Subsidizing Housing or Housing Finance?

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1. Introduction

Most governments have broad goals for the housing sector – e.g., "to provide every household with a decent house and healthful living environment". Such a general objective provides little guidance to policymakers, who have to respond to a plethora of societal concerns and pressures related to housing, urban development, and the growth and stability of the financial sector. Unfortunately, against a backdrop of major housing problems in most emerging economies, these political pressures often lead to subsidy programs that are drawn up hastily without considering what the precise objectives of the subsidy program are and how these are related to broader housing policy goals and other programs.

During the last decade, much attention has been paid to the importance of well functioning housing and housing finance markets in improving housing conditions for the majority of households in emerging economies (World Bank, 1993). This focus on markets brought to the fore the often negative effects of existing housing subsidy programs, in particular housing finance subsidies, on the expansion of housing and housing finance markets (Renaud, 1999). Instead, upfront demand oriented subsidies became the preferred instrument to subsidize housing in many emerging economies, particularly in Latin America, either tied to a private sector mortgage loan or as a production grant for a serviced plot and core house. In many countries such a singular focus on household demand is however premature, certainly in the context of large scale housing shortages and failing and incomplete land and housing finance markets.

Housing finance is a critical input in both the production and the consumption of housing. Yet, the housing finance sector in most emerging economies is often extremely limited in its scale and efficiency. Housing finance related subsidies can, together with regulatory and other policies, play a critical role in improving the efficiency of the finance sector. In the past housing finance subsidies where often designed to modify or replace markets. But these types of subsidies have been found fiscally untenable and deter private sector participation.

This brief paper intends to provide a framework for the analysis of housing subsidies in the context of market development and the broad set of issues a government has to consider when it decides to design or reform housing and housing finance subsidies.

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[*] This paper benefited from extremely helpful comments by Douglas B. Diamond Jr. Ph.D.
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2. Subsidies, Opportunity Costs and Housing Finance

Subsidies are often perceived as giving or receiving something for free. This notion is misleading. It is helpful to more explicitly define the subsidy concept. **A subsidy is an incentive provided by government to enable and persuade a certain class of producers or consumers to do something they would not otherwise do, by lowering the opportunity cost or otherwise increasing the potential benefit of doing so.** (adapted from the US Congress (1969))

Since housing is both a consumption and an investment good, an inclusive definition of opportunity cost needs to be used. For a household, lender or developer these costs are the yield they could have received if they had used the money for other purposes or at a later time, including a measure of possible greater uncertainty of future rewards. In turn, the opportunity cost to government of providing housing subsidies also needs to be considered within the same cost and uncertainty framework.

Government's costs of housing finance-linked subsidies are often "hidden" and highly uncertain. This is particularly problematic in many of the "traditional" and frequently used housing finance-linked subsidies, e.g., interest rate subsidies financed by off-budget credit lines, tax deductions of interest payments on mortgages, blanket government guarantees for credit risk or cash-flow risk. An extreme case of this type of hidden subsidy is where public lending institutions make loans at below-market fixed interest rates with funding drawn from special tax funds. The size of the subsidy in this case depends on uncertain future market interest rates (unless there is a market rate for such funding), and on credit losses that may be unpredictably larger than market expectations because public lenders are so much more exposed to political risks with respect to loan recovery enforcement. Other, more subtle, examples of hidden costs include government guarantees for default or cash-flow risk that do not fully charge for coverage of average credit risk, and ignore systemic risks in the economy or property markets. Unaccountable costs include the costs of restrictions imposed on the efficiency of financial markets, or the costs of redistributional effects of finance-linked subsidies, which work to the detriment of low-income households. For instance, tax deductions of interest payments benefit mostly higher and middle income households and have little impact on expanding home-ownership at the margin; government lenders or special tax funds mostly provide subsidized loans to higher income households.

