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Housing Allowances: Finding a Balance Between Social Justice and Market Incentives

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ABSTRACT *Safeguarding the affordability of, and thereby access to, housing is a key issue in housing policies across Europe. Housing allowance schemes have become a more important tool in pursuit of this aim in many countries during the past few decades. This themed issue reports on developments and dilemmas concerning housing allowance schemes in five countries.*

KEY WORDS: Housing allowances, housing policy, affordability

One of the goals of housing policy is to safeguard the affordability of housing, which is interpreted as the right to a reasonable standard of housing at a cost that represents a tolerable burden on household income (Lux, 2003). Across Europe governments are constantly reshaping their housing policies, especially tools to keep housing affordable.

Over the past few decades housing allowances have taken on greater importance in housing policy, sometimes even becoming the key tool. Also known as 'housing benefits' or 'housing assistance', they are intended to keep housing of a reasonable standard affordable. These schemes enable low-income households to consume more housing than their incomes would normally permit. This themed issue shows that, although allowance schemes share the same goal, they are constructed in very different ways from one country to another.

The development of housing allowances as a policy tool reflects a shift in the role of government on the housing market. It has enabled governments to move away from bricks-and-mortar subsidies in, e.g., Britain, Sweden, Germany and the Netherlands, where this type of subsidy played an important role in solving the housing shortage problem after the Second World War. Subsidized housing was provided for mid- as

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well as lower-income households. In the 1970s and 1980s, however, governments decided that providing subsidized housing for a broad target group in this way was inefficient from the distribution point of view. Housing allowances, being a means-tested subsidy, were seen as a more efficient way of keeping housing affordable for those in need (Kemp, 1997).

The introduction of housing allowances also enabled the state to relax the rather stringent post-war rent controls in the private rented sector without jeopardizing housing provision and affordability for low-income households facing rent increases. They were seen as a cost-efficient tool that permitted rents to rise, thus helping to keep the market efficient. These north European countries provide allowances in both the social and private rented sectors. The Scandinavian countries also provide housing allowances for owner occupiers (Åhren, 2004).

Other countries, e.g. the USA, Australia, Belgium and Ireland, have not participated in the recent debate on subsidized rents in the public sector. There low, subsidized rents are channelled through a small, marginalized social housing sector which exclusively targets vulnerable sections of the population. Entry regulation, and in some cases exit regulation, is in force to ensure proper targeting. The problem of rent subsidies to non-needy households, i.e. leakage, has been less significant because rents are means tested. The 'differential rents' in these countries are income dependent: the lower the income, the lower the rent (Ditch *et al.*, 2001). This system works in a similar way to housing allowances, but with a more pronounced link to a specific small tenure form. The degree of regulation is also usually higher. If there is a housing allowance scheme, it is merely a supplementary measure in the private rented sector.

Modern housing policy in eastern Europe is characterized by a drastic move away from deep in-kind subsidies administered in the form of highly subsidized rents for public housing. This has been achieved through privatization, whereby the new owners – normally the sitting tenants – have to bear the full cost of maintaining and running the property. Many tenants, and in some cases new owners, are protected by a recent housing allowance scheme. Many east European countries regard this as a modern way of protecting vulnerable households, without preventing the state from deregulating the housing market.

Table 1 shows the importance of housing allowances in housing policy: all the countries listed have long-standing or recent housing allowance schemes for tenants. Most of them provide housing allowances for owner-occupiers as well.

The debate on housing allowances includes technical and administrative aspects, which have important ramifications for the effects of a particular scheme. The most common set-up is a gap formula. In this formula housing allowance covers the difference between the actual rent and the rent that is considered reasonable for the household. Housing allowance therefore increases when rent increases up to a certain maximum rent. Various methods are used to phase out allowances, i.e. the upper rent limit is elastic, and they are phased out with increasing income. There may be additional rules to ensure that systems are fair, e.g. area-based or regional restrictions.

Table 1. Income-related housing allowances

	Income-related housing allowances for owner occupiers	Income-related housing allowances for tenants
Australia		○
Austria	●	●
Canada		○
Czech Republic	NEW	NEW
Denmark		○
Finland	○	○
France	○	●
Germany	NEW	●
Greece		○
Hungary	○	○
Iceland	○	○
Netherlands	NEW	○
Slovenia		●
Sweden	○	○
UK	●	○
USA		○

Source: Scanlon & Whitehead, 2004.
○ In existence since the mid-1990s.
● In existence in the mid-1990s and since changed.
NEW Recently introduced.

