

An international comparison of rent subsidy systems and feasibility of its application in Egypt: Towards a sustainable Housing subsidy.

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Abstract

Since WWII many western governments have left a deep imprint on the functioning of the housing market. Initially, most West-European governments concentrated on producing high volumes of housing to make up for the shortages that arose during the war. Later, in the 1960s and 1970s, more attention was paid to the quality of housing; then, in the 1980s and 1990s, the workings of the housing market became increasingly influenced by market forces, partly because of government budget deficits. In this period the principle that each household should be housed according to its needs was superseded by the principle that the housing supply should be based on the effective demand. In this phase of the public housing policy a shift occurred from production-oriented object-based subsidies to individual subject-based subsidies (Boelhouwer & van der Heijden, 1992; Kemeny, 1995; Kleinman, 1996; Doling 1997). Hence, from the mid-1970s complex rent subsidy systems started emerging in many countries (for an overview see Kemp, 1997, 2000). At the end of the 1990s these frequently complicated policy instruments again became the subject of debate, notably in Western Europe (Stephens et al. 2002; Boelhouwer & Haffner 2002). This debate had an impact on developing countries as Egypt, that copied western old subsidy system the type of distortion in Egypt housing market put pressure on the rents and poses the essentiality for its subsidy. The more critical approach towards rent subsidies can be explained by the fact that social and economic policy was stressing more participation in the labour market. What matters in the case of rent subsidies is the ability to pay for good-quality housing. Moreover, by allowing households greater freedom of choice, the rent subsidy also pushes up the demand for better quality homes. If this extra demand then triggers an increase in the housing costs, it could usher to (unwelcome) over-consumption of rent services.

The central theme of this paper is the tension between income-dependent rent subsidies (anti-poverty) on the one hand and their effects stimulation of demand on the other.

The paper will conclude that, arguments justifies government intervention in the housing market for efficiency reasons. These arguments stem from some specific characteristics of the housing market in developing countries, notably, inadequate provision of information, underdeveloped competition, an inflexible supply due to deficient market forces and market failure in general. The paper will state that reforms are needed to ensure diversity in subsidy and its financial sustainability.

1-Introduction

The central theme of this paper is the tension between income-dependent rent subsidies (anti-poverty) on the one hand stimulation of demand on the other. This question will be approached from two angles. The paper shall begin with the perspective of welfare economics and explore the arguments it offers for determining the optimal system of rent subsidy. It shall then show how four countries have organized their own rent subsidy programme, starting with the voucher system in the USA, which is radically different from rent subsidy systems in Western Europe and is sometimes quoted as a possible alternative. The second programme is wohngeld in Germany, a broad system which is available to all ownership sectors and social security claimants as well. The British housing benefit programme has been included in the study because of the high prevalence of the poverty trap in the UK. Belgium is an interesting case because the social housing organizations pursue a rent policy which is based on the household income of the tenant. Section 3 of this paper will assess these systems using criteria based on the objective of income-dependent arrangements (i.e. to facilitate affordable housing for low-income groups). The paper shall determine the extent to which each system prevents poverty in the process. The paper shall then weigh the effects of the systems on stimulation of demand against the options open to the recipients of rent subsidy. Finally, the paper will look at the system applicability and sustainability in Egyptian Context.

2. principles of welfare and rent subsidy

There are arguments based on welfare economics that justify government intervention in the housing market for efficiency reasons. These arguments stem from some specific characteristics of the housing market, notably, inadequate provision of information, underdeveloped competition, an inflexible supply due to deficient market forces and market failure in general.

The government can also intervene in the housing market to combat social inequality. The theory in such cases is that when there are no arguments for improving efficiency, justice is best served by income transfer whether it is to be 'tied' or 'untied'. They allow the market to do its work and thus reflect the principles of welfare economics. But, they are fairly costly for the government (Barr, 1998). In the rented sector this can be based on the rent or the income. These requirements deliver the following four main types of demand subsidization. The order is more or less hierarchical ranging from income-independent to income-dependent:

- A fixed subsidy in the case of a ceiling rent and/or income;
- A rent-dependent subsidy;
- An income-dependent subsidy;
- A rent- and income-dependent subsidy.

