



Social Safety Nets Primer Notes

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Demand-Side Subsidies for Housing

The Rationale for Government Intervention

Several governments in developing countries have been using demand-side programs to increase access to housing services among the poor. From the perspective of a social safety net, the main justification for providing housing assistance is that adequate shelter is a basic need that governments have a responsibility to help to fulfill, especially during times of hardship. In transition countries, assisting the poor with their housing-related expenditures can mitigate the hardship caused by planned price increases. The introduction of housing assistance in such cases makes it possible to implement reforms such as price increases or deregulation.

Housing assistance programs can satisfy other important policy goals like promoting homeownership and developing the market-based housing sector. Housing and housing-related infrastructure programs can also support economic development by helping people to set up home-based businesses and encouraging community development or neighborhood revitalization initiatives.

Program Descriptions

The two kinds of demand-side subsidies that are most likely to be recommended and implemented today in the housing sector are capital grants and allowances. These are subsidies that are given directly to households or directly paid to service providers on behalf of the households.

Capital Grants. Capital grants are one-time subsidies that households can use to purchase, build, or complete (new or existing) units or to rehabilitate existing units. The grants are usually funded via an explicit appropriation process within the government's budget, which makes their cost transparent to the public.

Sometimes capital grants are difficult to justify as they often involve sizeable amounts of money per

beneficiary. Once appropriated, however, they can be used to assist a given pool of beneficiaries, making the program attractive to some politicians. To protect against fraud and waste, households may be given their grants in tranches according to what progress has been made or how much work has been completed. The amounts involved can range from the modest to the price of an entire dwelling.

Capital grants have been popular in South America where several governments followed the so-called 'Chilean model'. This emphasizes government policies that:

- (i) shift the responsibility for housing production away from the government to the private sector;
- (ii) provide one-time grants for home purchase while curtailing all indirect subsidies; and
- (iii) institute transparent mechanisms for selecting beneficiaries based on household income and a savings contribution.

Housing Allowances. A housing allowance is a regular ongoing subsidy provided to owners or renters to offset some of the costs of their housing and housing-related services. Allowances can take two forms. Under one approach, the household receives a fixed subsidy based on the typical prices prevailing in the housing market and must pay the difference between this amount and the total rent (or total housing-related expenditures) of its housing unit. As a result, each household's contribution will vary depending upon how successful it is in finding an economical unit. This 'norm-based' approach gives households a powerful incentive to shop for the best housing deal.

Under the second approach, the government specifies a fixed amount of money that a household must pay towards its own housing costs (usually a percentage of its income) regardless of

the total amount of its rent. The government pays the difference between what it deems the household able to pay and the rent (or total housing-related expenditures). Under this system, sometimes called a ‘burden limit’, the size of the subsidy varies depending on the household’s contribution. There is little incentive for a household to shop for a good deal because it pays the same amount under any scenario.

A housing allowance, in spite of its name, represents one way to subsidize a variety of housing-related expenditures such as utilities and maintenance fees. In fact, many housing allowance programs are based on the concept of ‘gross housing expenditures’, which, in addition to a rent component, usually includes fees for energy, water, sewage, and solid waste disposal. Given these attributes, it is not surprising that housing allowances have primarily been used in transition countries in the past decade. In these countries, allowances form a part of the social safety net and are often intended to help protect households from reform-related increases in the prices of maintenance fees, utilities, and rent.

What is the Appropriate Approach?

Policymakers have to weigh the strengths and limitations of each approach in deciding which one to use, taking into account the different circumstances.

Capital Grants. The main drawback of capital grants is that they are often administratively complex and require considerable institutional capacity (although less than an allowance program and they can be put into operation fairly quickly). They have proven to be particularly useful in the aftermath of natural disasters, in supporting relocation efforts, and in complementing housing finance programs. Because they can be used to purchase or rehabilitate existing units or to build new units, capital grants can be effective in both tight and loose housing markets. A capital-grant program works best where there is a well-developed private sector that can readily supply and rehabilitate units. If a country has a housing finance system, a capital-grant program can make market-rate loans affordable to households (by lowering the principal on loans). By requiring

households to make contributions, the subsidy level of the capital grant can be reduced.

Allowance. A housing allowance program is most likely to be acceptable in a relatively well-off country with a solid institutional capacity, secure tenure, and a relatively sound, high-quality housing stock. An allowance program is unlikely to be appropriate in a very poor country where the government may have trouble sustaining recurring subsidy payments and where there is not much support for providing cash assistance to renters or owners who remain in the substandard or informal housing that may make up a large share of the total housing stock. Also, housing allowances probably will not work well in tight housing markets as they are not as effective as capital grants in directly encouraging new construction. The norm-based allowance is preferable because of the price distortions introduced under the burden-limit approach.

Conclusions. If economists and policymakers were to have their choice they would probably avoid programs earmarked for housing altogether in favor of a general means-tested cash benefit in which the subsidy is partly based on housing consumption norms. If a government already has a cash benefit program they may want to consider the possibility of using it to deliver housing-related subsidies, especially if the subsidies are not large. However, the desire by society or government to encourage consumption of these goods and the potentially high expense of these programs often makes this option impractical.

In low-income countries the high cost of capital-grant and housing-allowance programs might limit the coverage to poor households. Upgrading existing housing and infrastructure may be a more cost-effective way to improve the living conditions of large numbers of poor households occupying informal housing with insecure tenure.

Perhaps one of the best uses of capital grants and allowances is to ease the phasing out traditional supply-side programs, by helping governments to reduce their involvement in the direct production of housing and to encourage the development of the private sector.

The World Bank Social Safety Nets Primer series is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking on the role of social safety nets in the broader development agenda.



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