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Housing Policy Reform:
A Constructive Critique*

by

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1. INTRODUCTION

Development of post-war housing policies in western nations has been described as having passed through three main phases in response to changing economic, social and political circumstances (see Marcuse, 1982; Martens, 1985; Roistacher, 1986). The first phase was the post war recovery period where general housing shortages dominated housing priorities; the second phase was the attempt to improve the efficiency and equity of government assistance towards housing and the third phase has been described as a period of fiscal austerity. Maclennan and O'Sullivan (1987) argue that this third phase can be better characterised as one of expenditure switching where cuts in controlled, visible expenditures (or on-budget items) have been offset by increases in uncontrolled and poorly targetted, invisible expenditures (or off-budget items).

At an international level, a growing recognition of the importance of the tax expenditures which are the major source of invisible or off-budget items has led to calls for their inclusion in national budgets by international bodies or committees (see, for example, McDaniel and Surrey, 1985; OECD, 1984). Within housing, the tendency for tax expenditures which benefit owner-occupiers to overtake direct expenditures which are better targetted and benefit tenants has been observed in many countries. Table 1 summarizes changes from 1979/80 to 1984/85 for a number of different countries. In this table, definitions of tax expenditures employed vary between countries and analysts, reflecting some of the difficulties involved in estimating these. Data presented, therefore, is indicative only and is simply intended to show the robustness of the claim that tax expenditures have increased faster than direct expenditures regardless of country or definition.

Two major approaches have been used to estimate housing related tax expenditures: the first treats housing as an investment good (and assumes that income should be taxed and interest deductible); the second treats housing as a consumption good (and assumes that no income should be taxed nor interest deducted). Likewise, direct expenditures have been defined as either including or excluding capital expenditures. No attempts have been made to adjust the information presented for these differences; in cases where both definitions were used, the order of magnitude of the expenditure level was significantly altered but there was no apparent systematic effect on the conclusions reached about the respective rates of change.

In all countries included in this table, distribution of direct expenditures has tended to be increasingly well targetted towards lower income households as countries have switched from production to consumption subsidies. Distribution of tax expenditures, on the other hand, tends to be perverse, favouring high income households more than low. Depending on the nature of the specific programs involved, direct expenditures may benefit households in any tenure; tax expenditures, however, are invariably directed towards owner-occupiers. Once income support payments such as housing allowances, housing benefits etc. are removed from the direct expenditure figures, the remaining direct and tax expenditures undertaken show a disproportionate amount of support going to owner-occupiers vis a vis tenants. For further discussion of these points in an Australian institutional environment, see Flood and Yates (1986). For Canda, see Fallis (1980). For Nordic countries, see Ahrens (1986). For UK see Hills (1980); Kilroy (1982); Robinson (1981) and Welham (1982). For US see Aaron (1972).

This paper examines the reforms which have been proposed to counter the effects of this growing imbalance in the form of support provided for housing and develops a new proposal for housing policy reform which overcomes the weaknesses of previously proposed solutions. It uses recent debate and experience in the UK as well as the proposals for reform emanating from this debate to provide a framework for this constructive critique. The critique of existing proposals takes into account economic, social and political obstacles to change and is used as a springboard for a proposal which moves beyond policy reform to a reform of the whole structure of housing provision.

Section 2 of the paper provides a background to the debate which has taken place in the UK; section 3 provides a critique of the rational economic solutions conventionally proposed; section 4 develops specific aspects of this critique and sections 5 and 6 outline the four essential components of the reform package proposed and the stages suggested for implementation of this package.

2. IMPACT OF POLICY AND APPROACHES TO REFORM IN THE UK

Although recent debate about housing policy in the UK has tended to be focussed on privatisation in relation to council house sales, the transfer of resources from the public to the private sector arising from this particular aspect of housing policy is relatively insignificant compared with the much greater transfer of resources which results from the favourable tax treatment of owner-occupiers and which has been occurring over a much longer time span (see, for example, CIPFA, 1982; Maclennan and O'Sullivan, 1987; Silver, 1986). Recognition of the increasing inequities and inefficiencies in housing policies which condone both massive capital subsidies to tenants irrespective of their incomes and the rapid growth of uncontrolled, poorly targetted tax expenditures favouring owner-occupation at a time when direct expenditures, which have become increasingly well targetted on lower income renters, have been cut has led both to predictions of a polarised society and to various proposals for reform.

Support for the argument that polarisation by income characteristics has been occurring can be found in Bentham (1986); Robinson and O'Sullivan (1983) and Robinson et al (1985); by socio-economic group in Hamnett (1984a) and by spatial and/or employment status in Forrest and Murie (1986); Hamnett (1984b) and Thorns (1982). Predictions that this polarisation might lead to residualisation of the public sector can be found in Forrest and Murie (1986) and Silver (1986) and that it can result in transmitted affluence or poverty can be found in Murie and Forrest (1980) and Jenkins and Maynard (1983).

Most proposals for reform which have been suggested in an attempt to redress this growing imbalance can be classified into one of the two broad categories depending on whether they are based on acceptance of the validity of a market based economy or are concerned with removing the provision of housing, which is seen as an essential commodity, from it. In the former category are proposals based on reforming policy; in the latter, are proposals based on reforming the institutional/social relations which determine the outcomes of policy.

Proposals based on reforming policy can be further classifed as 'rational economic' or 'rational political' solutions; both concentrate on offsetting the perceived weaknesses of current policy which are seen to arise from the form of government intervention and from inequalities in the distribution of income.

Rational economic solutions recognise that, in theory at least, there is no trade off between efficiency and equity and that removal of subsidies to owner-occupiers will simultaneously improve both. Rational political solutions acknowledge the difficulty of removing such subsidies and rationalise support for the status quo by ideological commitments to different notions of egalitarianism or social justice. On the right, equality of opportunity is given more weight than equality of outcome; in this case policies giving preference to owner-occupation are justified by ostensibly extending access to that tenure to all. On the left, the greater desire for equality of outcome is met by supporting policies which ostensibly provide the same benefits to households in the public sector. Neither approach, in fact, results in equality of opportunity nor in equality of outcome. Both equality of opportunity and outcome require implementation of a policy in which tenure choice is meaningful; this can only arise when there are no financial advantages in renting or owning and when there are no constraints on access to either tenure.

Both solutions support intervention to ensure provision of minimum housing standards although the means of doing this can vary; with neo-liberals favouring income support and the left (anything from social democratic or Fabian to Marxist) favouring direct provision through public housing. This distinction has led to the claim that tenure debate is thus framed within an ideological war over state involvement in social welfare (Lundqvist, 1986) with freedom of choice via cash transfers to correct for income distribution problems competing with state involvement to protect distributive outcomes.

The second approach to proposals for reform predominantly arises from those who wish to remove housing from the vagaries of a market economy by 'decommodifying' housing. These are based on a claim that the market has no capacity to allocate housing resources according to need and that egalitarian outcomes are inconsistent with the operation of the capitalist system; inequalities, instead, are a structural feature of any capitalist economy. The proposals are based on the assumption that, by over-riding the operation of the market, equality of opportunity and equality of outcome can be identically achieved.

Proposals such as those which call for the nationalisation of land, the municipalisation of private rental housing, a return to non-profit making financial institutions and the control of house prices are all examples of proposals to remove the provision of housing from the operation of a market based economy. Most of these proposals arise from a concern with the production relations involved in the provision of housing and are based on the assumption that producers rather than consumers of housing ultimately benefit from any support directed towards the latter. This focus of concern, therefore, ignores the distributional inequities amongst consumers which arise from the forms of support provided.

This dichotomy between the proposals is undoubtedly one of the reasons for their lack of success. A failure to acknowledge the political, institutional and ideological underpinnings in proposals based on reforming policy is as likely to be an explanation of why they are not adopted as is a failure to acknowledge the pervasiveness and strengths of the structure of property rights inherent in a market based economy.