The paper shall apply the criteria outlined below to discuss the main types of demand subsidization. These criteria are derived more or less directly from an income-dependent system. The aim of an income-dependent system is to make good-quality housing affordable at the lower end of the housing market (criteria 1, b and c).

a. The prevention of poverty

This criterion focuses on how far poverty is prevented. Two concepts play a role here: first, the affordability of (good) housing; second, the effectiveness of the system, or the extent to which the support actually ends up with the needy tenants.

b. Stimulation of demand

This aspect of the income subsidy can be split into various parts. First, it is important that the recipients are able to afford a specific minimum level of housing. After all, the aim of the rent subsidy is usually to improve the quality of housing at the lower end of the market.

Second, it is open to question whether the pursuit of better quality does not actually make housing more expensive for subsidy recipients with above-minimum incomes than would have been desirable without the subsidy. In this way rent subsidies cause a disruption in demand which leads to over-consumption of the rent services.

c. Freedom of choice for the tenant

This criterion originates directly from welfare economics, the intention being that the tenant receives an untied supplement to his income. As soon as this supplement is tied to rent/housing, the tenant can no longer choose between rent/housing and an alternative; hence, any choice is theoretically confined to (a part of) the (social) (rented) housing stock. In other words, freedom of choice for the tenant relates to the degree of (financial) accessibility of the entire (rented) housing stock. It should also be mentioned that the income transfers can be limited on the grounds of the actual (object-tied) rent or a normative rent (per area). When used as subsidy guidelines, normative rents tend more towards optimal distribution as envisaged by welfare economics and allow citizens to make their own choices. In addition, everyone is treated equally.

3. Analysing rent subsidy developed countries experiences

Rent certificates have been part of the US federal housing policy since 1971 (Apgar Jr., 2000; Katz & Turner, 2000; Van der Bos, 2002). In the early 1980s the policy started focusing more on certificates and vouchers (both subject-based subsidies) and less on object-based subsidies (Varady et al., 1999). A voucher is a subsidy that the recipient can use to rent a house in the private sector. The US administration's intention when it introduced the voucher system was not only to reduce object-based subsidies but also to stop the concentration of poverty in the inner cities (Varady et al., 1999). The aim of the voucher therefore is not only to make housing affordable for the subsidy recipient but also to make him look for a better home in a better neighbourhood.

The federal administration decides on the target group, which consists of low-income households. The group is determined on the basis of the average local household income per region and is split into three bands: up to 30%, 50% and 80% (Van der Bos, 2002). Finally, the size of the household is taken into account to establish the income limits.

Applicants for a rent voucher have sixty days (with a possible extension to 120) to find a house in the private sector, which meets the minimum requirements, has a reasonable rent, and is being let by a private landlord who is willing to participate in the voucher programme (Katz & Turner, 2000). On balance, a voucher recipient pays around 30% of the household income in rent (Katz & Turner, 2000). The shortfall in the actual rent is made up to a maximum of the reasonable market rent.

Nowadays, some 1.5 million tenant households make use of the budgeted housing voucher programme (Katz & Turner, 2000). This represents only 5% of the tenants in the private sector.

In 1963, subject-based subsidies gained legal status in Germany through the national housing subsidy system a.k.a. wohngeld. In 1965 – when the housing subsidy was introduced – the subsidy programme acquired its current form with the introduction of the Housing Subsidy Act (Wohngeldgesetz). The aim of the wohngeld programme is to limit housing costs to a standard percentage of the disposable household income

(Tomann, 1990, p. 928). The subsidy always goes to the tenant and not – as in the USA – to the landlord. The size of the subsidy depends on the number of people in the household, the year in which the home is first habitable (four categories), the local rent level (six categories) and the household income (Bundesministerium für Verkehr, Bau- und Wohnungswesen, 2001). The subsidy applies up to a maximum local normative rent and a maximum household income, with a correction for the number of people in the household. Tenants and owner-occupiers can apply for it. The purpose is to contribute to the housing costs; not to pay them in full. It is, however, the intention that everyone who is eligible for a subsidy should actually apply for it.

