RENTAL HOUSING IN DEVELOPING COUNTRIES:
ISSUES AND CONSTRAINTS

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Stephen Malpezzi is an economist in the Urban Development Division of the World Bank. However the views expressed in this paper are the author's and do not necessarily represent policy or views of the World Bank or any other institution.

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ABSTRACT

This draft paper has been prepared for the UNCHS Expert Group Meeting on Rental Housing in Developing Countries, Rotterdam, October 9-13 1989.

Despite the importance of rental housing in many urban markets, issues specific to rental are often neglected by researchers and policy makers. This paper describes in a quite general way how housing markets work in developing countries, and then goes on to apply the principles derived to rental issues. Demand and supply, in particular for rental housing; input markets (land, infrastructure and finance); regulation, including rent controls; and taxation are discussed in turn. The role of public and private sectors, and of official development assistance, including World Bank urban lending and research, are also discussed.
TABLE OF CONTENTS

I. INTRODUCTION ................................................................ 1

II. A FRAMEWORK FOR ANALYSIS: HOW HOUSING MARKETS WORK .......... 2

III. HOUSING MARKET BEHAVIOR, WITH A FOCUS ON RENTERS ............. 4
    A. Housing Demand ................................................................ 4
    B. Housing Supply .................................................................. 5
    C. Renting and Owning                                       6
        Forms of Tenure ................................................................. 6
        Tenure Choice ................................................................. 9

IV. RENTAL HOUSING MARKET ISSUES AND CONSTRAINTS .................. 11
    A. Land Markets .................................................................. 11
        Tenure Security ............................................................... 11
        Land Regulation ............................................................. 11
    B. Infrastructure ................................................................... 13
    C. Finance ........................................................................... 13
        General ............................................................................. 13
        Financial Issues Specific to Rental .................................. 16
    D. The Regulatory Framework ........................................... 16
        Subsidies, Taxes, Regulation, and Other Interventions: A
        Simple Model .................................................................. 17
        Some Common Regulations Impeding Rental Housing .... 18
    E. Rent Controls ................................................................... 19
        Decontrol Options ............................................................ 23
    F. Taxation and Housing ..................................................... 24
        How Should Housing be Taxed? ....................................... 24

V. PUBLIC PROVISION OF RENTAL HOUSING ..................................... 26
    A. Share of Public Housing in Developing Countries .................. 26
    B. Efficiency of Public Housing ........................................... 26
        Off Budget Expenditures .................................................. 28
    C. Privatization of Public Housing ....................................... 28
        Decision Rules: When to Privatize, Not ......................... 29
        How to Privatize ............................................................. 30

VI. RENTAL HOUSING: ROLE OF THE WORLD BANK
    AND OTHER DEVELOPMENT INSTITUTIONS .................................... 32
    A. Lending Operations: World Bank Financed Urban Projects,
       1972-89 ........................................................................ 32
    B. Recent Trends ................................................................... 33

VII. SUMMARY AND CONCLUSIONS .................................................. 34
    A. Old Lessons in Housing Market Policy ................................ 34
    B. Recent Lessons in Subsidy and Incentive Policy .............. 35
    C. Policies With A Specific Rental Focus .............................. 36

REFERENCES .............................................................................. 38
LIST OF FIGURES

Figure 1: How Housing Markets Work ........................................ 2
Figure 2: Cross Country Model of LDC Rental Housing Demand ............ 4
Figure 3: Housing Investment and GDP Per Capita .......................... 5
Figure 4: Housing Investment and GDP ....................................... 5
Figure 5: Urban Tenure and Percent Urban .................................... 9
Figure 6: Urban Tenure and GNP Per Capita .................................. 9
Figure 7: Housing Price to Income and Housing Finance ................ 14
Figure 8: House Price to Income and Interest Rate Policy ............... 15
LIST OF BOXES

Rent Controls in Kumasi, Ghana ........................................... 20
I. INTRODUCTION

Roughly 40 percent of the world's urban dwellers are renters; in many developing country cities, two thirds or more of the housing stock is rental. In the past few decades, much of the urban development community focused their housing efforts on moving governmental strategies from public rental housing which was costly and inefficient (and rarely well targeted) to sites and services and upgrading strategies. At least the former of the two substitute strategies was conceived of as, in one way or another, a low cost homeownership scheme. To the surprise of some, and the consternation of a few (at least at first), many of these units were rented out, in whole or in part. Together with the well known fact that much of the urban housing market was rental and would remain so, especially in larger cities, this required rethinking on the part of many of us.1/

When presented the preceding facts few practitioners, analysts or donors argued with the importance of rental housing per se, but the project focus of the past twenty years made it difficult to give this concrete realization. As is developed below (and in many other papers) the past decade in urban development has been characterized by the struggle to move from the project arena to the policy arena. The difficulties donors and governments have in finding ways to work with the private sector also worked against rental; public rental housing was no longer considered a viable option, but what to do to encourage -- or at least stop discouraging -- private rental?

The first steps widely supported by donors in the "policy reform" and "private sector enabling" directions have often been in housing finance, but in a way which again tended to focus attention on owner occupation. A maintained hypothesis of this paper is that encouraging one form of tenure over another is not a suitable goal for public policy;2/ this is one area where consumer sovereignty can safely reign.

As a consequence, it becomes hard to disentangle rental housing policy from housing policy generally. While the focus of this paper is "what is to be done," it is important to set the stage with "what is," so the next few pages discuss a general framework for housing policy; some important facts about housing market behavior; some of the more common constraints and issues. These will, it is hoped, inform the discussions that follow of the relative roles of the public and private sectors; of the donor community; and of researchers and analysts. In all of this no attempt will be made to exclude issues as they touch other forms of tenure; but the focus will be on rental.

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1/ Exceptions to these generalizations are easy to find. For example, Michael Edwards and Alan Gilbert published papers along these lines some years ago. See also The Urban Edge (February 1984) and Lemer (1986). While the organization is quite different, this paper is in some respects an extension and updating of Lemer's paper.

2/ This is not to suggest that security of tenure is not an appropriate goal. Both rental and owner occupied forms of tenure can be more or less secure.
II. A FRAMEWORK FOR ANALYSIS: HOW HOUSING MARKETS WORK

Clearly some housing problems stem directly from poverty. Improving housing conditions which are bad solely because incomes are low must be accomplished by improving the productivity and incomes of the poor. But many countries which are succeeding in the task of general development find housing conditions lagging. Many countries at all levels of development find housing conditions worse than they need be because their housing markets are not functioning.

Figure 1 shows a schematic diagram of how the housing market works. Inputs such as land, labor, finance, materials, and infrastructure are combined by supply-side agents such as landlords and developers to produce housing services. Both homeowners and renters are producers as well, to the extent they maintain and upgrade their units. Relative prices inform producers of housing services about whether to provide more or less housing, and the input suppliers about providing more or fewer inputs.

The market for housing services per se can be well approximated as a competitive market. For the activities in the middle box, there are few barriers to entry or large economies of scale in most countries. This does not mean, of course, that anybody in a poor country can become a landlord or developer. But there are seldom so few landlords or developers that they exert significant market power, unless they also control inputs that are not competitive, or their numbers are limited -- intentionally or not -- by regulation.

The market for many inputs is not competitive, however: (a) their ownership may be so concentrated that owners can fix prices, as in some land markets; (b) large economies of scale may make the production of some inputs a natural monopoly, as with some types of infrastructure; and (c) government regulations may restrict the competitive allocation of inputs, notably finance and serviced land.

It is worth emphasizing that analysis of the competitiveness of the housing market, and of its input markets, depends critically on the conditions of entry and exit, and on the regulatory framework, as well as the existence or lack of economies of scale. There is little public policy can do to make a housing market or an input market more competitive by changing economies of scale; these are largely technically determined. There is a lot policy can do to affect conditions of entry and exit, and the regulatory framework. That is, the

competitiveness of each market is partly determined by policies. Rather than bemoan lack of competitiveness, where it exists, making markets competitive is an important intermediate policy goal.

The implications of this analysis are clear. Problems in housing markets are often caused by problems in the input markets. Government actions that attack these problems directly are the right ones. Rather than adopt this approach, however, many governments intervene in production (the middle box). Governments that try to fix prices -- for example, by rent controls -- distort the signals being sent to the market and may exacerbate the original problem.

This general framework, which we have presented in a number of analyses of housing markets generally,\(^4\) can serve well in the study of rental markets as well.

\(^4\) See Mayo, Malpezzi and Gross (1986), and The Urban Edge (1988).
III. HOUSING MARKET BEHAVIOR, WITH A FOCUS ON RENTERS

A. Housing Demand

The structure of rental demand in developing countries can be roughly but fairly represented as follows. Within particular markets, demand is income inelastic: most estimates using household housing consumption and incomes from cross section data range between .4 to .6 or so. Across markets demand is elastic: our estimates are that, using city averages of housing consumption and incomes as the unit of observation, the elasticity ranges somewhere above 1 but less than 1.6.\(^5\) Figure 2 presents a graphical representation of the above.

A number of other points can be made about demand which we only mention in passing here. Within markets, owner and renter elasticities are surprisingly similar, but the level of owner consumption is higher; and the difference increases with income.

Less is known about price elasticities, partly because decomposing consumption into price and quantity is more difficult technically. Our own estimates, of around -1, are among the highest, and our particular technique subject to bias towards -1 (Malpezzi and Mayo 1987a). Estimates from aggregate data over time also suggest a high elasticity (Ingram, 1983). Other estimates from cross sectional data suggest - .4 as a reasonable lower bound (Mayo 1981). Clearly more research is needed here.