The reform proposed in this paper is based on several assumptions. Firstly, that, to be effective, proposals need to simultaneously work towards reforming both policies and those underlying institutional structures which impede either the implementation or successful operation of those policies; secondly, that an economically rational solution is an essential starting point to removing differences between tenures; thirdly, that policies must not be seen as an attack on owner-occupation and, finally, that although it is simpler to begin with a reform of policy rather than with a reform of the structure of provision of housing, unless policy reform is directed towards changing the nature of the provision of owner-occupation it will not succeed.

In the following section, a critique of the conventionally proposed economically rational solutions is presented as a means of highlighting the attributes of housing which need to be taken into account.

3. RATIONAL ECONOMIC APPROACH

The approach to the reform of housing policy which will be examined in this section will eventually provide the starting point for the reforms to be suggested in the final section. This 'rational' economic solution to the inequities which arise from the current distribution of housing assistance has been to remove the financial advantages which owner-occupied housing has over rental housing and to target assistance provided. This approach attains horizontal equity between tenures and improves vertical equity. Recent examples of such approaches in the UK can be found in Berthoud and Ermisch (1985), Ermisch (1984), Fender (1986), the Inquiry into British Housing (1985), Walker (1986) and Warburton (1983). These proposals differ in detail either because of different interpretations as to the precise nature of the favourable tax treatment accorded to owner-occupiers or because of explicit adoption of second best solutions for what are seen to be politically rational reasons.

Within these economically rational solutions, conflict arises in attempting to balance what O'Sullivan (1984) calls tenure neutrality and tax neutrality. Owner-occupiers as landlords receive preferential treatment over rental landlords because they are not required to pay tax on the imputed income received in the form of rent and real capital gains received from their property; this advantage arises from a tax system which is non tenure neutral. As well, owners of property receive preferential treatment over owners of financial assets because they are able to deduct nominal interest payments from the income but only pay tax on real income whereas owners of financial assets are required to pay tax on nominal income received; this advantage arises from a tax system which is non tax neutral. Each of these distinctions arises from the tax treatment of housing as an asset or an investment good. As a consumption good, housing receives preferential treatment over other durable goods because of the deductibility of mortgage interest.[1] See O'Sullivan (1984) and Wood (1986) for a more detailed discussion of these issues and also Grey, Hepworth and Odling-Smee (1981) and Whitehead (1977).

The rational economic policies which will be focussed on here and in the final sections of the paper are those which are based on the taxation of imputed rent and real capital gains and on retention of nominal interest deductions.[2] These policies address the advantages arising from the tax treatment of housing as an investment good and are intended to ensure tenure neutrality; they ensure that owners of rental or owner-occupied property are treated identically by the tax system. For detailed discussion of specific analyses of the advantages arising from the tax treatment of investment income from housing and for estimates of the distributional impact of these in the UK, see Atkinson and King (1980), Hills (1980), Hughes (1979, 1980), Kilroy (1978) and Robinson (1981). For a discussion of capitalisation of these advantages see Barrow and Robinson (1986) and O'Sullivan (1984).

The inability of lower income households to meet housing costs has been addressed by combining these policies with income support schemes or by the introduction of housing allowances. Many variations of policies designed to provide supplementary assistance for housing exist but most are based either on the assumption that housing costs should not exceed a defined maximum proportion of income or on the provision of support for a defined minimum standard of housing or on some combination of these. See Ermisch (1984), Berthoud and Ermisch (1985) and Walker (1986) for discussions of particular housing

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1. Differences arising from the imposition of indirect taxes are ignored since it is assumed that the tax burden imposed by rates roughly offsets the advantage of having no VAT imposed on housing services. For information see Fender (1986); for a contrary view see Merrett (1986).
2. They also imply the charging of market rents for public housing and the relaxation of rent control in the private market.

benefit schemes and Kemp (1986) for an overview of the current housing benefit system in the UK.

This economically rational solution, therefore, is based on the assumption that there are only two main sources of the problems which arise in the housing market; the first arises from the form of government intervention and the second from inequalities in the underlying distribution of income. There are three main sources of weakness in this solution. These arise from within its own framework, from a neglect of the factors which have led to proposals for politically rational solutions and from a neglect of the institutional framework within which housing is provided.

Firstly, within its own rational economic framework, it is based on the assumption that, apart from inefficiencies arising from the current form of government intervention, the housing market is competitive and it assumes that, once inequalities in the underlying distribution of income are overcome, the problems of ensuring adequate and affordable housing for all will be solved.

It makes no attempt to overcome other obvious imperfections which exist in housing and housing related markets; namely that housing is not a perfectly divisible good, that tenure choice is a dichotomous decision and that the renting and investment components of owner-occupied housing are joint products. For example, within the constraints imposed by income, households cannot always obtain the type of housing they want: gardens may be too large or too small; neighbours and neighbourhoods may change in unexpected directions; rooms cannot be added or subtracted as needed. Households are generally forced either to rent or own all of their housing; there is generally little scope for limiting ownership to what can be afforded or desired and renting any extra housing needed.

As well it makes no allowance for consumer disequilibrium. Households cannot always easily adjust the amount of their housing even if they would like to; housing costs might be higher than desired but if costs of adjustment, whether financial or psychic, are high or if there is no supply of lower cost housing, then the possibilities of adjustment are considerably reduced. In addition to these imperfections, the uncertainty and risk associated with future profiles of both house prices and income have meant that capital markets have not adapted mortgage instruments to overcome the access constraints imposed by the front-loading of conventional mortgage instruments. Imperfections also arise because of the institutional realities of a housing market in which newly constructed housing is a very small proportion of the total housing stock with the result that total supply is very slow to respond to changes in needs and house prices are highly unstable. These latter problems are exacerbated by geographical or locational problems associated with mismatches in demand for and supply of housing.

Secondly, weaknesses arise because it ignores the political and administrative issues involved in implementing a policy which might cause hardship to existing owner-occupiers because of these various imperfections. It ignores, for example, the fact that, while imputed rent and real capital gain increase the purchasing power of owner-occupier households, they do not yield an income stream from which tax liabilities can be paid. Proposals to expand housing allowances may protect some households but not all affected will be picked up in the housing benefit safety net. This potential hardship at an individual level might be a source of any electoral backlash which arises from the introduction of a policy which is distributionally sound at an aggregate level. Those likely to be most affected are low income households with high housing assets. Many housing policy analysts have argued that removal of the subsidies which benefit owner-occupiers is likely to be politically infeasible either because owner-occupiers now constitute a majority of the electorate (for example, Malpass and Murie, 1982) or because it would be seen as an attack on the ideology of home-ownership which is so well entrenched in the community. (Housing Policy Review, 1977). Whilst not all agree with these arguments, both must be taken into consideration.

On the administrative side, it ignores many of the processes which might need to be changed in order to facilitate implementation of such a set of proposals. It ignores, for example, the possibility that budgetary changes and review may only take place in incremental steps (Lindblom, 1959; Wildavsky, 1979), that such review may be limited to on-budget items and that proposals which require more than incremental adjustments to the tax structure may have little chance of implementation.

Thirdly, as argued in the political sociological/economic literature, it ignores the social and institutional relations which are associated with the provision of housing (see, for example, Ball, 1983, 1986; Harloe and Martens, 1984; Merrett, 1982; Silver, 1986). Much of this new urban sociology critique is focussed on the role of the construction and exchange professionals involved in the provision of housing. However, it also points to weaknesses arising from a neglect of the institutional factors which affect the tenure structure of the provision of housing. Reforms need to take into account the fact that there are a number of attributes or characteristics of owner-occupied housing which distinguish it from that in the rental sector and which influence the outcomes of policy.