In 2001 the wohngeld budget was increased by DM 1.4 billion to around DM 8.5 billion. In the BRD some 3.2 million tenants receive wohngeld, accounting for 7% of the total number of households as opposed to 11% in former East Germany.

In the UK the national rent rebate system for council tenants was introduced by the 1972 Housing Finance Act. The system was also extended with housing allowances for the private sector (which includes the housing associations). According to Hills (1991, p. 14), the national rent subsidy system was introduced because it was thought that income-dependent subject-based subsidization was a more effective instrument of redistribution than object-based subsidization. Tenants can receive subsidies for the rent and the council tax. There is also a difference in the size of the subsidy for households that receive social security and those which do not. Households on social security and those which are not but have below-minimum incomes, receive a subsidy for the full rent, plus all the increases (Hills, 1991; McCrone & Stephens, 1995). Stephens et al. (2002) point out that the social safety net in the UK is so low that it is hardly surprising that the housing costs of social security claimants are paid in full. This group includes a relatively large number of households in which no-one works (especially in the social rented sector). In addition to the rent, 80% of the council tax per capita is subsidized through the housing benefit programme. The underlying idea is that, after housing costs and leaving aside the council tax subsidy, a household should retain a minimum income which is in proportion to the number of people it supports (Kemp, 1997).

Households which are not on social security receive a subsidy which is equal to the difference between the local reference rent (LRR, normative rent) and 65% of the income that is above the minimum (Ditch et al., 2001; Kemp, 1997; Hills, 1991). Rent increases are also fully subsidized for this group. However, since 1996, still only half of the rent that exceeds the LRR has been subsidized.

Stephens et al. (2002) point out that in 1988 almost two-thirds of council tenants received a rent subsidy. Holmans & Whitehead (1998) estimate this figure to be one-third in the private sector.

In contrast with the other countries in the study, Belgium has no income-dependent system for subsidizing rent; individual support in the social rented sector is organized through individual rent policy. This works as follows. First, the (current) cost price rent of the home is established. This forms the starting point for calculating the basic rent, whereby a predetermined percentage of the cost price rent is retained. The subject component appears in the last stage when the net monthly rent is determined for the tenant. This net or real rent is calculated with an income coefficient which differs from region to region (Belgium is split into Flanders, Walloon Province and Brussels) and depends on the household income and the number of children. When this method is applied the real rent can end up above or below the basic rent. There are, however, certain conditions: the real rent may not fall to less than half of the basic rent, it may not exceed a specific percentage of the income, and it may not exceed the normal rent in the private sector. In Flanders and Walloon Province the rent is annually adjusted (downward and upward) according to the trend of the household income. If the financial circumstances of the tenant change drastically or if renovations have been carried out,

the rent can also be raised in the middle of the year. Lessors in the social sector have to make up the difference between the basic rent and the real rent from their own resources. They are able to do so because they receive annual rent subsidies from the government. In addition, all three regions still run a child-dependent rent-reduction programme which is directly refunded by the government (Van de Ven, 1995, p. 45).

A second form of subject-based subsidy is the Relocation, Installation and Rent Allowance (Verhuis-, Installatie-, en Huurtoelage, VIHT), which is available to both the public and the private sector and is allocated to households that move out of homes which are designated as unfit for human habitation. As social housing accounts for a mere 16% of the total housing stock only a few Belgian tenants are eligible for subject-based subsidies.

4. Assessment of the rent subsidy system in the six countries

the paper shall assess the four systems by returning to the criteria that we formulated on the basis of welfare economics in section 2. These criteria relate to the prevention of poverty, unnecessary stimulation of the housing services and, freedom of choice for the subsidy recipient.