The demand results above are from studies of developing countries, with a range of per capita GNP of roughly $300 per capita to $2,500. There is some evidence that for developed countries cross section income and price elasticities within markets are similar; but evidence is mixed on the elasticity across markets and countries. Micro data suggest that average housing consumption to income ratios are lower for developed countries than for Korea and some other higher income developing countries, implying that the long run elasticity is less than one over some part of the range between the two groups. Data on housing investment analyzed by Burns and Grebler (discussed below) is also consistent with this pattern. But time series data on several developed countries is more consistent with a higher very long run elasticity. The analysis is further complicated by the strong effects of tax codes and financing terms on housing user costs in the developed countries. Expanding cross country demand studies to the full range of countries, developing and developed, should be high on any future research agenda.

\(^5\) Malpezzi and Mayo (1987a,b).
If supply is elastic in the very long run, housing supply should mirror the demand patterns discussed above. Figure 3 shows the plot of housing investment as a share of GDP (called SHTO in the literature since Burns and Grebler) and the quadratic regression line. Figure 4 shows the similar pattern of housing investment as a share of gross fixed capital formation.

But Figures 3 and 4 focus on new construction. Another underresearched area is housing from the existing stock. Other than the few studies surveyed in Ferchiou (1982) and Thomsen (1986), very little has been done on filtering and other changes in utilization of the existing stock. There is a useful literature on upgrading, for example Jimenez (1982). Utilization of the existing stock comes up particularly in rental, as will be discussed below.

With the oil, debt and other shocks to a number of economies, the housing investment data show downward shifts between the mid 70s and the 80s. Is this temporary adjustment or a permanent shift? Structural adjustment has hit some cities hard, especially in the areas of nutrition, health and education, but housing and infrastructure have also been hard hit. But note in passing that “adjustment with a human face” must focus first on nutrition, health and education, since these can’t be deferred without incurring large costs. And it will be seen below that the role we suggest does not revolve so much around shifting resources into housing as making good use of the resources there. These changes are not inconsistent with adjustment; in fact they may be required for successful adjustment.

C. Renting and Owning

Forms of Tenure

In much of this paper, as in much of the housing market literature in both developed and developing countries, households are classified as either homeowners and renters. Sometimes we refer to a residual category including households which don't pay cash rent but have other characteristics similar to renters. As always there is a tradeoff between simplicity and analytical tractability, and realism. Whether or not such a gross simplification is sensible depends on the purpose at hand. Clearly in a paper that purports to be about rental housing the diversity of actual tenure forms need to be addressed at some point.

Households can own or rent structures and/or land, usage rights can be fee simple or leased for short or long term, households may or may not hold title or customary rights over adjacent property and common space, they may rent from relatives or the government as well as private landlords, long term tenants may be treated differently from recent movers, rent may be paid in cash or in kind, periodically or in a lump sum, or some combination of the two, lump sum payments may or may not be returned, with or without interest, on leaving the unit, tenants may or may not receive utilities, maintenance and other services as part of the package, tenants from family or kinship groups may have different rights than strangers, and there are a thousand kinds of informal tenure if there is one.

This list is already confusing but by no means exhaustive. A number of schemes can be suggested to try to categorize tenure forms, or put them in a spectrum. All legal systems, formal or customary, define some system of property rights. Anglo-American lawyers refer to a "bundle of sticks," that is, that any property right can be broken down into component rights. Particular tenures in particular places can be described in terms of the property rights they comprise. This can facilitate comparison and even ranking. The framework looks something like the following:
Table 1: Simple Example of Tenant's Property Rights in Different Tenures

| Forms of Tenure | ----- | | -----
| Property Rights | Home Ownership (U.S.) | Rental (U.S.) | Rental (Egypt) | Chonsei (Korea) |
| Freedom from Eviction | Yes | Duration of the Lease | Indefinite Lease | Duration of the Lease |
| Able to Sublet | Yes | If Landlord Approves | Yes | No |
| Real Housing Costs | Fall v. Inflation | Roughly Fixed | Fall v. Inflation | Rise v. Inflation |
| Fixed Nominal Housing Costs | Roughly Fixed | No | Yes | Yes |
| Able to Bequeath Unit | Yes | No | Yes | No |
| Able to Sell Unit | Yes | No | No | No |
| Capital Gains | Yes | No | No | No |

This example is simplistic, but the idea is clear. Unfortunately, detailed classification and analysis of such property rights remains for future work. We will return to this in "suggestions for future research" later in the paper.

Despite the shortcomings of doing so, it is worthwhile to present a few numbers that show the prevalence of renting in selected developing country cities (Table 2, mainly from UN sources, assembled in Gilbert 1983). In a third of the places listed, rental is the majority form of tenure. In many of the countries or cities with large "other" forms of tenure, these have many of the characteristics of rental.

A Lotus database with a slightly expanded set of tenure data, a subset of cross country data from the World Bank's World Development Report, and other country data, is available on request from the author. The database requires Lotus version 2.01 or higher, which is not available from the author. The data are also used in the cross country graphs below.
Table 2: Urban Housing Tenure, Selected Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>City</th>
<th>Year</th>
<th>Owner Occupants</th>
<th>Renters</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td></td>
<td>1981</td>
<td>27.9</td>
<td>15.7</td>
<td>56.4</td>
</tr>
<tr>
<td>Indonesia</td>
<td></td>
<td>1971</td>
<td>59.2</td>
<td>24.7</td>
<td>16.1</td>
</tr>
<tr>
<td>Korea</td>
<td></td>
<td>1969</td>
<td>48.4</td>
<td>50.3</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1980</td>
<td>42.9</td>
<td>55.5</td>
<td>1.6</td>
</tr>
<tr>
<td>Philippines</td>
<td></td>
<td>1967</td>
<td>73.9</td>
<td>19.3</td>
<td>6.8</td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td>1980</td>
<td>55.0</td>
<td>39.6</td>
<td>5.4</td>
</tr>
<tr>
<td>India</td>
<td></td>
<td>1971</td>
<td>47.1</td>
<td>52.9</td>
<td>0.0</td>
</tr>
<tr>
<td>Pakistan</td>
<td></td>
<td>1980</td>
<td>67.7</td>
<td>21.9</td>
<td>10.4</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td></td>
<td>1971</td>
<td>47.7</td>
<td>47.3</td>
<td>5.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1981</td>
<td>57.3</td>
<td>28.6</td>
<td>14.1</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Addis Ababa</td>
<td>1961</td>
<td>23.3</td>
<td>66.8</td>
<td>9.9</td>
</tr>
<tr>
<td>Mauritius</td>
<td></td>
<td>1960</td>
<td>30.6</td>
<td>56.2</td>
<td>13.2</td>
</tr>
<tr>
<td>Zaire</td>
<td></td>
<td>1967</td>
<td>47.4</td>
<td>38.3</td>
<td>14.3</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td></td>
<td>1962</td>
<td>64.2</td>
<td>32.1</td>
<td>3.7</td>
</tr>
<tr>
<td>Egypt</td>
<td></td>
<td>1960</td>
<td>43.0</td>
<td>57.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Cairo</td>
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<td>-</td>
<td>69.0</td>
</tr>
<tr>
<td>Beni Suer</td>
<td></td>
<td>1981</td>
<td>74.0</td>
<td>-</td>
<td>26.0</td>
</tr>
<tr>
<td>Morocco</td>
<td></td>
<td>1960</td>
<td>32.6</td>
<td>58.8</td>
<td>8.6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1971</td>
<td>28.9</td>
<td>62.8</td>
<td>8.3</td>
</tr>
<tr>
<td>Tunisia</td>
<td></td>
<td>1966</td>
<td>53.4</td>
<td>34.6</td>
<td>12.0</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td></td>
<td>1961</td>
<td>47.5</td>
<td>52.5</td>
<td>0.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1971</td>
<td>46.6</td>
<td>53.4</td>
<td>0.0</td>
</tr>
<tr>
<td>Argentina</td>
<td></td>
<td>1960</td>
<td>38.4</td>
<td>49.4</td>
<td>12.2</td>
</tr>
<tr>
<td>Colombia</td>
<td></td>
<td>1964</td>
<td>54.1</td>
<td>38.8</td>
<td>7.1</td>
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<tr>
<td>Valencia</td>
<td></td>
<td>1970</td>
<td>68.9</td>
<td>29.4</td>
<td>1.7</td>
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<tr>
<td>Bogota</td>
<td></td>
<td>1973</td>
<td>44.9</td>
<td>50.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Bogota</td>
<td></td>
<td>1977</td>
<td>43.4</td>
<td>-</td>
<td>56.6</td>
</tr>
<tr>
<td>Valencia</td>
<td></td>
<td>1978</td>
<td>94.9</td>
<td>4.5</td>
<td>0.6</td>
</tr>
<tr>
<td>Bogota</td>
<td></td>
<td>1978</td>
<td>62.2</td>
<td>36.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Guatemala</td>
<td></td>
<td>1964</td>
<td>69.3</td>
<td>12.5</td>
<td>18.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1973</td>
<td>52.0</td>
<td>31.3</td>
<td>16.7</td>
</tr>
<tr>
<td>Mexico</td>
<td></td>
<td>1960</td>
<td>43.9</td>
<td>51.9</td>
<td>4.2</td>
</tr>
<tr>
<td>Mexico City</td>
<td></td>
<td>1960</td>
<td>19.8</td>
<td>-</td>
<td>80.2</td>
</tr>
<tr>
<td>Mexico</td>
<td></td>
<td>1978</td>
<td>54.2</td>
<td>-</td>
<td>45.8</td>
</tr>
<tr>
<td>Mexico City</td>
<td></td>
<td>1978</td>
<td>71.3</td>
<td>12.7</td>
<td>16.0</td>
</tr>
<tr>
<td>Panama</td>
<td></td>
<td>1960</td>
<td>27.1</td>
<td>68.3</td>
<td>4.6</td>
</tr>
<tr>
<td>Peru</td>
<td></td>
<td>1961</td>
<td>39.4</td>
<td>44.7</td>
<td>15.9</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Lagos Metro</td>
<td>1972</td>
<td>8.8</td>
<td>-</td>
<td>91.2</td>
</tr>
<tr>
<td>Kano</td>
<td></td>
<td>1973</td>
<td>46.3</td>
<td>-</td>
<td>53.7</td>
</tr>
</tbody>
</table>

Sources: see text.
Tenure Choice

Many studies of tenure choice have been carried out in developed countries (e.g. Rosen 1979, Li 1977). These studies usually find income and stage of the life cycle are important determinants of tenure choice, as is the relative cost of owning versus renting. But other than the study of Korea by Lim et al. (1980) remarkably little empirical work has been done on tenure choice. Limited by the econometrics of the day, they aggregated a number of tenure categories into owning and renting, and estimated an OLS tenure choice model for that simple binary choice. Not surprisingly, the authors found that income was a significant determinant of homeownership.