Instead of concentrating solely on the financial benefits of one tenure over another, for example, policy reforms need to recognise the rights, responsibilities (including management), costs (including risks and time profile of payments) and other benefits which are associated with housing and which can vary by tenure, by time and by geographical location (Forrest and Murie, 1984). It is these additional factors which are often at the source of the barriers to the successful implementation of the types of policy outlined above.

The tenure specific attributes of housing which need to be addressed by policy will be further developed below.

4. INSTITUTIONAL ATTRIBUTES OF TENURE

These weaknesses of an economically rational approach can be discussed in more detail by explicitly relating them to those attributes of housing which differ by tenure and which arise because of ownership and occupation can be provided either jointly or separately. These differences, in turn, arise from the socio-legal framework which determines the underlying nature of property rights associated with tenure and from the institutional relations which govern the finance of housing.

Differences in the rights associated with different tenure forms explain differences in the time profiles of the stream of payments or outlays for each tenure. Owner-occupation requires the simultaneous purchase of use or occupation rights and exchange or ownership rights. This results in what can be a considerably higher repayment burden than the purchase of use rights alone required in rental housing. Institutional rigidities in the mortgage system can exacerbate these differences by tilting the payment stream for owner-occupiers towards the early years of occupation.

One of the reasons why institutions have not adapted mortgage instruments in times of inflation and one of the further sources of difference between tenures arises from the different risks associated with them. The exchange risks involved in the owner-occupied housing market can be readily illustrated by reference to the extreme short-run volatility of house prices. These risks are likely to be greater in the private sector than in the public sector precisely because they are borne individually; one of the benefits of a social rented or co-operative ownership sector is that the risks can be pooled. Risks are likely to vary geographically and to be greatest for those who, for whatever reason, have little control over the timing of the purchase or sale of their dwelling. It is likely to be greatest amongst those dependent solely on labour income, those for whom job security is least and those for whom the possibilities of household dissolution are greatest.

Whitehead and Kleinman (1986) provide a useful and systematic analysis of further attributes which distinguish owning and renting.[3] They argue, for example, as a result of the separation of ownership and occupation which occurs with rental housing, renters have a lesser commitment to housing than do owner-occupiers in three specific ways; these relate to the ownership, management and finance of the assets involved.

From a financial point of view this means that, for the individual household requiring only consumption services, access costs are

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3. The following page closely follows the arguments presented by Whitehead and Kleinman (1986, pp 123-144).

generally lower. Transaction costs are high for owner-occupiers because of the commissions, fees and taxes to be paid on exchange; for renters, costs only have to cover the rental services purchased. From a management point of view, because renters do not have the responsibility for maintenance, they are not faced with cost uncertainties associated with repairs nor are they faced with the effort involved in ensuring that they are undertaken. From an ownership point of view, renting allows more flexibility in terms of investment choices in that it does not result in the tying up of financial assets in a relatively illiquid form. This may well be a critical attribute for households who have relatively few assets and who face a high risk of reductions in income. Whitehead and Kleinman also argue that the indivisibilities which exist in housing mean that renting is a more flexible in terms of consumption choices than is owning for those households who require only a small amounts of space for shelter (such as a single room rather than a whole dwelling).

In principle these specific factors inherent to tenure generally mean that the rental sector better serves those mobile households who require a considerable amount of flexibility in housing and for whom unstable income, job location and household structure mean that owning is a costly and time-consuming activity. In practice, of course, these advantages are limited by the shortage of both private and public rental housing.

As well as the above attributes of housing which are inherent to tenure, there are also a number of additional attributes which arise out of the nature of housing finance provision. The first of these arises from the time profiles associated with the payment of housing costs. To some extent owners have control over the nature and timing of their payments:[4] they can determine the balance between equity and debt finance and, to a limited extent, can choose from a range of alternative mortgage interest instruments; they can choose to delay or bring forward maintenance expenditures and, if they get into arrears with their repayments, they generally have a range of options

4. As Whitehead and Kleinman point out, for some marginal owner-purchasers, these choices are more apparent than real; this is particularly the case for many low income households (see, for example, Doling et al, 1986).

presented to them. Renters, on the other hand, have little control over the size and timing of their housing payments and face eviction if they fall behind in these. The second arises from the easier access to credit available to owners. Owners have access to long-term, relatively cheap credit; this enables them both to accumulate wealth in the form of an asset favourably treated by the tax system and to gain access to other forms of credit.

It has been argued, however, that much of the support for owner-occupation arises not from its financial advantages over rental housing but from the desire for individual property rights embedded firmly in the current provision of owner-occupation (Saunders, 1982; Merrett, 1982). Merrett goes so far as arguing that the social meaning of owner-occupation exists because of the differences between rights specific to it and other tenures. For the owner-occupier these rights apply to both the use and exchange of the property, providing control over the use which is made of the dwelling, security of tenure and the freedom to acquire or dispose of the property at will.

A final difference between tenures which also results from the coincidence of rights over use and exchange in the owner-occupied sector and their separation in the private rental sector arises from management. To a large extent there has been an assumption that responsibility for management is associated with exchange rights rather than use rights. One reason which has been given for the implementation of Right to Buy is that it arises from a desire to improve management efficiency. The Audit Commission (1986), for example, pointed to the need for improvement. However, as it should be possible to separate management from ownership (as is done in some co-operative ownership schemes where management companies deal with repairs, maintenance etc.), this argument should carry little weight.

Households need to be able to mix and match the characteristics desired by choosing neither rental housing nor owner-occupied housing but by choosing so much rental housing and so much owner-occupied housing. This can be achieved by breaking down the complementarity hitherto involved in the property rights associated with owner-occupied housing. In order to do this it is necessary to decide which rights are regarded by households as being fundamentally important and which are regarded as being negotiable.

Sociologists have argued that preference for owner-occupation arises from a desire for ontological security (Saunders, 1982) which is provided by security of tenure and freedom, choice and control over the use value of housing. Under the current structure of owner-occupation, such rights are protected for outright owners. As has been pointed out, however, there is no guarantee that mortgaged ownership provides any such guarantee (for example, Forrest and Murie, 1984; Doling, Karn and Stafford, 1986).

One hypothesis underlying the reforms to be suggested in the next section is that reform can only be successful if these rights are protected and that this can only be done if owner-occupation is reformed in such a way that individuals can retain separate property rights over use and exchange value of housing. Because of the inherent conflict between owner and tenant when ownership and occupation are both separated and provided privately, it has been assumed that removing the distinction between owning and renting so that tenure choice is no longer a dichotomous decision but involves the choice of where to locate on a continuum from one hundred percent renting to one hundred percent owning, requires the explicit involvement of a landlord whose objectives do not conflict with those of the tenant. For the purpose of this paper, it is irrelevant whether such a landlord is the state, a non-profit institution or some co-operative organisation; it is, however, assumed to be a non-private landlord.

The reform proposals to be outlined in the next section are based on ensuring that use rights over housing are protected to a greater extent that at present by the introduction of a housing costs insurance scheme. In order to participate in this, however, households may be required to enter into an equity sharing arrangement with the government. This arrangement is intended to enable them to maintain their exchange rights over housing in that they can dispose of their property whenever it suits them with the government acting as a silent equity sharing partner; any disadvantage to the government by their choice of timing can be offset by government purchase of any remaining equity in the property.

The approach taken in this paper is based on a rejection of those reforms which start with institutional reform basically on the grounds that they provide no indication of how such institutional reform is to be implemented. Thus it implies rejection of Ball's idea of controlling house prices by nationalising land (Ball, 1983; 1986) and rejection of the Labour Housing Group's idea of municipalising private rental housing through compulsory acquisition (Merrett, 1986). Similarly, it rejects as a starting point the new urban sociology approach which argues that outcome of policy is dependent upon dynamic interaction of social and institutional relations in provision of housing and requires, therefore, that these institutions be changed simply because it provides no prescription for change other than the overthrow of a capitalist system. (Harloe and Martens, 1984; Martens, 1985.