The degree of poverty prevention is central in this criterion. Two concepts play a role: first, the affordability of (good) housing; and second, the effectiveness of the system, or the amount of support which actually goes to needy tenants.

Affordability

Like Stephens et al (2002), the paper shall distinguish between two models for affordability: the safety net model and the affordability model. In the safety net model poverty is tackled solely through social welfare. The rent subsidy prevents the household income from falling below the minimum (social security) level after deduction of housing expenses. The social security system takes no account of housing expenses. The UK was the only country in the study with an income-dependent subsidy system organized along these lines. It is therefore only logical that housing benefit in the UK falls under the ministry responsible for social affairs. The upshot is that the full rent needs to be covered through the Housing Benefit in the UK.

In the affordability model a housing norm is included in the provision of social security. So, if housing consumption grows, subject-based subsidies are possible. Germany operate such a system, which is based on the affordability of the housing.

If the choice is for an income-related system, the subsidy will make an important contribution to preventing poverty. Insofar as we could judge, this is the situation in all the countries in the study. A normative rent (per area) – as applied in Germany, the USA and the UK – makes it less easy to respond effectively to individual needs than an object-tied rent.

Two observations need to be made about the role of the German wohngeld in preventing poverty. First, the average rent quotes of the wohngeld recipients are higher than the average rent quotes of all households. Only the very worst pain is alleviated. Second, wohngeld is not automatically corrected for inflation. As a result, households are regularly excluded from the system.

Effectiveness

In principle, all tenants in Germany and the UK are entitled to a subsidy. Accordingly, everyone who satisfies the conditions receives it. In Belgium and USA only specific groups enjoy this right. In Belgium, where the subsidy is only allocated to low-income

tenants in the social rented sector, the availability of sufficient rented housing is a major problem. The stock is small and houses are still being sold regularly to encourage home ownership. Belgium leaves a lot to be desired in terms of prevention of poverty – and specifically the availability of good housing for low-income groups.

In the USA the voucher programme is budgeted and subject to allocation regulations. Slightly less than three-quarters of the budget go to households with a maximum income of 30% of the average local household income. So, the support ends up with the tenants who need it most. However, not everyone who is eligible for a voucher actually 'receives' one. The upshot is that an estimated two-thirds of the target group does not get a chance.

In addition, anyone entitled to a voucher must personally look for private rented accommodation that is eligible for the system. There are indications that this is not always achieved within the appointed time. Moreover, some private landlords refuse to participate in the voucher system because of all the red tape. This explains why people sometimes have to return a voucher and cannot get a rent subsidy. It also explains why the failure rate in Boston, one of the tightest housing markets in the USA, is so extraordinarily high at 50% (Van der Bos, 2002).

Stimulation of demand

As far as stimulation of demand is concerned the subsidy can be examined from various angles. First, the recipient must be able to pay for a basic level of housing. After all, the whole point of the rent subsidy is to improve quality at the low end of the housing market. This goal is indeed being achieved by the countries in the study. In the USA the rent voucher also has a secondary purpose, i.e. to improve the quality of private-sector rented housing. So, the aim is also to encourage landlords to improve the quality of their property.

One observation must, however, be made in relation to the general comment that basic housing is available at the low end of the market. In a tight market the normative rents threaten to become so restrictive that they stand in the way of realizing basic quality housing at the low end of the market. This factor certainly plays a role in some of the urban housing markets in the USA, where tenants cannot find a suitable home with an affordable rent that matches the normative rent. They then have to hand back the voucher and return to the end of the queue. In the same context it is known that in around 75% of the cases in former West Germany (1998) the actual rent is higher than the normative rent and that this figure has risen by 26 percentage points in four years. These problematic situations occur relatively more often in the case of lower, local normative rents. They have also been a potential threat for private tenants in the UK since 1996, when the Local Reference Rents were introduced.