A number of papers have presented evidence that in some cities, large fractions of low income households own in the informal sector; as incomes rise they rent in the formal sector; and the richest again become homeowners. Yet such patterns have not been scrutinized or explained carefully. Strassman (1980) suggests that availability of services such as piped water may catalyze investment by some households and make the shift to renting such units attractive relative to current owners of informal units without such amenities. In a very stylized version of such a world we would observe the lowest income households owning very low quality housing, perhaps in the informal sector or with little tenure security; past some threshold, households would begin into a higher quality rental submarket; finally, at higher incomes and (perhaps) overcoming financial constraints, households would be able to purchase such housing.

In the absence of detailed case studies of tenure choice, we can at least look at the pattern of proportions across countries. Figures 5 and 6 present simple plots of the percent of households renting against percent of total

8/ In the U.S. the tax code has a strong effect on the relative price of tenure, and it varies with income since the chief tax break, the mortgage interest deduction, increases with income. This partly explains the strong demand for homeownership for middle and upper income Americans.
population found in urban areas, and GNP per capita (the latter in logarithmic scale. A simple regression model quadratic in percent urban population and GNP per capita yields the following:

Table 1: Simple Cross Country Tenure Regression

| Sample: 57 Countries |  |
| Dependent Variable: Percent of Urban Population Renting |  |
| Adjusted R-Squared: 0.13 |  |
| Degrees of Freedom: 52 |  |

| Coefficient | Standard Error | Prob>|T| |
|---|---|---|
| Percent Urban, 1985 | 0.0112 | 0.0039 | 0.006 |
| Percent Urban, Squared | -0.0001 | 0.000037 | 0.002 |
| GNP Per Capita, 1986 | 0.0000028 | 0.0000023 | 0.236 |
| GNP Per Capita, Squared | -1.14E-09 | 1.33E-09 | 0.395 |
| Constant | 0.1616 | 0.0997 | 0.111 |

Note that the percent of urban renters first increases, then falls as average per capita incomes rise, but that the effect is weak. A similar pattern can be found with percent urban; the effect is stronger, but still not pronounced. One variable conspicuous by its absence is the relative price of each tenure form. Constructing such a variable is possible but requires some effort (Malpezzi and Mayo, 1987 b). To a household, the user cost of a rental unit is the periodic rent paid, plus any deposits or key money payments appropriately discounted, plus their own payments to others for housing services (e.g. household maintenance expenditures). User cost for owners is even more complicated, since it must account for financing, depreciation, and inflation. So here is another fruitful area for future research.
IV. RENTAL HOUSING MARKET ISSUES AND CONSTRAINTS

A. Land Markets

Tenure Security

An estimated 20 to 40 percent of all urban households in developing countries are living on land to which neither they nor their landlords have legal title. In many cities the figure is much higher. Squatter settlements are the most conspicuous sign of how land markets work in developing countries, but they do not define what is wrong with those markets.

The market for land in developing countries is often highly unorganized. Information about who owns what is poor; squatter settlements increase uncertainty about property rights; the legal and administrative systems for establishing, recording, and transferring title are inadequate. These failures have serious ramifications, many of which disproportionately affect the poor. Property transactions are slow or stalled, incentives for new construction and upgrading are depressed; lenders are unwilling to extend credit to property holders without clear title; and property taxation is impeded, often with the result that infrastructure investments can neither be made nor maintained because costs are not recovered.

Given the ineffectual and costly nature of squatter removal, governments have increasingly taken a more direct approach to dealing with squatter settlements and to improving the efficiency of urban land markets. They have tried to upgrade rather than remove squatter settlements and slums. Upgrading schemes have generally involved physical improvement of slum areas and increasing security of tenure by mapping, by cadastral registration, and by government's selling land to squatters (often at subsidized prices). The impact of such efforts can be dramatic, prompting large additional spending by the residents. Potential problems include low direct cost recovery (endemic) and possible displacement of some original residents -- especially renters, as rents rise. Tenure security is an issue for all tenure groups.

Several studies have estimated the value of tenure security to renters as well as homeowners. For example, Jimenez (1984) found that in Davao, renters of formal units paid premia averaging 18 percent over otherwise identical informal units (owners paid even higher premia, averaging 58 percent). A similar study found that the average informal rental unit in Manila would rent for 15 percent more if in the formal sector (owner premia averaged 25 percent; see Friedman, Jimenez and Mayo, 1988). Renters, like owners, are willing to pay for secure tenure.

Land Regulation

Land development standards constitute one of the major constraints encountered by developers in responding to the demand for low-cost housing,
rental or owner occupied, in developed\textsuperscript{2/} and developing\textsuperscript{10/} countries alike. Analysis of developing country land use standards using the Bertaud Model shows that some standards and practices verge on the extravagant.

In Malaysia, for example, the area per household provided for roads is up to four times larger than the area for roads in projects in other countries of Asia, Europe and America for a similar range of plot size. Using international practice as a yardstick, it appears that about 25\% of the land developed for residential purpose is wasted. This waste is due in large part to excessive road areas, arbitrary setback regulations, and in lesser part to redundant community facilities. Many other countries -- developing and developed -- have similar regulatory problems.

These kinds of inappropriate standards constitute a problem for all tenure groups; but a reasonable conjecture is that, since areas with large proportions of rental housing are often more dense than areas primarily occupied by owner-occupiers, such standards reduce the supply of and drive up costs for rental units even more than for other units. This could be true even in cases where rental units are primarily "filtered" from what is originally owner-occupied stock.

Another large regulatory cost to developers is the delay imposed by regulatory procedures which tie up capital and increase risk. In the United States, for example, developers often take a year or more to receive planning permissions; in many developing countries they can be at least as long. Zoning -- prohibiting certain land uses altogether in certain areas -- can, when carefully implemented, reduce externalities (i.e. reduce the shifting of costs from the landowner who receives the benefit of use to his or her neighbors); but the evidence is that in many countries zoning is undertaken with little or no attention to the economic costs and benefits, so that zoning yields little benefit in relation to its cost. A fuller discussion can be found in Fischel (1986); a rough and ready measure of the distortion, if any, is when rezoning alone (from, say, agricultural to residential use) increases the value of a parcel by a factor of 5 or 10. This suggests that, on the margin, too little land is being provided for residential uses.

Regulations which impose such costs reduce the supply of land and, consequently, to an escalation of land prices. Lower resulting densities increase the cost per dwelling of providing and maintaining infrastructure. Indirectly, lower densities result in higher transport costs and a reduction in overall urban efficiency. Adjustments in both land-use standards and in engineering practices could significantly reduce costs and increase the supply of low-income housing with little reduction in the benefits to users.

\textsuperscript{2/} Fischel (1986), Mills (1979).
\textsuperscript{10/} Kim (1987); Angel et al. (1986).
B. Infrastructure

The provision of infrastructure and related services--transport, water, sanitation, and so forth--is a traditional public sector activity, and one of particular importance to low-income groups. Directly, households benefit from several types of infrastructure through saving time and money (for example, publicly supplied water rates versus user charges) and through improved living conditions. Often infrastructure investments encourage new construction and upgrading of existing housing, including the provision of more houses to rent. Households also benefit indirectly from infrastructure investments, if these are seen as legitimizing previously illegal or informal settlements (discussed in the previous section).

Government policies on the supply and pricing of urban infrastructure are characterized by various conflicting tendencies. For example, governments have taken the view that (a) water and sanitation (and sometimes other types of infrastructure) are merit goods; (b) infrastructure has significant externalities; (c) low-income households may, out of ignorance, seriously underestimate the benefits of improved water and sanitation; and (d) some of these services involve large economies of scale—that is, they are “natural monopolies” or at least require investments too large for the private sector. These views have led to governments’ taking the leading role in providing urban infrastructure, but often with underinvestment, and prices that are too low to recover costs. The result has been severe rationing and chronic problems in maintaining and expanding the stock of urban infrastructure. Cities are therefore both less efficient and more inequitable than they could be with alternative policies.

Of the possible alternative policies, cost recovery is a high priority. In some cases, better information about people’s willingness to pay for improved water and sanitation could help. Poor households are widely assumed to be unable or unwilling to pay for improved services; often this is not so. For example, many urban households spend significant amounts of time collecting water from standpipes or wells; in cities with water vendors, people often pay high unit prices for water. Understanding the demand for water, sanitation, and other urban services also helps to indicate the correct type of technology. For example, the choice between a communal standpipe system and individual house connections depends on the demand for water and the value people place on the time spent in water collection.