Reforms, instead, are based on working within the framework of existing institutions but changing their operation so that the outcomes are changed (with result that institutions will be changed as well). It is assumed that it is not possible to move from a position where private provision of housing dominates the market to one of total government/social control in one step, regardless of whether this is thought desirable or necessary. Any change must specify the process by which the outcome is to be achieved and must be based on moving only in incremental steps.

Reform, however, is not based on the assumption that the role of the state must be seen as dichotomous with emphasis either on a free market and government intervention limited to income support only or with direct government provision of housing. Instead it allows movement from one role to the other as economic circumstances change and as social structures respond to the changed options available.

5. A PACKAGE PROPOSAL FOR POLICY REFORM; AN OVERVIEW

As indicated in the previous section, the starting point for the proposal for reform in this paper is the rational economic solution based on removing the tax advantages which accrue to owner-occupiers from their investment in housing and providing housing related income support to enable low income households to meet their recurrent housing costs. However, several modifications are made to that policy in order to overcome the weaknesses outlined above.

The proposals for reform to be outlined in this section can be packaged into one policy which consists of four separate but interdependent elements. These four elements consist of the taxation of income from housing; the implementation of a housing allowance or housing benefit scheme; the provision of shared equity arrangements; and the introduction of housing bonds into the market. Several steps or stages are suggested for the implementation of this package. These aim to address the political and administrative problems associated with what will undoubtedly be seen as a radical package and to ensure that the housing problems with the highest priority (taken to be the elimination of housing related poverty) are treated first. This section provides an overview of the policy package; the following section provides a more detailed analysis of its component parts and suggests how such a policy could be implemented.

The first modification to the rational economic solution outlined above is that introduction of a tax on the income derived from housing is not to be achieved by a net increase in taxation but by the introduction of what is to be called a new housing cost insurance scheme which integrates the tax on housing income and the provision of a housing allowance into a single package. The intention of this is to enable the reform to be packaged politically as a policy in support of owner-occupation rather than being seen as an attack on owner-occupiers. Success in this depends on being able to persuade the electorate of the benefits of life cycle redistribution of housing costs, of the advantages of pooling risks regarding capital gains (or losses) on housing, of the desirability of protecting vulnerable home owners and of the acceptability of redistributing support from those who do not need it.

Given the skewed nature of the income distribution, any redistribution of assistance from those with above average incomes to those with below average incomes should result in a greater number benefitting from such a policy than are harmed. This result of redistribution arises from the second modification to the rational economic solution; namely that the reform proposed is to be revenue neutral. This means that the tax imposed is to be an hypothecated tax with the revenue received from higher income households being used to provide a housing cost cover for lower income households.

Besides providing the equivalent of a housing allowance for low income households and gaining, in principle, the support of such households, the introduction of a non-profit self-financing (compulsory) insurance scheme should also gain the support of those individuals and institutions involved in the construction and finance of housing since it will serve to reduce some of the uncertainty and instability associated with housing provision without reducing the overall level of support. One of the benefits of a redistribution of assistance from high income households to low income households and particularly to those in areas of economic decline is that it should serve to moderate some of the fluctuations in house prices, partly by reducing the demand amongst high income groups and partly by effectively counteracting declines in income amongst lower income households which could otherwise have resulted in forced sales. In addition, the following modifications should contribute to this dampening effect on house price cycles by pooling the risks associated with capital gains and losses.

Two further modifications are made to the rational economic solution outlined above. These are designed to separate the consumption and investment aspects of housing. The first of these is brought about by introducing a guaranteed equity sharing scheme for eligible households for whom this jointness creates financial difficulties. This guarantee comes as a part of the insurance package. Such a scheme enables eligible households to change the consumption/investment balance towards consumption and away from investment. It also provides the means by which individual households are able to reduce the risks associated with the capital gain or loss on a particular dwelling in a particular location since the return on equity in any individual dwelling can be tied to the overall national average capital gain on all equity shared housing.

A fourth and final modification enables further separation of the consumption and investment aspects of housing by providing housing bonds which yield a taxed real rate of return roughly equal to the net rent and real capital gain currently available to investors in housing and an untaxed capital gain tied to the actual gains on equity shared housing. This modification splits the joint consumption/investment decision in a way which changes the balance away from consumption and towards investment.

The package proposal for reform incorporating these four elements is based on acceptance of the argument that the ideology of home-ownership is so well entrenched that it is politically infeasible to introduce or implement any policy which is seen as an attack on owner-occupation. The rationale behind the critical modifications to the conventional rational economic solution is simple; it is based on the assumption that, if the objective support for home-ownership cannot be changed, then it is necessary to change the socio, legal, financial and institutional constraints which together define the nature of home-ownership and, in so doing, to change the nature of home-ownership in such a way that the relevant distinctions between renting and owning are removed.

In the previous section the potential conflict between landlord and tenant which arises from the separation of ownership and occupation was acknowledged. Because of this, it is essential that the third and fourth modifications outlined above be implemented by a landlord with objectives which do not conflict with those of the tenant. There is no reason, however, why such a landlord need be a monolithic state bureaucracy. The flexibility currently provided by a variety of housing associations under the umbrella of the Housing Corporation indicates that schemes could operate successfully on a sub-national level. There is also no reason why such schemes could not be implemented by the private sector for those cases where mutually satisfactory contracts can be devised; such cases will be successful, however, only when involvement is voluntary (see Whitehead and Kleinman (1986) for this argument in relation to the private rental sector). State backed schemes are necessary to guarantee access and protection from exploitation.

The outcome of such a scheme is to provide a cross between owner-occupation and social rental housing as currently defined. Security of tenure over accommodation at a standard defined by that available in the social rental sector is guaranteed as are rights of occupancy equivalent to those currently defined by owner-occupation.

Direct state provision of housing becomes a variable determined by population preferences and economic conditions. In times of economic decline it is likely that marginal and even intra-marginal households will have neither the capacity nor the desire to maintain their investment in owner-occupied housing. Any take up of equity sharing in lieu of tax responsibilities will mean an endogenous shift of government resources into the existing stock of housing capital; any take up of housing bonds or buying back of equity shares will result in an endogenous shift of government resources out of housing. Thus government involvement will act as a counter-cyclical policy operating on housing investment as unemployment benefits and income taxes do on consumption to dampen cycles in economic behaviour. This result, however, does not imply any greater a commitment to housing on the part of the government than is currently provided; it results from a redistribution of that assistance. To ensure sufficient funds are available for the relief of housing related poverty, eligibility limits may need to be imposed on the extent of equity sharing undertaken. This is discussed below.

This proposal has adapted the conventional rational economic approach in several critical ways without changing the underlying intention of removing the horizontal and vertical inequities which arise from the current form of housing finance provision. The policies suggested are based on an explicit policy of redistribution of government assistance from those who no longer need support to those whose housing costs impose undue burdens. This includes those marginal home owners who currently receive few of the benefits traditionally ascribed to owner-occupation.

6. THE POLICY PACKAGE: A STAGED PRESCRIPTION.

This reform proposal, which must be seen as a long-term rather than as a short term proposal, can be implemented in several stages although the last two of these may need to be simultaneous rather than consecutive.

Stage 1:

Before any steps are taken to implement reform, two essential preconditions must be met; both bureaucrats and politicians need to be persuaded to undertake reform of policy and the electorate at large needs to be persuaded to accept these reforms.

A first step, therefore, is to ensure that information about the extent of tax expenditures is incorporated into annual budget data. Some countries have begun to provide tax expenditure budgets (for example, Canada and France). In the UK, however, these estimates are relegated to an appendix and are not included 'up-front' in the summary information showing relative shares and rates of growth of assistance to various sectors in the economy. In addition, the tax expenditures on housing which are incorporated in the appendix are not consistent with the generally accepted guidelines as defined in a recent major study of tax expenditures in six OECD countries (McDaniel and Surrey, 1985). The requirement that this be done will make these expenditures visible and so help focus bureaucratic attention on the budgetary implications of leaving tax expenditures as an off-budget item; the information provided will enable politicians to more rationally allocate budget assistance.

