has increased substantially, especially in western Europe.

38. At the same time, transitional economies are exposed to the specific risk of systematic gaps in financing of great parts of their housing stock, which over time may substantially increase the importance of the physical existence of their social housing stock. We may say that at present these countries are expecting that with the end of the transitional period their output per man-hour will rise to a level permitting them to have the same housing consumption rate as they had before the transition (evidently at present this level is unaffordable and may be maintained only at the expense of future generations). Transitional economies have also to face much greater risks resulting from inefficient management of social housing because of the lack of mechanisms of public control and of efficient bureaucracy in the sector.

39. Social housing policy in the twenty-first century will depend more on local externalities and the impact of past policies, as well as on the strength of organizational, regulatory and market frameworks.

C. Recommendations

40. The development of a social housing policy should be based on a comparative assessment of risks caused by market failures on the one hand, and explicit and implicit costs of the social housing sector administration on the other.

41. Policies towards social housing should be developed and assessed on the basis of criteria which are not limited to the immediate tasks of social housing but rather take into account more general positive externalities.

42. More active cooperation of public and private actors in the social housing sector should be encouraged in an effort to use the potential of the latter for providing a more flexible response to the rapidly-changing needs of citizens in the housing sector. The search for new models and terms of cooperation should include more involvement of non-profit organizations and of “non-professional” landlords (households who enter the private rental market only during certain periods of their lifetime and who do not consider rents as a main source of their income) in order to solve the social housing demands.

43. Exchange between private and public sectors of experience of good policies and practices of housing management should be made more widespread - including performance measurement permitting alleviation of the risks of inefficient decision-making.

44. Transition economies, where social housing is to a great extent a result of uncontrolled curtailment of State involvement and privatization, are in need of the development of an all-inclusive social housing policy based on the economic and fiscal capacities of a country and its historical and cultural traditions.

45. In transition economies, it may appear advisable in certain cases to expand the understanding of social housing by providing assistance to homeowners who in the foreseeable

future will be unable adequately to finance their home maintenance costs (consistent with the capacities of a national economy).

46. Housing sector-related obligations of States and municipalities, including implicit forms of subsidies and so on, should be clearly defined. Assessment of the total costs of social housing for a community, including its opportunity costs, should become a mandatory input for housing policy decision makers.

47. As long as transitional economies face a much greater risk of inefficient management of social housing, typically because of a lack of mechanisms of public control and of efficient bureaucracy in the sector, the positive experiences of western European countries which have reached high standards of management of social housing (Austria, the Netherlands and the Scandinavian countries) should be widely used.

48. In order for policy makers to be able to judge adequately the efficiency of their country's housing sector, the regular collection of a number of social housing indicators is recommended. Such indicators should include measures on:

- (a) Social rented dwellings newly completed (as a percentage of newly-completed dwellings per year);
- (b) The full cost of constructing one unit of social housing (including opportunity cost);
- (c) Rent per unit in social housing as a percentage of rent for comparable housing in the private market;
- (d) Share of annual cost of social housing to landlord covered by rent;
- (e) Rent per unit as percentage of:
 - average household income;
 - average income of targeted group of households;
- (f) Median income of social housing tenants vs median income in the community;
- (g) Indices of localization of social housing in particular communities within a metropolitan area (share of social housing in a community/share of social housing in a metropolitan area; standard deviation of share of social housing in communities of a metropolitan area).