C. Finance

General

Housing -- rental or owner occupied -- is always financed, in the sense that virtually all owners of housing capital must pay for their units over several periods. Even landlords and owner occupants who own their units “free and clear” finance the unit in the sense that holding such a large asset has a financial opportunity cost. But in most countries only a small share of this
potential finance, often one fourth or less of the value of the underlying assets, is in the form of mortgages or other formal sector finance.

Consider the following analogy between financing housing (of whatever tenure), and rental housing. In the former, the process of financial intermediation works as follows. Households and individuals who have a comparative advantage in savings (given their income, current asset position, and stage in the life cycle) deposit funds which the financial system channels to those who in a similar vein can use the funds most productively. This defines the process of intermediation in financial form.

Rental housing can be viewed as intermediation in non-financial form. Those who have a comparative advantage in doing so have deferred some consumption (now and/or in the past) but have chosen a nonfinancial asset, a housing unit. The rental housing market channels those housing services to households who have the greatest demand for such services. All economies have both financial and nonfinancial intermediation; both are inherently efficiency-increasing activities. Just as some financial markets perform better than others, so do some housing markets. In both, the key to improved performance often lies with public policies, especially in the regulatory area.

Consider the average house price to income ratio as a rough and ready indicator of the performance of the housing sector. In countries with less elastic supply for whatever reason, asset prices will be bid up. Let us assert, for the moment, that we observe a wide range of such ratios across countries, much wider than can be explained by underlying differences in housing demand (Malpezzi and Mayo 1987b; Buckley 1989). In particular, they depend partly on the state of capital markets.

Figure 5 shows that the better the housing finance system performs, the lower housing prices relative to incomes. Certainly we don’t argue that housing finance is the sole or even the most important determinant of such differentials,

11/ While these are asset prices, not rents, the link between asset prices and rents is obvious.
based on such simple bivariate correlations. The mechanism by which finance availability affects prices is open to discussion. But the pattern is clear.

Despite these potential benefits, few developing countries have widespread and successful systems of housing finance. Development planners often seem to treat housing more as a consumption good than an investment and fail to recognize either its potential for encouraging savings or the macroeconomic links between it and other sectors of the economy. It is also clear that the development of housing finance institutions is strongly related to the general sophistication of a country's financial system, which in turn is closely related to overall economic development. In addition, recent economic circumstances in many developing countries--rapid inflation, shifting terms of trade, and slow growth--have not been conducive to the development of housing finance institutions. Many have also had inappropriate lending and borrowing policies (often under the direction of governments) and have thus been seriously weakened within the past decade.

The viability of housing finance institutions has often been jeopardized by governments which, in wanting to make housing more "affordable," have sought to keep down interest rates. Particularly during the 1970s, when inflation was rapid in most developing countries, many housing finance institutions lent at negative real rates of interest, which often led to considerable decapitalization by the early 1980s.

Figure 6 shows the simple correlation between house prices and interest rate policy. While heavily regulated rates are often justified on the grounds of affordability, the simple correlation between regulation suggests that artificially low rates may be tied to inelastic supply and higher prices. While such a link remains to be demonstrated conclusively, an inevitable consequence of keeping mortgage rates below market rates is that loans are rationed.

Usually, the rationing benefits those who are perceived to have the lowest risk of default--often, wealthier people or those favored by government policy such as civil servants, many of whom are also relatively well off. Subsidies

12/ The simple bivariate plot doesn't explain any mechanism which might bring this about. In fact, in one simple model, given an otherwise inelastic supply of housing, increases in finance shift the demand curve to the right, and house prices rise. In the long run this ceteris paribus assumption presumably doesn't hold, but explaining Figure 5 more formally remains as an interesting area for future research.

13/ Especially since only one developing country, Thailand, rates a "1" on Agarwala's interest rate index and has corresponding house price data.
to better-off households are not only unfair; they are also an inefficient way of achieving whatever housing goals they are believed to serve. Lump-sum subsidies—in the form of writing down the cost of land or materials—could achieve the same production goals with far fewer distortions in resource allocation and far less harm to the viability of housing finance institutions.

Financial Issues Specific to Rental

Perhaps the overriding financial issue specific to rental is an obvious one. In many countries, formal housing finance is available only to owner occupied housing, de facto if not de jure. In particular, inability to refinance existing units may adversely affect rental markets.

Legislating equal lending terms for owner occupied and rental housing would be a mistake. The risks involved in these two kinds of units are often quite different. Yet both are ultimately underwritten by one of the safest assets in any economy, at least in legal systems where the unit is effective collateral, i.e. where foreclosure is one of the "rules of the game." While lenders should be free to price different risks appropriately, the regulatory framework should be studied to determine that intended or unintended discrimination purely on the basis of tenure is avoided. The simplest cases are those in which government policies effectively preclude the development of private mortgage markets14/ and the official programs consist entirely or mainly of lending for owner occupation. Others are more subtle, for example non-financial regulations such as rent controls or limitations on tenure conversions which raise financial risks.

D. The Regulatory Framework

It should be obvious by now that we believe changes in regulation are often among the most pressing areas for reform. Regulatory reform can play a key role in the three areas just discussed, i.e., increasing the supply of finance, infrastructure, and developable land. Zoning, taxes, rent controls, and building standards are other obvious regulatory areas to study for possible change. Governments must carefully weigh the costs and benefits, and the distributional consequences, of regulation. But some regulation is required to set the "rules of the game." Regulation should strive for a "level playing field" in so far as is practical, between housing and non-housing investments, and between rental and owner occupied housing.

There are so many regulations, and other taxes and subsidies which affect the incentives faced by housing market participants, on both the supply and demand side. And there are so many differences in these incentives, between owner occupied and rental units, between units in programs and in private markets, between formal and informal markets. We need a simple tool to enable us to make comparisons in incentives, to find out the slope of the playing field.

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14/ Either by outright prohibition or taxation, or by setting up public agencies which (often unintentionally) inhibit private lending.
Subsidies, Taxes, Regulation, and Other Interventions: A Simple Model

Government subsidizes, regulates, taxes and otherwise intervenes in housing markets for a variety of purposes. Each policy intervention can be analyzed in turn by examining how the interventions change prices and corresponding present values. Present values have the advantage of enabling direct comparisons of the costs and benefits of quite different interventions in different programs. In particular, for our purposes, they permit comparisons between owner occupied and rental units, and between public and private units. Some interventions impose costs on market participants (e.g., land use regulations, taxes, rent controls, building regulations) and some provide benefits (e.g., land subsidies, tax relief, financial subsidies). Some interventions confer corresponding costs and benefits on different market participants; for example, rent controls benefit some tenants at the expense of landlords (and perhaps some other tenants). Other interventions confer costs and/or benefits on some participants without an obvious corresponding gain or loss elsewhere. For example, some very high infrastructure standards can confer large costs on developers (and eventually homeowners and tenants) without producing much in the way of benefit for anybody.

While there is nothing technically difficult about doing so, hardly ever are the effects of all the numerous taxes, regulations and subsidies added up. In the U.S. the “user cost” literature takes this approach, usually focusing on the interaction between taxes, inflation, and finance.\(^{15}\) In a number of developing countries we are beginning to adopt a variant of the same approach.\(^{16}\)

In this framework, there are three entities from whose point of view housing policies and programs are evaluated: the economy, housing suppliers (landlords and developers), and households. The same present value method can be used to evaluate public housing programs or to analyze incentives in the private housing market. The model permits comparisons of the profitability of various types of housing (high versus low-cost, owner-occupied versus rental, one location versus another). Present value analysis provides a convenient summary of the economic return to housing investment of various types, and also permits analysis of how government actions such as land-use regulation, financing policy, infrastructure provision, taxation, price controls and other regulations, affect incentives to investors.

Regulations are not good or bad per se; the way to approach any specific regulation is to ask what are the benefits relative to the cost. Exemption from

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15/ As it happens, there is a large literature on the user cost of homeownership, but a much smaller literature comparing rental housing to owner occupation or to other investments. DeLeeuw and Ozanne (1981) and Breuggeman (1985) are among the latter.

16/ Hannah et al. (1989) and Malpezzi (1989) illustrate with the case of Malaysia. Unfortunately for our present focus, only one of 14 cases studied was rental, and it was not discussed in much detail. But Malpezzi (1989) does lay out how analysis of rental units should proceed. See also Chapter 6 of Malpezzi, Tipple and Willis, which presents a related rental model.
a regulation which has an identifiable benefit to society similar to its cost is a subsidy to the exempted at the expense of others. It is reduction in regulations which do not yield corresponding benefits which are pure cost reductions. In other words there is a baseline of "normal" desirable regulation from which extra regulatory costs are measured. In a world where regulation seems to have fallen out of favor (at least with analysts if not with regulators), there are still cries for more regulation in some areas, especially the environment. Is this just an inconsistency arising from the clash of two policy "fads," or is there some lesson to be learned for both regulatory and environmental policy?

Despite their best intentions, most governments, developed and developing, do have systematic tendencies to overregulate. Why do regulations so often offend both efficiency and equity? The tendency to overregulate can be explained by (1) the failure to consider costs and benefits, from which follows (2) every interested party adds his own small regulation which are never considered together (the adding up problem), (3) some overregulation results from a breakdown in exchange between regulators and the regulated, and (4) regulations are an opportunity for rent seeking behavior by vested interests. Given such overregulation, understanding the reduction in efficiency is easy: regulations that so arise impose larger transactions costs than benefits. Inequities also follow: the poor are not usually particularly good at rent seeking behavior, and since regulations raise costs and restrict supply, it's the poor that are often rationed out first. Regulations on lot size, for example, aren't directly binding on the rich.

Other areas are clearly underregulated. The environment is one area in which a consensus is building that more needs to be done. What we've argued above is that our path is clear for all regulation: do the cost-benefit of specific regulations; eliminate or modify regulations whose benefits exceed costs; keep or enact or enforce the ones which make the grade. Get the regulations right. The superficial inconsistency of arguing for tighter environmental regulations disappears in this framework; even more importantly, we have at least in principle a tool to discriminate between important and frivolous environmental issues, and policies.