A second step is to make the economically rational decisions socially and politically acceptable. In part this can be done by making bureaucrats, politicians and the electorate more aware of the current distribution of assistance provided by these housing related tax expenditures. However, this latter step obviously will be difficult; successful implementation of such a policy may require it to be preceeded by a saturation advertising campaign where those who will benefit from such changes can be informed of their self interest.

This could be undertaken as a part of a pre-policy advertising campaign. A follow up campaign could then be used to 'sell' the benefits to be derived from the new proposals.[5] In the UK an ideal opportunity for such a campaign arises from the proposed abolition of the current rating system. See Fender (1986) for an argument for integrating reform of housing finance and local taxation. Some of the advantages which could be highlighted in such a campaign were outlined above. Once the ground has been prepared, the following stages of this proposal can be implemented.

Stage 2:

The second stage of this proposal consists of the implementation of the rational economic solution re-packaged as a compulsory housing cost insurance scheme. Such a scheme must be compulsory for obvious reasons; first, the levy is being introduced to improve equity and efficiency in the distribution and allocation of housing resources; second, even if this were not the case, a compulsory levy would be required to overcome adverse selection problems where only those most likely to make claims upon the system would be likely to register. Given that those most likely to make claims are, by imposed eligibility requirements, those at the lower end of the income scale, such an outcome would conflict with the explicit redistributional aim of policy. This housing cost insurance scheme would be financed by what, for the average tax payer, would amount to roughly a one percent levy on the value of equity held in owner-occupied housing.

To ensure tenure neutrality under current tax arrangements in the UK, this levy would have to be calculated as a real return on housing (based on net rental value plus real capital gain) and taxed at the householder's marginal tax rate. Mortgage interest deductibility

5. The advertising campaign conducted in the run up to the various privatisation of various British public authorities (for example, British Gas) provides an example of the effectiveness of such a saturation approach. The timing of such a campaign to coincide with the move from rates to a community charge as the basis for local taxation would ease its political passage through an electoral minefield.

would be retained and extended to cover all mortgage interest.[6] The revenue received from this insurance levy and the tax revenue currently received from income from rental property would be hypothecated and used to provide housing benefit cover for all.

Based on 1986 estimates of the total value of owner-occupied housing stock in the UK and making no allowances for those households who are subject to marginal tax rates above or below the standard rate, this levy would provide some £5600m in tax revenue (Fender, 1986).

The exact nature of an appropriate housing benefit scheme need not be spelled out here but, using a simple illustrative approach, cover could be based on the rent required to provide an adequate minimum standard of accommodation appropriate for a particular household in a particular location. On the basis of average national data (this, therefore ignores regional variations, which is not what is recommended), Berthoud and Ermisch (1985) suggest that, including rates, an appropriate minimum weekly allowance for a household with children would be £23.40.

Allowances would be paid to owner-occupiers and tenants alike. In other words, this cover is provided regardless of tenure although it will be subject to income and rental cost limits for obvious reasons. Unlike the present housing benefit scheme in the UK, therefore, it would provide some protection for those low income owner-occupiers who are not entitled to supplementary benefit payments and who lose out since they receive no help with mortgage or maintenance costs even though tenants in the same economic circumstances may receive assistance with rent payments which, in cash terms, may be less of a burden (Walker, 1986).

If means tested, this allowance would decrease by a fixed percentage, say 20 percent, as income increases above supplementary benefit level; alternatively, the allowance could be provided on a universal basis. Given that the scheme is to be extended to owners as well as renters, there may be some problem of containment of costs if actual

6. Or introduced in those countries where it is currently available to rental landlords but not to owner-occupiers (such as Australia and Israel).

rather than standardised rent payments are used to determine benefits paid. See Berthoud and Ermisch (1985) for a fuller description of alternative schemes and for a critique of schemes based on actual rather than standardised payments[7] and O'Higgins (1987) for a discussion of the relative advantages of means tested versus universal benefits in terms of egalitarian criteria.

At this point, the scheme proposed is not different in concept from that spelled out and costed by Ermisch (1984) and Berthoud and Ermsich (1985) or by Walker (1986). The aim of such proposals for reform is to devise a system of housing benefits which are consistent for both tenants and owner-occupiers; these, therefore, must be based on paying housing benefit to cover only the rental equivalent of outlays faced by owners. Full costing of any policy proposal will obviously depend on the specific nature of the form of housing benefit introduced. Berthoud and Ermisch have shown that imposing a levy based on a 3 percent real return on owner-occupied housing and paying all households in the UK a set allowance subject to a proportional taper, with an income limit set at 1.85 times the supplementary benefits requirement, will leave a surplus of over £1000m to be further redistributed, even after allowance is made for a move to market rents in the public sector. Without the additional redistribution, however, only 31 percent of all households and 9 percent of owner-occupiers gain from the Berthoud and Ermisch proposals compared with the existing system of housing benefits and no housing taxation. Replacement of the means tested benefit with a universal benefit, however, results in 51 percent of all households gaining and 44 percent of all owners, even without the additional £1000m being redistributed. Thus, these initial calculations show that such a scheme is both financially and, potentially, politically feasible.

Cases 1 and 2 in the appendix to this paper indicate the extent of the insurance cover provided by this housing benefit for an owner-

7. Walker (1986) proposes a scheme where cover is based on actual rents paid. This can create difficulties in providing eligible households with no incentive to economise on rental costs and could be unnecessarily costly. In the absence of adequate low cost accommodation, however, such a proposal could be considered as a temporary measure.

occupier faced with a loss of income and a consequent increase in the burden of housing costs.

Stage 3:

As seen in case 2 in the appendix, the housing benefit cover provided by the insurance scheme may not be sufficient to ensure that those householders who are consuming more housing than deemed to be 'standard' or adequate for their needs are fully protected from the burden of housing costs when income declines.

In an earlier section of this paper it was pointed out that one of the main weaknesses with the approach as outlined in stage 2 is that it concentrates on removing imperfections introduced into the housing market via government subsidies but does not face up to imperfections inherent in housing related markets and particularly to those related to housing finance for owner-occupiers. It ignores, for example, the problem that, when house prices are rising, part of the interest payments made by owners represent personal saving which impose an unavoidable burden on home purchasers.

The third stage of the proposal being put forward in this paper is designed to overcome this particular problem. It also overcomes any the cash flow problems which might arise with the introduction of a compulsory housing costs insurance scheme. This is done by introducing an equity sharing arrangement where housing benefit for owner-occupiers is extended to cover actual housing costs if these exceed the chosen share of income (taken as 20 percent above) rather than just the rental equivalent of these costs. Actual costs may be higher than those allowed for in the housing benefit described in stage two for several reasons: first, because of the effect of the tax/insurance liability; second, because of above standard non-interest costs (such as repairs and maintenance)[8]; and, third, because of mortgage repayments over those equivalent to the real return on housing. These latter payments cover the difference between nominal and real rates of interest and any capital repayments of the loan. Support in each of these cases, however, is not in the form of non-repayable income assistance; instead, any additional government assistance must be 'paid for' through equity sharing in housing. In this paper, the term 'equity sharing' has been used as shorthand for a form of indexed loan; it differs from the more commonly available indexed loans only in that the claim the government or lending institution has upon the householder is related to the current value of the mortaged dwelling rather than being predetermined. Because of this, the risk associated with capital gain and loss is also shared.