This system is safe for tenants, who will be protected if they are able to find homes that are affordable, i.e. below the upper rent limit. It has two disadvantages, however, one being the need for a maximum rent to control the cost of housing allowances, which restricts freedom of choice for tenants. Moreover, the gap system – where it compensates households more than marginally within the gap – encourages tenants to consume more housing than they need, which can increase rent levels and thus the cost to the state of housing allowances, as it reduces the need to find cheaper homes or negotiate lower rents. This is the reason for a debate on shopping incentives.

The housing voucher system, which is used in the US, is considered as an alternative. This housing policy tool was introduced there in the 1980s following the large-scale Experimental Housing Allowance Program experiment: ‘A voucher is a capped or restricted subsidy which gives purchasing power to an individual and some freedom to choose how that subsidy will be spent – among suppliers and/or among a set of goods and services’ (Steuerle *et al*., 1998). In a voucher scheme the allowance covers the difference between a reference rent and the expenses a household is expected to cover by itself. Hence the amount of subsidy depends only on the household’s income, not on the rent of a particular home.

A voucher-style subsidy is therefore supposed to give households freedom of choice and an incentive to shop for the best price and quality of housing available on the market. A drawback of voucher schemes is that they do not safeguard affordability, since households may not be able to find homes within their financial means. Another aspect inherent in voucher schemes, and a point that attracts criticism, is the fact that allowances will be allocated to households that meet the income criteria but are not in serious housing need.

Not surprisingly, the debate on vouchers and shopping incentives is taking place in countries with large-scale housing allowance schemes, such as Great Britain and the Netherlands (Priemus & Kemp, 2004; Kemp, 2000; Gibb, 1995). The discussion, which reflects a broader trend for governments to move away from a market-regulating approach to a market-enabling approach, has been going on since the end of the Second World War. The focus seems to be shifting from crude, fairly simple economic support to low-income households that targets their housing consumption needs to a wave of fine-tuning attempts. The aim is to lower the cost to society and reduce the distorting impact on the housing market. Mark Stephens, Hegedüs and Teller, and Sien Winters deal with this topic in this issue.

Another debate on the market effects of housing allowances that is taking place in various countries concerns labour market participation (Priemus & Kemp, 2004). Housing allowances are assumed to have a disincentive effect on this, since a marginal increment in income inevitably causes a reduction in housing allowances, thus producing a high marginal effect. This creates a labour market disincentive that conflicts with the primary goal of the allowance, to provide income supplements for those in need – targeted at decent and affordable homes – without affecting their wider economic behaviour. This inherent tension is discussed in the papers by Kath Hulse and Bill Randolph, Viggo Nordvik and Per Åhrén, and Mark Stephens in this issue.

Mark Stephens presents an assessment of the British housing benefit system, stressing that high fiscal expenditure on housing benefits should be seen in the context of relatively inexpensive social security provision. Mainstream social security benefits do not cover housing costs, hence the housing allowance scheme has wider coverage, with 63 per cent of social sector tenants and 25 per cent of private sector tenants receiving allowances.

Stephens describes the history of this scheme, with its roots in social security policy, and evaluates the British system in terms of impacts on affordability, housing expenditure, over-consumption and labour market participation. He evaluates its effectiveness by comparing affordability repercussions in the social and the private rented sectors. Affordability in the latter has deteriorated even further since additional cost control mechanisms were introduced in the mid-1990s.

He notes that the government is not satisfied with the current system because of the supposed work disincentive, maladministration and over-consumption. In his evaluation, however, he points out that there is remarkably little evidence to substantiate the claims of work disincentive and excessive housing consumption. He is therefore critical of the current experiment with a flat-rate, non-rent-dependent housing allowance in the private rented sector and the intention to extend this system into the social sector. He concludes that quasi-market mechanisms – such as voucher schemes – place choice above the safety net objective.

Viggo Nordvik and Per Åhrén analyse the Norwegian housing allowance scheme, which is modest compared to many other North European schemes, covering only 6 per cent of Norwegian households. It is tenure-neutral and was set up as a traditional gap-oriented scheme. The marginal withdrawal rate as income increases ranges from 30–58 per cent. Since housing allowances cover a small, one might say even marginal, part of the population, one could expect serious labour market disincentive.