The *"hidden" and uncertain costs* of traditional housing finance subsidies have come under international scrutiny (e.g., IMF and EU transparency rules). An increasing number of countries require that all off-budget costs of subsidies be calculated, including realistic cost scenarios for future years. Equally, the *inefficiency* of many existing subsidy programs has become a concern fuelled by fiscal constraints in many countries. Efficiency is evaluated not just in terms of the cost per subsidy, but also whether the subsidies results in added value for the consumer, and actually changes the behavior of producers or consumers. Less attention still is paid to the *inequity* of many of the housing subsidies, in particular the housing finance-linked subsidies, which mostly benefit middle and upper middle households who can qualify for a mortgage loan, and are often increasing with the size of the loan. The negative impact of subsidy programs on urban form and development is yet another hidden cost, e.g., when subsidies to lenders/developers result in low-income subsidized housing being constructed on cheap land far away from urban centers and employment. Chile, South Africa and Indonesia are some of the countries that face urban development problems in relation to their national subsidy programs.

Ultimately, subsidies are the result of the political process in each country which operates on a different basis than the policy design system. Thus, there is not always a clear policy rationale for every aspect of housing subsidies or even for whole subsidy programs.

3. When to Subsidize Housing Finance and not Housing Itself?

Rationales and objectives. Formal housing markets often fail to cater to the needs of low- and moderate-income households. In many developing and emerging economies, the great majority of newly formed households cannot afford the lowest priced house in the *formal* housing market (either as renters or owners). As a consequence, only a small proportion of the requirement for new housing can be fulfilled by new standard housing construction and the subsequent filtering up of lower-income households into the vacated houses. The only choice open to most newly formed households under such conditions is to double up with relatives, or build or rent a house in the unauthorized sector.

Designing subsidy programs to deal with these issues is complex. Policymakers must understand the causes of the supply or demand constraints in some depth, before they can design efficient programs. The most important step in formulating housing subsidy policy is to be clear about the goals. Are there specific situations or goals that suggest that housing subsidies could be more effective than regulatory actions or that would specifically call for housing finance subsidies? The more clear the objectives, the sharper the regulatory and subsidy tools can be defined. Specifically, answers are needed to the following questions:

- *Is the lack of supply of new formal-sector houses, be they rental or owner-occupied, due to policy failure in the regulatory environment* (e.g., subdivision, planning and building standards), which is out of step with what most households can afford or minimally need from a public health perspective? Or are the standards truly in line with health, environmental or societal values but *incomes required to attain those levels are not generally obtainable*?

- *Are there constraints in access to serviced land* because of public or private monopolies, because cadasters, deed and lien registrations are inefficient, because local governments are unable to provide infrastructure or *timely* and reasonably priced permits for development, or because of historical ambiguity of ownership?

- *Are problems in accessing housing finance and not just low incomes major reasons why a large proportion of households cannot acquire standard housing?* And is the lack of access to finance due to structural or monopoly issues in the industry, or incompleteness of markets that have not been able to price for the costs and risks in middle and low income markets? Are there regulatory or other constraints in the development of alternative lenders who could cater to the needs of lower-income households?

In most emerging economies, the answers to these questions will show that there are two frontiers in the housing sector that require urgent attention: (i) how to expand new formal sector housing construction for a larger proportion of middle income households (let us say to the 60^{th} percentile of the income distribution), and facilitate filtering up of lower-middle income households through the vacated stock, and, (ii) how to expand housing solutions for low-income households for whom formal markets do not work yet? These two frontiers need to be approached jointly so the strategies designed for each segment can complement each other.

Once policymakers understand the underlying causes of unsatisfactory housing conditions and production, they may be able to solve problems directly through changes in regulations to improve the efficiency of the land and housing finance system, or they may decide that subsidies are required. Unfortunately, changing laws, regulations and standards is often a complex and iterative process that is highly charged politically. Yet if the government does not address these regulatory issues first, whatever subsidies are applied to housing and finance markets will not be effectively translated into more and better housing (Hoek-Smit and Grigsby, 2002). This may be the single most important reason why housing finance subsidies are often so inefficient and inequitable.

Objectives of Housing Finance Subsidies. Subsidy policies frequently use the housing finance system in three different ways to reach housing sector objectives.

- *Overcome failure and incompleteness of housing finance systems and improve their efficiency*. Failures in the housing finance market frequently compound or are at the core of problems of delivering standard quality housing to moderate and low-income households. Indeed, the housing opportunities of even higher income households may be truncated by such failures.

  When housing finance systems fail and remain small or excessively expensive, system or institutional subsidies may be necessary to improve either mortgage finance or other non-mortgage-based housing finance systems. System subsidies, when designed well, can improve both the supply of and demand for housing and thus expand the number of households that can obtain formal housing, increase the contributions of the housing sector to the economy and to urban development. Such subsidies are often politically popular since they focus on improving efficiency.