Some Common Regulations Impeding Rental Housing

Let us bring the section to a close by enumerating some of the specific regulations which have been found to be problematic. In the regulatory arena as elsewhere, rental housing faces at least the same problems as housing generally. Regulatory constraints specific to rental include those which limit access to finance for rental housing. Restrictions on financing sales of existing stock, upgrading and conversion affect rental as much or more as owner occupied housing.

17/ See Blinder (1987), Chapter 4.
Particular attention should also be paid to building codes, land use standards, and other regulations which discriminate against low cost rental housing. For example, regulations in many countries restrict compound or multifamily housing; and these are often primarily rental. Where appropriate, land use regulations should be modified to permit construction of such units in urban areas. Building in indigenous materials should be permitted, subject to proper construction techniques.

Programs to expand the supply of serviced land also often discriminate --- intentionally or not --- against rental. Land development schemes, public or private, should not discriminate against rental in provision of serviced land. Don’t require owner occupancy for access to land in any program designed to improve land availability (including sites and services).

One class of public intervention which have been the subject of a great deal of cost-benefit analysis are controls on rents. Another class of equal interest is taxation. Since there is so much we can say about them, they rate their own sections.

E. Rent Controls

A majority of countries have some form of price control on some or all of their rental housing stock. In many countries rent control is among the most visible and contentious housing policy issues. Unlike many housing programs, rent control has very small on-budget costs. This makes it initially attractive to policy makers faced with budget constraints. The off-budget costs are usually unknown, and are perceived to be born by a small and well-off group. Research has shown that in fact these costs can be large and difficult to control, and that the incidence of the costs can be quite arbitrary and regressive. Controls can also have important negative collateral effects on, for example, property tax revenues, labor mobility, and employment.

Rent control is usually thought of as a policy applied to private markets, but publicly provided housing is also subject to controls, and to some of the attendant problems like reduced revenue and maintenance. For example, most urban housing in China is owned by the state or state enterprises. Rents are typically 5 yuan per month or less (less than U.S.$2). As a consequence, housing subsidies are about 25 percent of the state budget. Many units are undermaintained because of lack of financing.18/ Severely controlled prices can cause problems for public as well as private housing.

Rent control can be analyzed as an implicit tax on housing capital. In the simplest case, where imposition of controls reduces the price of an existing stock of rental housing, the tax is borne by landlords for the benefit of tenants. Over time, as the market adjusts to controls, the incidence of the "tax" becomes more complicated.

18/ Zhang (1986).
Rent Controls in Kumasi, Ghana

The last twenty-five years have seen Ghana decline from one of the richest countries in Sub-Saharan Africa to one in which the infrastructure and capital stock, including housing, are in very poor condition. During the period 1965 to 1986, real per capita gross national product (GNP) declined at an average annual rate of 1.7 percent per year.

Forty years of rent control have been successful in keeping rents in Kumasi very low; on average, rents are less than 2 percent of total consumption. There can be few households in Kumasi who cannot afford the monthly rent of a room. But housing conditions in Kumasi are bad, even given low incomes. Controls are not the only reason, but they contribute. And recently more and more households are paying large advances, causing particular difficulty given the difficulty in financing large lump sum payments for most Ghanaians.

Using a model which permits comparison of controlled units at controlled prices (PcQc); controlled units at estimated market prices (PmQc); and estimated market demand at market prices (PmQm) Malpezzi, Tipple and Willis (1989) find:

- Renters pay a fraction of the estimated market rents for their units -- roughly half, on average.
- But household would spend even more than the estimated market price of housing in the absence of controls -- about 3 to 4 times their 1986 expenditure. That is, consumption of housing services has been greatly reduced under controls.
- The ratio of benefits to costs is low. Under the most “favorable” assumption in terms of controls’ efficiency, tenants receive net benefits which are less than half the static cost to landlords. If the price elasticity is on the order of -0.5, net benefits to most tenants is negative; both landlords and (most) tenants are made worse off by controls.
- Landlords differ little from renters except in the amount of housing they are able to consume. Their median incomes are about 1/3 higher, but there is significant overlap: about 1/4 of landlords have incomes above the tenant median; about 3/4 of tenants have incomes above the landlord median.

The bottom line, then, is that rent control reduces the rents households pay, but the benefit of this rent reduction is more or less offset by the welfare loss from underconsumption of housing.

Rent control is not the only problem in Kumasi’s rental or housing market generally. Other problems -- in land, infrastructure, finance, materials -- adversely affect the market, and drive costs up. They drive costs up higher for the poor than for others. Relaxation of rent control is necessary but not sufficient for expanding the supply of rental housing. Relaxation/decontrol must be accompanied by measures to ensure a rapid supply response to the demand for rental housing, or else rapidly rising rents could squeeze existing tenants and jeopardize decontrol. Political consensus is, after all, required for successful change.

Alternatives for decontrol exist. Malpezzi, Tipple and Willis discuss a number of alternatives, including decontrolling new construction, indexing rents for existing units to general prices, and letting real rents for existing units rise gradually. But whatever option is chosen, actions must be taken to ensure elasticity of housing supply so that increases in rents are accompanied by an increase in production. This requires that rent control is seen as one part of a housing strategy which reduces supply side constraints, including land, infrastructure, materials, and finance; so that changes in controls result in increased housing consumption rather than through greatly increased prices.

There are many different kinds of rent control regimes. For example, one key feature is whether controlled rents are adjusted for changes in costs (with cost pass-through provisions or adjustments for inflation); how close the adjustment is to changes in market conditions; how it is applied to different classes of units; or whether rents are effectively frozen over time. Other key provisions which vary from place to place include breadth of coverage, how initial rent levels are set, treatment of new construction, whether rents are reset for new tenants, and tenure security provisions. Rent control’s effects
can vary markedly depending on these specifics, and on market conditions, as well as enforcement practices.\textsuperscript{12/}

Although it is commonly accepted that rent control can reduce the efficiency of the rental market, the magnitude of such effects is debated, and proponents of controls usually justify them as a redistributive policy. The three key questions are: what are the efficiency losses from controls? (What are the off-budget costs?) Do they redistribute income as intended? (Analyze the incidence of the "tax"). Are the benefits to some tenants worth the costs?

Studies which calculate the static cost born by owners of existing rental units show that the reductions from market rent can be substantial, but that tenants, in general, value the implicit subsidy of controls less than it costs. In Cairo, Egypt, monthly rents for a typical unit are less than 40 percent of estimated market rents. Key money and other side payments make up about a third of the difference (but mostly for newer units). Benefits to tenants are further reduced because they are not free to choose a unit of appropriate size and location (Malpezzi 1986). In Bangalore, India, controls reduced median rents by about 30 percent, according to a 1974 survey; this rent reduction has certainly increased, since overall prices have more than doubled since 1974, while rents have lagged behind. Further, statistical evidence suggests that much of the benefit of reduced rents is eroded by reduced housing consumption (Malpezzi and Tewari, forthcoming). In Amman, Jordan, the static cost of controls is about 30 percent of estimated market rent; the benefit to the typical tenant is only 65 percent of cost (Struyk, 1988).

These aggregate statistics mask large variations in costs and benefits to individual tenants. Often long term tenants of older buildings receive lower rents at landlords' expense, while recent movers pay large amounts of illegal key money, if they can find a unit at all. Rent control is a very inefficient transfer mechanism.

Rent control can also imposes dynamic costs. Controls can reduce dwelling maintenance, reduce the useful life of dwellings, and inhibit new construction. Controls provide strong incentives to convert rental units to other uses. These market responses shift the incidence of rent control's costs forward to tenants, over time. It is theoretically possible to design a rent control regime which does not discourage maintenance and starts with a pricing scheme which rewards maintenance and new construction (Olsen 1988). In practice, revaluation and maintenance inspections are expensive and difficult to organize; and new construction can still be adversely affected by the expectation of future controls.

These dynamic effects also vary by type of regime, and can be quite surprising. In Cairo, key money payments and the lack of alternative investment opportunities for remittances from abroad have combined to keep new construction afloat, while reducing maintenance. Scarce housing capital is wasted by rapid building, holding units vacant in anticipation of large key money, and allowing them to deteriorate rapidly once occupied. In Kumasi, Ghana, on the other hand,

\textsuperscript{12/} Malpezzi and Rydell (1986).
controls have helped eliminate landlord profits. Rents for rooms in compound houses are held to 300 cedis per room, about the price of a loaf of bread. But at least around 1986, this contributed to a slowdown rather than the nearly complete shutdown which might be expected. In a recent sample of 279 houses, only 3 new structures were built in the last 5 years; but proportionately more rental rooms were added. Malpezzi, Tipple and Willis (1989) demonstrate that in the disrupted economic environment of the late 70s and early 80s capital preservation -- a rate of real return less negative than the return to other assets -- provided some incentive for investment.

Some tenants are, on balance, worse off under controls because of constraints on housing consumption. And in markets with significant uncontrolled sectors, rent controls can drive up the price of uncontrolled housing, an important unintended consequence further complicating the incidence of its costs.

In addition, the benefits are very poorly and in some cases perversely targeted. Analysis of individual costs and benefits in the markets mentioned above shows no consistent redistributive effect. Typical landlords are better off than typical tenants, but the differences are not great; there are many well off tenants benefitting from controls and many landlords with modest incomes. In Bangalore, about 10 percent of tenants are also landlords; and as a class, they are as well off as owning landlords. In general, even when the cost of controls has not yet largely shifted to tenants, it is not clear why it is desirable to tax such a narrow base as landlords. Even in a market with a high rate of rental accommodation, rental housing is typically less than 40 percent of fixed capital formation. This is a large percentage, but the effect of controls will inevitably be to distort investment decisions towards uncontrolled capital, often including luxury accommodation.