The authors focus on the negative effect of a housing allowance system on labour market participation. The authors investigated the propensity of households to remain receiver of housing allowance and the evolvement of this propensity over time. The results of this survival analysis of housing allowance recipients over a period of nine years show that 30 per cent of housing allowance recipients exit the scheme every year. This exit rate appears to be stable over time. They interpret this as an indication that the Norwegian system has not created a dependency culture. According to the authors an important policy implication that it seems that labour market disincentives do not appear to an extent as one could fear.

Kath Hulse and Bill Randolph present results from Australia, also comparing possible negative effects of public housing and housing allowances on labour market participation from a housing and welfare policy point of view. The below-market rents in the public rented sector, and housing allowances in the private sector, produce a marginal reduction in subsidy as recipients' income increases. This is more profound in the public sector, which can be explained by the fact that subsidies for tenants in the private sector are lower than for those in the public sector.

The poverty trap caused by income and tax policy is aggravated by housing allowances and rent setting in the public sector: this is what Hulse and Randolph conclude from a calculation of marginal tax rates. In economic terms there is a considerable work disincentive. The paper presents a survey of both private and public tenants, however, who appeared to understand how taking up a job affects their rental assistance. In the case of 20–25 per cent of public tenant, a raise in their income-dependent rent was a concern when looking for work, but there was little indication that housing allowances played a role in job decisions by private tenants.

Sien Winters describes the Flemish housing market and reflects on the need for a housing allowance scheme for the private rented sector. Belgian housing policy traditionally aims to promote home ownership. The social rented sector covers less than 6 per cent of the housing market, while 20 per cent of the market consists of private rented homes. The author describes the problems of affordability and lack of quality in the private rental market, then outlines the economic prerequisites for a housing allowance scheme in Belgium.

She concludes that priority should be given to enlarging the social rented sector. Since it takes time to build social rented homes, however, and the housing problems are considered to be severe, housing allowances could be an interesting option for relieving the current problems in the private rental market. The author urges a public–private partnership with the Social Rental Agencies that operate in the private sector, where they act as intermediaries, providing housing for tenants with social problems (they currently let a total of 3,400 homes), giving social guidance to tenants in need and issuing rent guarantees to landlords. They receive government subsidy to meet their operating costs. Winters considers that a housing allowance scheme run by them in the private sector could be a viable alternative to enlarging the social rented sector.

József Hegedüs and Nora Teller analyse the origin and development of housing allowances in central and eastern Europe in the 1990s, with special emphasis on Hungary. These countries once had a dominant public housing sector where rents were extremely low; reflecting the ideological view that access to housing is a social right. Even the marginalized private owner-occupied sector was subsidized through below-market interest rates. The public sector was privatized at the beginning of the 1990s, resulting in the new owners – normally the previous tenants – having to pay an increasing share of maintenance and utility costs. At the same time rents were increased in what remained of the public sector, for the same reason.

The result of this drastic change was a massive affordability problem, as there was already a mismatch between resources and housing standards – a heritage of the old deeply subsidized housing market. The solution to this has been a whole range of different housing policy tools, with housing allowances as one important ingredient.

Hegedüs and Teller analyse five countries: the Czech Republic, Hungary, Poland, Slovakia and Slovenia. All of these countries introduced an allowance system in 1993–1994, with the exception of Slovakia, which did so in 2000. They opted for a gap system, which was normally applied to all parts of the housing market. Most of them made the system very selective, only reaching the poorest section of the population. This was due partly to fiscal reasons: the state or local authority cannot afford a more generous system, in spite of the widespread affordability problem.

Summary

Housing allowances are seen as a way of making housing policy more targeted. They enable financial subsidies to be reduced or even abolished in the social rented sector, with housing allowances protecting needy households as rents rise towards market levels. In the private sector, distorting rent controls can be abolished or relaxed, again enabled by a housing allowance scheme. Better targeting has its price, as subsidies tend to be deeper for eligible households, producing high marginal effects and a work disincentive problem. This sheds light on how a modern allowance scheme should be constructed, especially in times of fiscal austerity. The problem is to make the system well balanced: not so generous that it shelters households more than necessary and not so economical that it does not properly address the affordability problem.

The papers in this themed issue show that countries are searching, in their own way and within their own context, for the best balance between social justice and market incentives in their housing allowance schemes. The basic view of housing as a merit good is still respected in a housing market that is increasingly seen as a competitive market where government intervention should be enabling rather than regulating.

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