Such an arrangement would apply in place of the discount currently offered to those public tenants availing themselves of the right to buy legislation[9] and for other owners could operate in a similar way to some of the various equity conversion, stay put or home income plan schemes for the elderly (see Wheeler, 1986). As with many of these latter schemes, there is no reason why it has to be government based; facilities could be, and in some cases have been, provided by private institutions although these do tend to be only available for better off owners. If operated on a private basis, private institutions would take over the responsibility for paying the tax and recoup this from individual owners by adoption of appropriate mortgage instruments. Unfortunately, most private institutions are prepared to move to appropriate mortgage instruments (such as interest only, or indexed arrangements) only when there is substantial spare equity to insure them against default and when the security of the loans increases over time (Walker, 1986). Provision of a state guarantee for the equivalent of rental payments does

8. Any problems which arise from age differentials in the stock of housing causing different repairs/maintenance responsibilities could be taken into account either by an option of transfering responsibility of repairs and maintenance in return for an appropriate equity share based on standard costs (that is, by separating management and ownership responsibilities) or by meeting these from equity as they arise.
9. Here, a 50 percent discount would be replaced with 50 percent government equity in house but rights of use and disposal would be as for owner-occupied housing.

reduce some of risk for institutions but may not be sufficient to induce them to offer services to marginal home-owners. Thus, the government will need to provide a competing service to ensure that schemes are available to all and to ensure that excess profits do not push up costs. Under such circumstances, private financial institutions will enter the housing costs insurance market only if they can be organised more efficiently than the public sector or if they are able to restrict their services to lower risk cases; because of adverse selection problems arising from any government operated scheme, these two qualifications are not necessarily independent.

Cases 2, 3 and 4 in the appendix illustrate the combined operation of the housing benefit and equity sharing arrangements available under the housing cost insurance scheme for owners and for owner-purchasers with different incomes. The first options illustrated in each of cases 2 and 3 show how both consumption and investment in housing must be simultaneously reduced if these attributes are treated as joint products; the second options show how investment in housing can be reduced without reducing the consumption of housing services once these are separated.

This extension of the stage 2 housing benefit proposal stems from a recognition of one of reasons why imputed rent tax has been seen as being politically unpopular; namely, that it results in households incurring an income tax liability when there is no cash flow from which to meet it. As a result, some households could be placed in financial difficulty. It also recognises that owner-occupation is not a panacea for all households and results in some being in severe financial stress. One of the sources of this severe financial stress is the enforced illiquidity of a household's (often limited) assets which results from investment in housing. Stage 3 of the proposal overcomes this by providing a means of separating the shelter aspects of housing, for which rent is paid, from the investment aspects of housing, the returns of which are uncertain and received in the form of unrealized capital gain. The separation of housing benefit into a "by right" component for rental and a "by choice" component for investment is based on the assumption that it is the shelter component of housing which is seen as a merit good and the proper basis for government assistance in housing. Conventionally support for this component has been provided either directly through public housing or indirectly through housing allowances for those in private rental.

This third stage is based on recognition of fact that, for owner-occupied housing, under current institutional arrangements, this shelter component is a joint product with the investment component and that problems of owner-occupiers are two-fold. In the first place, are problems which arise because households are unable to meet their recurrent costs (ie the components of the rental costs of housing); in the second place, are problems which arise because households are unable to meet mortgage costs (which may be partly rental costs but) which are predominantly capital costs and are unable to meet the tax liability based on their housing investment.

In implementing this proposal, the government has several policy variables available to it; it must choose the appropriate tax levy, the minimum cost of housing to be supported by housing benefit, the proportion of income to be required in meeting housing costs and the maximum amount of support which will be provided in any equity sharing arrangement.

Stage 4:

The final stage of this proposal reform consists of the introduction of housing bonds which provide a taxable real rate of return and a non-taxable capital gain indexed to the overall rate of house price inflation of those houses involved in government equity sharing arrangement. The real return on the bonds is provided by the rent paid under the equity sharing arrangement which, within limits, is underwritten by the housing benefit scheme. The capital gain is provided by the eventual recoupment from sale or equity buy back of those houses involved in the equity sharing arrangements.

These bonds are available to anyone with assets which they would like to invest in owner-occupied housing but are unable to do so for a number of reasons. First, their current combination of assets and income may be insufficient to enable them to overcome access constraints in the private housing market and there may be a queue for a government provided loan/housing under the equity sharing scheme discussed in stage 3. Second, the households may not want to invest in the same geographical location in which they need to live; in this case, the option to equity share with the government in its own house and to invest in housing bonds offers a means of pooling the risk associated with uncertain capital gains in housing. In other words, the combination of equity sharing and housing bonds means that individuals or households can invest in housing generally rather than having all assets tied up in a specific house; this opportunity is more advantageous than the risk pooling provided by co-operative housing since it can be provided on a broader geographical scale. It does raise problems of adverse selection, however, since equity sharing with the government may only be taken up by those in declining areas; thus, the bonds may not be seen to be a good investment. The combination of untaxed capital gain and the averaging of house price losses and gains, however, may serve to offset this. Third, certain individuals or households may not want to consume any more housing even though they would like to invest in more in order, for example, to provide cover against future housing related cost/taxes which are tied to the value of housing. Such bonds would be transferable into equity into housing or can be used to meet statutory obligations regarding tax levies.

The introduction of bonds in this Stage 4 is intended to provide a means of investing in owner-occupied housing for those in rental housing or further investing in it for those in owner-occupied housing; they provide an investment opportunity for owner-occupiers and renters which yields returns equivalent to those available in owner-occupied housing. The existence of such bonds means that housing outlays can be increased there is a gap between housing costs and, say, 20 percent of income and reduced when income falls and housing costs exceed this share of income. Thus, they provide opportunities for evening out the time profile of housing expenditures and hence reducing the burden at a time when incomes might be lower for existing owners whilst simultaneously providing investment opportunities for non-owners.

Any funds derived from this scheme could be used to finance the purchase of owner-occupied housing for those with insufficient equity. This should help reduce demand for finance from private institutions since demand is met, instead, by government or non-profit institutions (therefore meeting one of Ball's requirements for changing the social/institutional relations in the provision of housing (Ball, 1983)).

7. Conclusions

The proposal suggested here adapts the conventional rational economic approach in several critical ways without changing the underlying intention of removing the horizontal and vertical inequities which arise from the current form of housing finance provision. The policies suggested are based on an explicit policy of redistribution of government assistance from those who no longer need support to those whose housing costs impose undue burdens. This includes those marginal home owners who currently receive few of the benefits traditionally ascribed to owner-occupation.

The overall proposal for reform is based on acceptance of the argument that the ideology of home-ownership is so well entrenched that it is politically infeasible to introduce or implement any policy which is seen as an attack on owner-occupation. The rationale behind the critical modifications to the conventional rational economic solution is simple; it is based on the assumption that, if the objective support for home-ownership cannot be changed, then it is necessary to change the socio, legal, financial and institutional constraints which together define the nature of home-ownership and, in so doing, to change the nature of home-ownership in such a way that the relevant distinctions between renting and owning are removed.

The fiscal reform embodied in these proposals aims to eliminate variation in the economic cost of housing by tenure with the housing gap scheme designed to meet cost of minimum standard of dwelling (which varies with household composition and housing location) and equity sharing arrangements based on providing choice of time profile of payments by separating rental and owning decisions. Thus, the policy package proposed embodies many of the aspects of both the right to buy and the right to rent policies which have been at the forefront of housing policies in the UK in the 1980's. However, it moves away from the either/or choice embodied in these proposals.

The combination of equity sharing and housing bonds means that exchange rights in housing can be traded independently of use rights; the use of housing bonds can provide an alternative to the mortgage market as a vehicle of exchange for housing. The separation of consumption and investment components of housing should enhance mobility and freedom of choice and ensure a more efficient operation of the housing market.

There are several difficulties with this scheme which have yet to be canvassed. The first relates to the fact that, no matter how well disguised, the policy does result in an increase in the tax burden for some households and an apparent increase in government expenditure in a climate when attempts are being made to reduce both tax burdens and government expenditure.