While enforced rent control's effects are never negligible, in many markets efficiency losses from other market imperfections are at least as great. Land markets, financial markets, and infrastructure are examples of input markets which may not function well, and inhibit the supply of rental (and other) housing. Successful decontrol requires attention to these supply side constraints.

Alternative methods of decontrol exist, and vary in their effects (Arnott 1981; Rydell et al. 1981). The simplest method, blanket lifting of controls, works best when the housing market is responsive (i.e. when housing production and housing input markets are free from major distortions). When market conditions are not favorable, gradual methods of decontrol can be coupled with direct attacks on collateral housing market problems, e.g. reform of the housing finance system. Examples of specific methods include indexing rents at or above the rate of inflation for a specified time before lifting controls; decontrolling specific segments of the market first; and revaluing for new tenants. A successful decontrol strategy must minimize the costs of adjustment to ensure political feasibility and sustainability; must be transparent and credible to potential investors; and must attack collateral problems in housing markets which could impede the supply response.
Decontrol Options

There are a number of options which could be considered for removing or relaxing controls. Arnott has provided a taxonomy of the main options:

- **Blanket lifting:** all rent controls are completely removed as of a certain date. This is the simplest method, but is very difficult politically, and may lead to short run dislocations.

- **Decontrol new construction:** an obvious option which is being undertaken in India, Brazil and a number of other markets. But new construction can still be inhibited unless government credibly guarantees units will not come under controls later.

- **Rents could also be immediately decontrolled for units which are meet certain standards, either now or after upgrading (e.g. for units which provide acceptable water supply and sanitation). Standards would have to be carefully chosen, however, to meet requirements without imposing unecessary costs.**

- **Floating up and out:** controls are gradually relaxed, for example rent rises are some multiple of CPI or wage index changes, until controls are no longer binding on most units. Then controls can be abolished. This method can permit a smoother adjustment if potential landlords view the gradual program as credible.

- **Vacancy decontrol:** Units are decontrolled as they become vacant. This method has been tried in some North American markets, but may keep mobility down, with possible adverse effects on housing and labor markets.

- **Vacancy rate decontrol:** particular markets are decontrolled as the vacancy rate rises above some threshold. But while controls (and other problems) remain, vacancy rates will probably remain extremely low. How can vacancy rates increase while controls remain?

- **Rent level decontrol:** decontrol by market segment. Rents could be decontrolled from the top down (the current system, with a threshold of 1,000 cedis, embodies this to a limited extent). But such a system can provide perverse incentives to raise rents above long run equilibrium levels in order to escape controls.

- **Contracting out:** landlord and tenant negotiate a payment to the tenant in return for his giving up the right to controls.

Of course these options are not all mutually exclusive. In many respects floating up and out often has some a priori appeal, because the market may take time to respond, particularly if other problems in input markets, etc. are severe. Blanket lifting carries the danger of a sharp short run rise in rents which would be reduced over time. Present value models provide a simple way to study these alternatives (Malpezzi, Tipple and Willis 1989); more complicated models of market wide effects can also be constructed (Arnott 1981; Rydell et al. 1981)
F. Taxation and Housing

While tax issues may be second order in some countries, especially the poorest, the topic may be particularly relevant in others. Tax incentives can be potent in changing behavior, but can lead to large revenue losses, which rarely if ever appear "on the books." Caps on deductions (such as those currently in place for mortgage interest deduction in the United Kingdom) may mitigate some of the worst effects. In countries with graduated tax schedules credits may be preferable to deductions on equity grounds; alternatively deductions may be limited to the basic (lowest) tax rate in a progressive tax system.

How Should Housing be Taxed?

How should the return on any productive asset be taxed? A view commonly held by economists is that if income is adopted as the basis of taxation,\textsuperscript{20} real income from whatever source derived should be subject to tax, but that income should be measured net of the costs of producing it. Both recurrent income (from wages and capital) and capital gains would be subject to tax, but only real capital gains would be taxed.

For rental housing, this suggests that rental income be taxed as ordinary income, as well as real capital gains. Offsetting deductions would be permitted landlords for the costs of doing business, including maintenance and repair, interest payments, property taxes, and net economic depreciation of the unit. "Extra" taxes, including implicit taxes such as rent control, are to be avoided.\textsuperscript{21}

These same principles suggest that, in the case of owner occupied housing, current costs (including interest payments, maintenance and repairs, net depreciation, and property taxes and rates) would be deducted from taxable income. Imputed rent would be taxed, that is the rent that the unit would command in the market; and the real portion of capital gains would be taxed. Taxation of rental units would be similar.

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\textsuperscript{20} Whether income or consumption is the most appropriate basis for taxation is widely discussed in the literature. See Congressional Budget Office (1980) and Hulten (1981). Note that most proponents of consumption taxation would also agree with the principles laid out here given that the decision had been made to adopt income as the basis of taxation.

\textsuperscript{21} For brevity these few paragraphs do not discuss all possible taxes, such as registration taxes or development period taxes, or all costs, or all possible tax subsides (e.g. investment tax credits). The intention is to illustrate broad principles and motivate more detailed studies. These can be carried out with present value models (DeLeeuw and Ozanne, 1981; Brueggeman, 1985; Malpezzi, 1989).
Taxation of owner occupants' imputed rental income is not very popular,\(^{22}\) and virtually all countries allow most households to defer if not escape capital gains taxation. A second best set of principles is, if imputed rents and capital gains are not taxed, do not permit the deduction of costs. Consider a country like the United States, where tax administration is fairly effective, and (since 1986) the taxation of rental housing is roughly in line with the principles enunciated above.\(^{22}\) U.S. owner occupants do not pay tax on imputed income, and generally do not pay taxes on capital gains.\(^{24}\) Unlike owners of rental housing capital, they are not permitted to deduct maintenance and repair expenditures, nor do they receive a depreciation allowance, but they are permitted to deduct mortgage interest payments and property taxes. The net effect, which can be demonstrated with the present value model described above, is to raise the after tax cost of rental housing capital relative to owner occupied.

\(^{22}\) To be more precise, taxation of income from housing capital is rarely integrated into central government income taxation. The fact that property is widely taxed by local governments suggests that the administrative difficulties in taxing income from capital may be overstated.

\(^{23}\) Except that capital gains are currently taxed at nominal rather than real rates, which leads to excess taxation which rises with inflation. Indexing capital gains is part of several tax proposals currently before the American legislature.

\(^{24}\) Although complying with the rules which cancel capital gains liability can impose indirect costs on homeowners.
V. PUBLIC PROVISION OF RENTAL HOUSING

A. Share of Public Housing in Developing Countries

Developing countries, as well as developed countries, differ widely in the share and nature of publicly provided and assisted rental housing. Of course, as noted above virtually all housing of whatever tenure receives some government assistance in some form (and virtually all is taxed in some way as well), so "publicly assisted" is surprisingly arbitrary and difficult to define rigorously. Publicly provided usually means that governments or local authorities own and manage rental units, but even here there are gray areas; some nonprofit housing authorities don't fit unambiguously into either public or private definitions; in socialist countries, where does rental housing provided by state enterprises fit in? And partly because of such definitional problems, a consistent data series for cross country comparisons is surprisingly difficult to construct.

Within market or mixed economies, most countries' public rental housing or council housing stock is a small percent of the total (5 percent or less); significant exceptions include the Netherlands (9 percent); the U.K. (29 percent); and Hong Kong (40 percent). Many centrally planned economies have much greater shares of their housing stock as public rental; for example China's urban housing stock is well over 80 percent public or enterprise rental.

Even in those countries where public and council housing is not a large share of total housing, the asset value of such housing can be significant, because housing's asset value is large due to its long life, and because a disproportionate number of these units are built on expensive urban land. For example, according to unpublished World Bank estimates some 15,000 public housing units in Ghana have an asset value of about 2 percent of GNP; yet most are barely maintained and the rents collected are so low that the government corporations which own the housing are technically insolvent. Privatization as a solution to such problems is discussed below; first a discussion of the relative efficiency of the public and private rental markets is in order.

B. Efficiency of Public Housing

Mayo (1983) makes an important distinction between production efficiency and consumption efficiency. Production efficiency refers to the economic value of the unit in relation to the cost of producing it. Consumption efficiency refers to the value the tenant places on the unit in relation to its market value. The concepts are equally applicable to rental programs and other programs.

Sources of potential production inefficiency in public housing include: inappropriate location, high wages, using the wrong factor proportions, high administrative costs, off budget costs of financing, tax breaks, higher maintenance costs, and absence of market discipline (i.e. private developers will go broke if they consistently build units worth less than their cost; public developers may not, or at least going broke may be deferred). Production
inefficiency would not exist if public developer/landlords were as efficient as private. It should be emphasized that the notion relies on the market prices of inputs and outputs (or shadow prices if these are distorted). There may well be cases where hidden subsidies (in finance, for example) or hidden costs (for administration, for example) make careful analysis necessary to reveal true relative efficiencies. A priori there is no obvious reason why public sector landlords might have true comparative advantages over private ones; there are not generally great economies of scale, and most private rental markets have many participants and reasonably open entry and exit. If the private rental market cannot meet demand because of (e.g.) problems in land or financial markets, or an inappropriate regulatory framework, we have already argued that these problems should be attacked directly.

Consumption inefficiency implies that the tenants value the housing less than the market, or that their consumption is constrained by the requirements of the program. This is a particular problem with public rental, since typically the product is very standardized while demand is not. Cash is, of course, the most efficient transfer in the sense that if the market works at all well most households would prefer the cash equivalent of a program to the program itself. A priori we might expect policies and programs which rely on private landlords to provide a wider range of options and to reduce consumption inefficiency.