The second point regarding the stimulation of demand is that improvements to quality could mean that the subsidy leads to more expensive housing for households with an above-minimum income than would have been otherwise desirable. The subsidy would then disrupt the demand, leading to over-consumption of the rent services.

The application of a normative rent (Germany, USA and UK) can be an effective means of curbing over-consumption and encourage the subsidy recipients who are looking for a good price-quality ratio to shop around.

The Belgian system of subject-based subsidies has minimal or no effect on the stimulation of demand. This is not so much determined by the nature of the system but rather by the small stock of social housing. What is more, in order to generate sufficient rent revenue some of the social housing is let to higher income groups, with the result that some of the potential demand from the low-income groups is not honoured.

Freedom of choice

An aspect of freedom of choice concerns the range of housing. Though tenants with an income transfer for the rented sector can no longer choose between renting a house and an alternative (such as buying a house or another consumer item), in some countries certain tenants have a wider choice than in others.

As mentioned earlier, German wohngeld recipients have, theoretically, the greatest choice. Home ownership is also an option, though the arrangements for this sector are intended more as a safety net than in the rented sector. The choice in the UK extends to the entire rented sector. The Americans are being indirectly forced to move from the social to the – far larger – private sector.

Belgians can only receive support in the social rented sector. Because social rented housing is in short supply and is also accessible to middle-income groups, the low-income groups have very little freedom of choice. A good house in the social rented sector is akin to a win in the state lottery. Many low-income households have no option but to rent accommodation in the private sector with a generally poor price-quality ratio.

5. Reflections on Egypt rental system

Cairo is primarily a rental market, according to Malpazzi (1995). Almost two-thirds of the households rent in the private market, another 7 percent rent public units or participate in government rental subsidy programs. Of the 63 percent of Cairo's population that rent in the private market, a third rent in the formal market, two thirds in the informal market. In fact, most new constructions for rental is in the informal sector and it has more than kept pace with population growth, affordability, willing and ability to pay by the majority of household rent seekers.

Rent is subsidized in Egypt, unfortunately subsidy comes from the pocket of private owners (landlords) through the rent control law. This has blocked any opportunity for development of a more balanced, fair and equitable system of subsidy that the government can employ, instead of watching the tenants-owners constitutional fights that evacuated the rent control law from its contents.

Long-time residents in Egypt receive the largest subsidies and the largest benefits, but the subsidy increases much faster with length of tenure because distortions in consumption also increase with length of tenure. Recent movers in Egypt tend to pay large amounts of key money, while tenants in place pay very small fractions of their income for shelter. An interesting result is that there is no discernible distributive effects of subsidies or total benefits. Neither benefits -indicated or regulated by housing rent law- nor subsidies are strongly related to household size, income or poverty, although there is a weak tendency for larger households to receive smaller subsidies.

The experiences presented in the paper can present a starting point for revisiting rent control laws and unbalanced subsidies. The government can introduce other rent subsidies else than rent control measures, which may help to reform market distortion and encourage investment in rental housing by private sector. In order to sustain such subsidy, careful targeting is needed.

6. Conclusions

The above information enables us to answer the question posed in the introduction, which concerns the tension between income-dependent housing subsidies (prevention of

poverty) and their effects on stimulation of demand and freedom of choice. As the paper have shown, all the countries in the study organize their income-dependent system in the rented sector in their own way. An income-dependent system that assures affordability inevitably involves, to some extent, for the downside of poverty prevention, i.e. the poverty and/or unemployment trap. On the other hand, a specific affordable housing quality inevitably restricts the freedom of choice of the subsidy recipient. So, there is no such thing as an ideal subject subsidy system that Egypt can adopt.

It is important to tailor a system that can include most households below the poverty line, whom their income cannot qualify for ownership without huge subsidization. And rental subsidy would be less costly in that direction. Egyptian government should rethink the rent control law and means of controlled ownerpocketed subsidy, to a more market oriented family subsidy. Thus a model subsidy system needs to be designed not only for ownership as indicated in the mortgage new law but also for rent, to ensure more balanced housing market.

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