Several responses can be made to this. In the first place, the increase in government expenditure is financed from an already existing 'tax expenditure'; that is, it is financed from an existing form of assistance provided to housing which does not appear in the government accounts because it is an off-budget item. Transferring this support to an on-budget item and redistributing it results in no net increase in total support. In the second place, the increased tax burden for some households is a direct reflection of the fact that redistribution, by definition, must result in increased burdens for some.

The second difficulty arises from the possibility that previously existing tax advantages which accrued to owner-occupiers may have been capitalised into house prices. To the extent that this has been the case, existing owners have benefitted at the expense of renters and new entrants to owner-occupation. Introduction of a tax on housing could put a downward pressure on house prices because of a consequent reduction in the demand for the amount of housing consumed by any individual household. This would improve access for would be owners and, to the extent that rents charged are related to asset prices, would reduce rents. It would create difficulties for existing owners only if the downward pressure on house prices was not evenly distributed across regions and so mobility was affected.[10]

The final difficulty is that such a proposal represents a radical change to the structure of housing assistance and provides a considerable redistribution of that assistance from owners to renters and from rich to poor. As such, it undoubtedly faces a considerable number of political hurdles. In overcoming these hurdles, each political party needs to assess the policy proposed against its underlying objectives or ideologies. The right needs to recognise that the proposals have the advantage of removing some of the distortions which encourage over-investment in housing. Elimination of at least some of the tax shelter which protects housing will free up resources for a more productive use in the economy and so enhance efficiency. The left needs to be reminded of its commitment to social justice.

The proposal put forward here is one of the rare occasions where the stated objectives of both left and right are better achieved by its introduction. Any failure to implement such a policy implies the existence of unstated objectives. Until these are made clear, proposals for reform will have little chance of success.

10. Because of the regional differences in house prices which already exist in most countries, this problem already exists. Any reduction is the general house price level can only improve mobility.

APPENDIX

The following examples are all based on the assumptions outlined below:

net rent	=	3%
gross rent	=	5%
rate of interest	=	12%
net of tax	=	8%
real rate of interest	=	3%
housing tax	=	1% house value (approx 30% rental value).

As indicated in the text, actual tax liability would need to be based on equity in housing and the householder's marginal tax rate; for simplicity in the cases illustrated below, however, a constant marginal tax rate of approximately .33 has been assumed in setting the housing tax at 1 percent of house value given that net rents are assumed to be 3 percent of house value.

These illustrative cases are based on approximate national income and house price averages for the UK in 1986 and, therefore, ignore regional variations. Standard housing costs of £1000 p.a. for a household with 2 adults and no children have been used as the amount to be covered by housing benefit. These have been based on Berthoud and Ermisch (1985) estimates which set minimum housing costs for rent only at £15 p.w. and for rent and rates at £21.50 p.w. These standard housing costs, of course, will vary both by household composition and by region. Given the assumptions spelled out above, costs of £1000 p.a. represents the net rent payable on a £20000 house. This £20000 figure has been used to set the maximum contribution available from the government under equity sharing arrangements.

All of the examples are based on the assumption of a means tested housing benefit with households being expected to contribute 20 percent of income towards housing costs.

Case 1:

income	10,000
house value	40,000; 100% equity

costs

maintenance	800	
tax	400	
total	1200	< 2000 = 20% income

Since housing outlays do not exceed 20 percent of income, such a household would not be eligible for any support from government and would face an additional tax burden of £400 p.a. However, should its income circumstances change (for example, through retirement, unemployment, sickness or loss of an income earner), it could then be covered by the housing costs insurance scheme. This possibility is illustrated in case 2.

Case 2:

income	2,500
house value	40,000; 100% equity

costs

maintenance	800	
tax	400	
total	1200	> 500 = 20% income

Since housing costs exceed 20 percent of income, this household is eligible for support under the housing costs insurance scheme. This support is available in 2 forms: the first is housing benefit cover for rental payments or their equivalent upto the set standard of £1000; the second is provided through eligibility for equity sharing arrangements if housing outlays exceed this standard.

Under HB: $HB = C - 20\% \ Y$
$= 1000 - 500$
$= 500$

Thus, the government contribution under the housing benefit scheme plus the required 20 percent of household income is sufficient to cover £1000 of costs; this leaves the household with £200 still to pay. Just two options for meeting this deficit will be considered here (although Wheeler (1986) provides a list of 5 options for elderly home-owners, each of which is essentially a variation or combination of the 2 suggested below). To reduce its housing costs to 20 percent of income, the household may choose to (i) move to a lower valued house or (ii) enter into an equity sharing arrangement.

(i) move to a lower valued house:

Given its income and assets held as equity in housing, the household can afford to live in house valued at £33333, incurring the following housing outlays

costs	
maintenance	667
tax	333
total	1000.

Thus, the housing benefit cover of £500 and the household contribution of 20 percent of income is just sufficient to meet total housing costs. In this case the household has traded down and released £6667 of its equity previously tied up in owner-occupied housing. Should it prefer not to move, it may choose, instead, to avail itself of the equity sharing arrangements made possible by the government.

(ii) enter equity sharing arrangement:

In this case the gap of £200 is picked up by government and treated as if it were a (taxable) interest payment by the government to the householder on an indexed loan of £10000 and which is used by the household to meet the net rental payments on the equity held by the government in its housing. As long as the gap between actual housing costs and 20 percent of income remains a constant fraction of total costs, this indexed loan will be adequate to protect the householder from all future housing costs; any variations in this fraction will require a reassessment of the amount of equity held by the government. Under the above arrangement, the government is required to outlay £500 to cover housing costs; in return for this it receives

£200 as revenue from the insurance tax levy and a 16.7 percent (= 6667/40000) equity in a £40,000 house, the value of which will increase or decrease with house prices; this latter is the trade-off for the 'missing' £200 not met by the householder. Net current outlays for the government, therefore, are less than those implied by the housing benefit scheme alone and future pressures on government outlays are reduced even more.

The householder's total tax commitments remain unchanged at £400 but this is now made up of a tax of £333 on equity in housing and £67 on the (real) interest earned from the government provided annuity. Maintenance payments of £800 are broken down into £667 on the household's investment in housing and £133 in rental payment to the government. The remaining (net) rental payment based on 3 percent of the government's equity holding in the shared asset is paid from the return on the annuity.

This policy can thus be seen as a variant on the Right to Sell policy advocated by the Labour Housing group (Merrett, 1986). As a result of this equity sharing arrangement and as a result of its past investment in housing, the household is able to consume more housing than would be possible if its housing consumption was restrained by its current income (as in (i) above) because of the illiquidity of its investment in housing.

The option of foregoing equity in payment for the gap in housing costs is obviously only available to those who have assets tied up in housing which are sufficient to generate a real return equal to the amount owed. For those households with an income/asset profile which is such that they are unable to enter owner-occupation or unable to generate sufficient income from equity currently tied up in housing to meet the relevant housing costs, government involvement in equity sharing may require an up front payment from the government. This situation is considered in case 3.

Case 3:

income	10,000		
house	40,000;	equity	15,000
		debt	25,000

costs

maintenance	800			
tax	400			
interest	(3000)			
after tax	2000			
total costs	3200	>	2000	= 20% income

Under the insurance provisions, this household is potentially eligible for support since housing costs exceed 20 percent of income. However, because 20 percent of household income covers far more than the minimum rental component covered by housing benefit, only eligibility under equity sharing arrangements is relevant.

Under HB: $HB = C - .20\,Y$
$= 1000 - 2000 < 0$, so not eligible.

As before, the household again has two options which will be considered here: either it reduces both its investment in and consumption of housing or it changes the balance between these by entering into an equity sharing arrangement with the government.