Empirical evidence suggests that public housing is rarely a very efficient way to increase housing consumption or welfare. In the most complete study to date Mayo (1983) reported that the consumption efficiency of U.S. public housing is about 86 percent (ratio of benefits to costs), and its production efficiency is only 43 percent (ratio of value to costs). Another study by Olsen and Barton (1983) that took a more narrow view of production efficiency reported that U.S. public housing costs 14 percent more than it was worth. Agrawal (1988) reports that for the 300,000 public housing units in Australia the mean consumption efficiency is .75 to .68. Piggott (1984) and De Borger (1985) found broadly similar results for the U.K. and Belgium, respectively.

There have been a few studies which present quantitative estimates of the welfare effects of public housing in lower income countries. Ondiege (1986) analyzed Nairobi public housing and found that the consumption inefficiency was fairly small - only about 3 percent. However, this was apparently because larger benefits accrue to richer households, raising questions about the equity basis of this program.

Daniel (1983) studied the effect of public housing on the distribution of income from Hungary. She found that the ratio of highest to lowest income deciles was 1 to 6; for housing consumption, 1 to 12; and for housing expenses per head, 1 to 23. Rents for flats are about 40 percent of maintenance costs, and about 15-20 percent of full cost (maintenance, depreciation, and a small profit to finance expansion). The average subsidy is 15% of income (only 10% in lowest decile). She examines the effect on income distribution and finds "the rented flat as an allowance in kind does not reduce vertical inequality in society, as it should under the declared intentions, on the contrary it augments it." (Emphasis in the original). Her findings suggested horizontal equity is also violated.
Yu and Li (1985) study Hong Kong's public units, which house 40 percent of its population. In 1980, the rent charged for public units was $10 per sq meter; the market rent for comparable units was $56 per sq meter. Consumption efficiency is .75.

None of the studies for lower income countries address production inefficiencies.

A related issue which has not received the attention it deserves is the extent to which public housing expenditure -- for owner occupied or rental units -- simply crowds out private. For example Murray (1983) found that for every hundred public rental housing units built in the United States during the seventies private construction was reduced by about 85 units. Further, Mayo et al. (1980) demonstrated that such public units cost about twice as much to build as they were worth (i.e. twice as much as private units, which on the margin are worth roughly what they cost). New construction programs which subsidize the construction of new privately managed units (largely though not entirely for the elderly) are also quite expensive (Malpezzi and Ozanne 1980). In the developed as well as developing countries it seems clear that publicly built housing or subsidized new construction has not given good value for money. But often the largest and most problematic expenditures never appear on the budget.

Off Budget Expenditures

While currently much discussed in developed countries, off budget expenditures are also often a problem in developing countries. In developed countries tax expenditures receive much of the attention. In developing countries there are often large implicit subsidies in the provision of land for shelter projects, although these are somewhat self limiting, as large implicit subsidies limit their scale. Housing finance subsidies are often "off the books;" Buckley and Mayo (1989) discuss the example of Argentina. Little data exist as yet on the size of off-budget expenditures for public rental housing.

C. Privatization of Public Housing

No current treatment of rental housing policies is complete without some discussion of the privatization of public rental housing. Britain has done it (although only for a small fraction of the stock) and many countries are considering it (developed as well as developing).

A wide range of traditional municipal services have been privatized by some municipalities. In many cases, private provision of these services has gone on unheralded for some time before the recent general popularity of the idea. Examples of services include water; sanitation; public housing; solid waste collection; electricity/energy; police, fire, and other public safety functions; education; (which is not a municipal service in most LDCs); transport; some personnel and administrative functions, e.g. pensions. Details and examples can be found in Roth (1987), among others. But clearly the service most relevant to this paper is public or council rental housing.
Three kinds of issues have been relatively neglected in the now vast literature on privatization, which tends to be heavy on ideology and light on analysis. First, when should services be privatized, or, more precisely, what criteria should govern a change in the manner of provision? Second, what concomitant regulatory changes are required for the new delivery system? Third, how can the privatization or other change be implemented? We will illustrate the issues and an approach using the example of publicly provided housing.

**Decision Rules: When to Privatize. Not**

It is not generally understood that in most cases the choice of public or private provision of a service can be separated from the "publicness" or social nature of that good or service. Public regulation of the private sector can in principle handle externalities, monopoly power, and "market failures" of various kinds as well or better than public provision. Even strictly public goods like defence are at least partly privately provided in mixed economies.

The criterion for efficient provision of a good or service is the present value of the cost of providing the optimal level of services publicly vs. the present value of the costs of doing so privately. Note that here costs are broadly defined to include the costs of regulation or incentives when required to ensure optimal output and pricing if unregulated private markets would fail for any of the reasons described above. Social goods can be privatized and regulated. Regulation can ensure or even improve equity; in many cases the public sector has not met expectations about serving the poor.

Consider the following simple example, of privatizing publicly owned housing. Consider a scheme which offers tenants a choice of purchasing their unit or remaining in the public system. In the simplest case the tenant will compare the sales price of the unit to the present value of expected future rents.

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25/ We discount the large recent literature that says everything with the possible exception of national defence should be privatized, just as we discount the large older literature that says government can do pretty much anything it sets out to do.

26/ Economists usually define a public good as having the following characteristic. A person who decides not to pay for the good cannot be excluded at reasonable cost. It follows that there are few truly public goods, as economists define them. National defence is commonly accepted as a public good. Many goods which are considered "public" in common expression economists classify as private goods with externalities (housing), monopoly (utilities), or market failure (excessive pollution). For lack of a better term I often refer to these latter cases as "social" goods.

27/ Abstracting from differences in individual and collective maintenance, availability of finance, etc.
Assuming that the public authority would provide maintenance over the life of the unit that would cost the tenant $C_t$ in each period, the tenant compares:

$$ SP + \sum C_t/(1+r)^t \ (\leq,\geq) \sum R_t/(1+r)^t $$

where $SP$ is sales price, $R_t$ is the expected rent at each time $t$, and $r$ is the rate of discount. The local authority compares the selling price to its net income:

$$ SP \ (\leq,\geq) \sum (R_t-C_t)/(1+r)^t $$

where $C_t$, the expected maintenance cost at time $t$, is for the moment assumed to be the same for public authority and tenant. Note that the original cost of the unit does not enter because it's a sunk cost.

Logically there are four possible outcomes: (1) the public authority wants to sell and the tenant wants to buy; (2) the public authority wants to hold the unit and the tenant wants to remain a renter; (3) the authority wants to hold the unit but the tenant wants to buy; (4) the authority wants to sell but the tenant does not want to buy.

Cases 1 and 2 are straightforward. In case 3 there is a conflict -- but not under the "right to buy." In case 4 there is another conflict which can be resolved with an appropriate price discount, up to the level where it's still cost effective for the authority to sell.

What are the likely outcomes? In many of our borrowing countries rents don't even cover variable costs, so local authorities should want to sell. But rents which are so low are also an inducement for tenants to remain tenants. If the authority, strapped for cash, cuts back on maintenance, tenants may opt for purchase anyway. A present value model can be built for analysis of such programs, and modified as required to include differences in maintenance behavior, transactions cost, financing, affordability constraints, capital gains, and resale restrictions.

Some authorities will have units which fall into each of the four decision categories, requiring different discounts, etc. With such a model many different examples illustrative of all important categories and permutations can be studied. In the British context, for example, such a model could be used to analyze why some 20 percent of the public housing stock has been sold off relatively easily but why much of the remainder is proving difficult to sell.

How to Privatize

Some basic questions should be asked when considering proposals for privatization in developing countries. What are the criteria to decide which units should be privatized? A reasonable conjecture is that by the simple present value criterion selling it off is much cheaper for most public housing. Analysis of representative units could be followed up with projections of the institution's balance sheet under different privatization scenarios.
When privatizing natural monopolies, or firms which face decreasing returns to scale (such as water authorities), regulation of the resulting private monopoly becomes an issue. Housing is not such an industry. But inappropriate existing regulations could throw up roadblocks to privatization.28/

Should units be auctioned? If so should tenants be given right of first refusal? While efficient, open auctions are probably politically infeasible. How then will units be appraised and priced? What discounts (if any) will be offered to sitting tenants?

Avoid restrictions on resale. They reduce labor mobility, among other problems. Should the privatization be based on the right of the tenant to buy or right of the agency to sell? In the former case, initiative rests with the tenant; in the latter, with the authority. In cases where tenants don’t want to buy should units be sold to non-tenants? Will evictions be necessary/feasible? How will households finance their purchases? Any discount should be taken up front, rather than in finance, to protect from large contingent liabilities. Where units share common land, hallways, etc., how will property rights and maintenance be dealt with? Is some form of condominium ownership required? Will enabling legislation be required? In cases where the public housing authority maintained infrastructure, who will take this over? How will asset sales be treated on the budget?

Based on the British experience, if privatization is based on right to buy the worst of the stock may remain in public hands. The 70 percent of the stock which remains public probably always caused 99 percent of the problems. Privatization is an option (rather, a range of options) with a lot of potential; but it’s not always simple and it’s not a panacea.

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28/ For example controls on private rents will discourage investors who are not owner occupiers. Financial regulations which make it difficult to finance the purchase of existing housing discourage all investors.
VI. RENTAL HOUSING: ROLE OF THE WORLD BANK AND OTHER DEVELOPMENT INSTITUTIONS

Housing investment is the largest single form of fixed capital investment in most economies, developing or developed. In developing countries, the shelter sector usually ranges from 10 to 30 percent of household expenditure, or 6 to 20 percent of GNP. Housing investment typically comprises from 10 to 50 percent of gross fixed capital formation. Further, housing investment’s share of GDP rises as economies develop. Other than human capital, housing and land is that with the widest ownership. As countries develop, investment in housing and its associated infrastructure is very large relative to investment in plant and equipment.

The World Bank’s interest in housing should therefore be no surprise. But development comprises much more than just efficiency and growth in GNP. The Bank’s original motivation for financing our borrower’s urban projects was concern with poverty. Shelter and its associated infrastructure is one of those areas, like education, which cut across concerns for both equity and efficiency. The Bank’s involvement on the lending side began in 1972 with urban loans to Senegal and Turkey, with loans to Malaysia, Botswana, India, Iran, Tunisia and Jamaica following within a few years.


The Bank’s urban lending portfolio is diverse. Urban projects have included transport, municipal finance, small scale enterprise, and emergency reconstruction. Some projects have focused on improving (public sector) municipal management. Some integrated projects are so complex that it’s hard for an outsider to see what they are focusing on at all. But the majority of lending operations focus on shelter -- “sites and services,” which started out as core housing which could be progressively developed but has evolved into low cost land development, and upgrading of existing settlements.29/ Housing finance lending started as a component of sites and services -- small materials loans to encourage progressive development -- but evolved into Bank analysis and support of larger housing finance institutions, with an emphasis on financial development per se as well as housing.30/ Since the Bank’s reorganization two years ago urban shelter lending has been integrated with water, sanitation, and transport, at least from an organizational point of view.

Much Bank lending in other sectors is urban in character -- particularly industry and energy, but it’s not stretching a point too far to note that almost every area the Bank is involved in, including agriculture, ultimately has profound implications for urban development and, to some extent, housing.


30/ See Buckley et al. (1988).
B. Recent Trends

While the Bank lends large sums of money for urban projects -- some U.S.$2 billion in the last completed fiscal year -- this is a tiny share of investments in the sector. In most countries World Bank finance -- and the government's, for that matter -- is less important than that of private investors. But government sets the rules of the game for those investors. Hence, we should always be more concerned with policies than with resource transfers per se.

Recall that early urban shelter projects were part of the shift away from public and council housing as a number of developing countries tried to reach downmarket and improve housing conditions for larger numbers of lower income households. Given this point of entry for urban shelter projects, the Bank only gradually began to focus on the underlying productivity of housing investment, and to focus on the entire market rather than narrow segments affected by specific projects. For one of the first lessons of Bank involvement in the sector was that if the housing delivery system doesn't produce for the top and middle of the markets, government programs will never successfully target the poor. The need to concern ourselves with the entire market underlines the increasing emphasis on policy reform. Policy reform is not a zero sum game between the poor and the rest of society.

Both owner occupied and rental housing can benefit from the emphasis on policy reform. It is worth noting that policy based lending is often discussed in the context of sector loans and other non-traditional "non-project loans, but the best projects focus clearly on policy issues as well.

While rental issues were not ignored in early Bank-financed urban projects, there was definitely an emphasis of sites and services projects which inevitably led to a focus on low-cost homeownership. As we have seen, a balanced, tenure-neutral approach needs to be taken to the market; and from time to time rental issues reemerged in the Bank (Urban Edge, 1984). Neatly for our present purpose, the increasing emphasis on policies makes it possible to better deal with rental issues in Bank lending operations, for few countries would want to borrow for bricks and mortar public rental projects in the current environment. For rental housing and the World Bank, and probably for the rest of the donor community, policy reform is the "only game in town."
VII. SUMMARY AND CONCLUSIONS

A. Old Lessons in Housing Market Policy

In "Shelter Strategies for the Urban Poor" we listed what we thought were some of the key areas for improvements in housing policy. These are no less valid for rental than for other tenure forms. At the risk of boring some readers familiar with that paper I'd like to repeat the list. We started with two conclusions from our demand work and the work of Burn and Grebler and others:

**Economic development is the most effective way of improving housing conditions in developing countries.** To ensure maximum benefits, governments should promote the efficiency of the housing sector and should avoid policies that cause significant market distortions and produce counterproductive results.

Research suggests that, as development proceeds, housing conditions improve more rapidly than incomes. Housing investment as a share of GNP increases rapidly, as does the fraction of income that people spend on housing. To a considerable degree, what is good for the economy is better for housing.

Governmental activities that deserve emphasis include:

**The provision of infrastructure with appropriate and affordable standards.** The benefits of infrastructure investments are considerable: rates of return to investment are high (often higher than in housing alone), household spending on housing is often spurred, and de facto security of tenure is established for many informal households.

**The recovery of the costs of providing and maintaining infrastructure** through efficient systems of taxes and user charges. Otherwise, enormous social and private economics costs result, as with the private provision of water and electricity in Lagos, for example.

**The development of systems of land information and a legal and administrative framework that promotes efficiency in land markets.** The costs of developing land are unnecessarily high in most developing countries, largely because of poor land information, backward systems of titling and property rights, and a cumbersome legal and administrative structure.

**The reform of land tenure systems in order to promote private spending on housing.** Most cities in developing countries are being built by the informal sector, with houses that are often illegal and with insecure tenure. Research shows that even very poor households place significant monetary premiums on security of tenure and that incentives to improve property are often dramatically increased when tenure in illegal or squatter settlements in legalized.

**The development of financial markets and institutions.** Development or reform of housing finance institutions should be a part of the overall process of financial reform and thus of promoting savings, financial intermediation, and the free movement of capital throughout the economy. Housing finance institutions should not be excessively concerned with providing housing...
subsidies, but should instead be seen as facilitating capital to move into a sector that is growing rapidly as development proceeds.

The critical review of housing subsidies, with the goals of increasing their effectiveness, avoiding unintended side effects, minimizing costs to the public and private sectors, and distributing benefits fairly in relation to need. In most developing countries, subsidy policies suffer from an almost total lack of strategic planning. The scale, distribution, and impact of subsidies are not known.

The pursuit of sites and services and, especially, slum upgrading projects as solutions for the housing problems of low- to moderate-income households. The best of such projects provide appropriate and affordable housing and services to low- and moderate-income groups, recover costs and minimize subsidies, target such subsidies as there are to those in greatest need, have high economic rates of return, and improve the ability to replicate projects on a broad scale.

The promotion of private housing, especially rental housing. The rental sector in most developing-country cities is large and growing, usually comprising at least 50 percent and sometimes as much as 90 percent of the housing stock. The sector is often hampered, however, by favorable treatment for owner-occupied housing.

Of the policies that governments should avoid, these deserve special mention:

The creation of unrealistic and costly building codes and zoning regulations. These increase costs, often without corresponding benefits, and may encourage development of illegal, informal areas.

The destruction of squatter settlements. Slum removal and urban renewal programs that simply displace the slums to other areas may encourage the development of larger and more militant squatter settlements.

The displacement of private investment by public activities. One study in the United States recently found that each 100 new units of publicly subsidized housing caused a drop of almost 85 units in private construction; other studies indicate that public housing actually has a negative economic rate of return (it is worth less than what it cost to build it. Similar displacement effects and inefficiencies undoubtedly exist in many developing countries and are to be avoided at all cost.

How would we augment this list today?

B. Recent Lessons in Subsidy and Incentive Policy

Tax incentives can be potent incentives, but can lead to large revenue losses. Caps on deductions (such as those currently in place in the United Kingdom) may mitigate some of the worst effects. Tax credits may be preferable
to deductions on equity grounds; alternatively deductions may be limited to the 
basic (lowest) tax rate in a progressive tax system.

Subsidies don't always cancel regulatory costs. In particular demand side 
subsidies can't readily counteract regulations such as land use controls which 
reduce housing supply.

Reduce off-budget expenditures for housing. While rarely measured the 
effects can be powerful. The U.S. and Argentina provide examples of the problems 
such entitlements can cause.

There is no substitute for sound macroeconomic policy. As a procyclical 
industry, housing often bears the brunt of macroeconomic instability. No housing 
program or policy ever designed will work indefinitely in completely unstable 
macroeconomic environments.

Costs and benefits of specific regulations can and should be measured. 
Strengthen and enforce those whose benefits exceed costs. Remove or modify 
those that don't.

And what are the particular issues for rental?

C. Policies With A Specific Rental Focus

We have, I think, discussed the main policy issues throughout the paper. 
Among the most important were:

Avoid trying to subsidize one tenure group at the expense of another. 
Horizontal equity measured in the usual ways (e.g. income) will be violated. 
In particular, when designing projects (sites and services, housing finance) 
try to remove unnecessary impediments to renter / landlord participation.

Level the regulatory playing field. The flip side of the preceding point; 
regulatory reforms in land, infrastructure, finance, and specifically in rent 
regulation, and rationalizing taxes can further tenure neutrality. Note that 
rental development is often denser than owner occupied; make sure standards 
permit such densification.

Rent controls are particularly inefficient means of subsidizing housing 
consumption by some renters at the expense of others. If strong enough and left 
in place long enough, many tenants themselves will lose more from disequilibrium 
in consumption than they gain in lower rents. And there is a lot of overlap in 
the income distributions of landlords and tenants; as income redistribution, rent 
control simply doesn’t work.

Removing roadblocks to financing rental housing. Permit formal sector 
lenders to loan money for rental housing, where this is currently discouraged 
(implicitly or explicitly) by financial regulations and policies. In particular, 
permit financing of resale, conversion, and upgrading of existing units.
Consider, where appropriate, the privatization of publicly owned rental housing. Take a hard look at what this part of the stock is currently costing the government, and how tenants value it. Consider options for private participation.

In public projects, such as sites and services and upgrading, don't prohibit or discourage rental. Avoid regulations against subletting.
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