(i) reduce housing aspirations:

Given its current income/asset profile, if it prefers not to take up the opportunity of government equity in its housing, this household can simply reduce its housing aspirations to a house worth approximately £29,000 rather than £40,000, incurring, therefore, the following costs with a £14,000 conventional loan:

costs

maintenance	580	
tax	290	
interest	(1680)	
after tax	1120	
total	1990	< 20% income

(ii) enter equity sharing arrangement:

In this case, 20 percent of household income must cover maintenance and tax costs based on the value of housing, nominal interest payments on a conventional loan and net rent (or real interest) payments on an indexed loan. Here it is assumed that the government is only prepared to provide a loan upto a maximum of £20,000 since this is taken to the be capital cost of directly providing public housing. As with public rental housing, shortages may imply some queuing for funds; this, however, should only be temporary after stage 4 of the scheme is implemented. At the maximum loan of £20,000, the household would be required to pay £600 in net rental payments; given maintenance and tax payments on a £40,000 house, this would just leave it sufficient to service the £5000 private loan required to meet the remaining deposit gap. Under this arrangement, the household incurs the following costs:

costs		
	maintenance	800
	tax (on equity)	200
	interest	(600)
	after tax	400
	rent	600
	total	2000

The government, on the other hand, must finance the £20,000 loan required. As long as it can raise this finance by means of the indexed housing bonds proposed, this will result in it incurring interest costs of only £600 which is covered by the net rent charged. As well, it receives £200 in revenue from the insurance levy, a 50% equity in a house currently worth £40,000. In addition, it also benefits from the £800 reduction in mortgage interest relief provided to the household attempting to purchase the same £40,000 house by incurring housing costs far in excess of 20 percent of income. Thus net costs are - £1000. If finance must be raised at nominal interest rates, interest costs incurred are higher by £1800 and net costs will be £800.

In cases such as this where maximum government support is required because of low household assets, any future reduction in income will require even greater government outlays. This situation is examined in case 4 below where the impact of a drop in income is considered. As in case 2, this drop in income means that the household is likely to be eligible for additional support through the housing benefit component of the insurance scheme.

Case 4:

	income	2,500		
	house value	40,000;	own equity	15,000
			own debt	5,000
			equity shared	20,000
costs				
	maintenance	800		
	tax	200		
	rent	600		
	interest	(600)		
	after tax	400		
	total	2000	>	500 = 20% income

Under the housing benefit component of the insurance cover, this household is eligible for support of any housing outlays in excess of 20 percent of income upto the set standard of £1000.

under HB: $HB = C - .20\,Y$
$= 1000 - 500 = 500.$

Thus, housing benefits plus 20% of income cover £1000 of housing costs. The household is, however, still £1000 short in meeting its current housing costs if this £40000 house is to continue to be occupied.

Under the equity sharing arrangements, the government is already providing a £20000 loan which has been taken as the maximum permissable. Acceptance of responsibility for the remaining £1000 would require additional outlays. Thus, this household will need to move as soon as accommodation at the set minimum standard becomes available in the same location. As an interim measure, however, the government can gradually increase its equity share using the household's equity released to cover additional costs.

In the first year, for example, it could increase its equity from £20,000 to £26,250, taking over the responsibility for the private loan and releasing £1250 from equity to cover rental and maintenance costs. Maintenance costs would remain at £800; rental costs increase to £788 (that is, 3% of £26250) and tax due would decrease to £137 (that is 1% of £13750) giving total costs of £1725 of which £500 are met by housing benefit cover and £1225 from equity released. Obviously this solution can only be a short term measure and it is not necessarily one which is in the household's best interest as it reduces its capacity to pay for its future housing needs.

Assuming that the household was able to move with its equity intact, it could afford to purchase a £20,000 house with no government equity or it could invest in a house worth approximately £25,000 by entering into an equity sharing arrangement with the government taking up 40% equity (= 10000/25000).

(i) move to a lower valued house with no equity sharing:

Under the first of these alternatives

costs

maintenance	400	
tax	200	
interest	(600)	
after tax	400	
total	1000	= 20% income

which is fully covered by the housing benefit cover of the insurance scheme. In this case, total government outlays of £500 are offset by £200 received from the tax levy.

(ii) enter equity sharing arrangement:
Under the second of these alternatives

costs

maintenance	500	
tax on equity	150	
rent	300	
total	950	< 20% income

which is fully covered by the housing benefit cover of the insurance scheme. In this case, total government outlays of £500 are almost covered by the revenue of £450 received from the tax levy and rent payment on government equity in housing. As well, it benefits from its 40% equity in a £25,000 house.

In the latter case, the household has chosen to use its assets to consume a greater amount of rental housing than it could afford if the consumption and investment attributes of housing had remained tied. In the former, it has reduced its consumption of housing to the standard sustainable with joint purchase of consumption and investment attributes given its own income and wealth situation.

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Table 1: Indirect and direct assistance for housing

	direct expenditures		tax expenditures	
Australia (method 1) (a)				
1977/78	$A 592m		$A 663m	
1984/85	$A 1561m		$A 2200m	
average annual increase		15%		20%
Denmark (method 2) (b)				
1977 (c)	DKR 2564m		DKR 5983m	
1979	DKR 3187m		DKR 11600m	
average annual increase		11%		39%
Finland (method 2) (b)				
1977 (c)	FMK 1324m		FMK 441m	
1979	FMK 1758m		FMK 607m	
average annual increase		15%		17%
Norway (method 2) (b)				
1977 (c)	NKR 3163m		NKR 1779m	
1979	NKR 2436m		NKR 3594m	
average annual increase		-12%		42%
Sweden (method 2) (b)				
1977 (c)	SEK 7556m		SEK 4250m	
1979	SEK 9303m		SEK 6400m	
average annual increase		11%		23%
UK (method 1) (d)				
1979/80	1945m		2925m	
1982/83	735m		4032m	
average annual increase		-28%		11%
UK (method 2) (e)				
1979/80	1595m		1300m	
1984/85	835m		3100m	
average annual increase		-12%		19%
US (method 2) (f)				
1980	$ 5376m		$ 15616m	
1986	$ 2300m		$ 27575m	
average annual increase		-13%		10%

Notes:

(a) Flood and Yates (1986): direct expenditures include capital outlays. In Australia, there is no imputed rent tax and mortgage interest cannot be deducted for owner-occupiers.

(b) Ahren (1986): direct expenditure estimates include interest subsidies, production grants and housing allowances; tax expenditures based on differences between income and interest costs actually incurred and those assessed for tax purposes. In all Nordic countries included in table, there is a low tax on imputed rent (approximately 2-3%, sometimes higher for higher valued properties) and interest on both housing and other loans is deductible (expect in Finland).

(c) estimated from information provided on changes in magnitude and relative shares on respective subsidies in Ahren (1986).

(d) CIPFA (1982), Warburton (1983): estimates based on 'economic' definitions of subsidy comparing cost of housing to consumer with and without government intervention; direct expenditures exclude housing benefits and cover only local authorities; tax expenditures based on assumption of a neutral tax system with only real capital gains taxed and real interest deductible. In UK, there is no tax on imputed rent but mortgage interest on loans upto a defined amount can be deducted.

(e) Walker (1986): estimates based on budget data from Public Expenditure White Papers; direct expenditures exclude housing benefits and capital expenditures and cover only local authorities; tax expenditures based on cost of mortgage interest relief. Wilkinson (1986) provides estimates which include housing benefits and capital expenditures and which show that, in constant prices, there was a 6% p.a. decline in outlays and a 3% p.a. increase in tax expenditures in the UK over an 8 year period to 1983/84.

(f) Roistacher (1986): estimates based on US budget data; direct expenditures based on all assistance to public and subsidized housing; tax expenditures based on cost of mortgage interest relief. In US, there is no imputed rent tax and mortgage interest is deductible.

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