Two important questions need to guide the design of system subsidies: (i) what are the specific funding or lending constraints in the market that would require subsidies, and (ii) what policy measures other than subsidies are needed to achieve the objectives. Frequently, however, such measures are mixing efficiency and social considerations and when that happens many of the system subsidies become distorting and can decrease efficiency.

- *Modify the housing finance system for the explicit reason of reaching social goals.* Some of the subsidies to the housing finance system go beyond correcting failure and purposely introduce a distortion in the housing finance market to seek other goals than improving efficiency. An example would be, the establishment of a subsidized state-lending institution or mortgage insurer that charges less than full market price or premium for its coverage in order to expand home-ownership or economic growth.

  While not improving the functioning of housing markets, these subsidies are mostly perceived positively from the perspective of housing policy. A critical issue with this type of system subsidy is how to safeguard against moral hazard.

- *Use the housing finance system to assist selected beneficiaries to upgrade the quality of the physical housing capital or to expand homeownership as a tenure choice.* These demand-side subsidies can either be channeled directly to individuals (e.g., up-front grants, tax subsidies) or public or market-based agents (e.g., interest subsidies through lenders). This type of housing-finance linked subsidy has an equity focus and can be designed to (i) alleviate constraints to access housing finance and expand home-ownership, or (ii) reduce the cost of housing or improve the quality of housing consumed for selected beneficiaries (owner-occupiers or renters) through housing finance-linked subsidies.

Whether dealing with problems related to housing finance systems or individual households, both types of subsidies must be based on a clear understanding of the specific constraints and risks that need to be addressed by the subsidy. We will now turn to some of those conditions and the different types of subsidy options that could be applied to resolve different problems at the level of the housing finance system or the individual household.

4. Subsidies to Overcome Failures in Housing Finance Markets

Only a few of the many possible reasons for failure in housing finance markets can be overcome by subsidies. There are two types of situations that justify subsidy actions: (i) Government can invest in housing and housing finance information and research as a public good, an activity that would not likely be undertaken and shared in the same way by the private sector. This would include, e.g., investing in property information and registration systems and consolidation of credit information, sponsoring research in standardization of mortgage procedures, new credit instruments, reasons for default and losses after default occurs, default trends; (ii) Government can take on risks, without being fully compensated, that would not (yet) be taken by private finance institutions.[‡] Ideally, these latter types of subsidies would be temporary, to be eliminated when markets have been brought to efficiency, i.e., when markets can carry the risk or cost of the specific intervention.

In this section we briefly discuss the broad classes of market failures and for each we discuss the possible role of subsidies to improve market efficiency, an oxymoron at first glance.

Sources of system failures. There are many different potential sources of these failures within the housing finance market. At least five general categories can be distinguished, each requiring different policy approaches:

- Failures due to macro-economic conditions (high inflation, falling real wages) that involve much more than the housing finance system per se.
- Distortions due to the presence of public or private monopolies
- System failures that increase the liquidity or interest rate risks or can lead to destabilization of the housing finance system.
- Failures due to lack of credit and property market information, lack of access to collateral in case of default, high transaction costs of lending, usury laws and other barriers which prevent suppliers of credit from profitably serving all or a portion of the housing market.
- Constraints particularly related to extending finance to the resale market for low-income housing (e.g., redlining) that cause weak market values in this segment of the housing market.

Only some of these problems can be assisted by subsidies, most will require regulatory changes or industry actions. We consider the possible role of subsidies next.

Addressing effects of macro-economic volatility on housing finance. Correcting adverse macroeconomic conditions mostly involves structural reforms, but many governments have attempted to soften the impacts on the housing market by providing explicit subsidies or by taking on certain risks in order to permit lenders to ignore the adverse prospects of lending under volatile economic conditions. Unfortunately, these latter types of intervention often have led to the creation of systems or institutions that cause distortions that can later on impede the expansion of housing finance (see 5 below).

Addressing monopoly problems in the housing finance sector. When one or a few large lenders gain excessive power over the housing finance sector, and unduly influence the pricing of loans, the type of products made available and the market segments served, there are likely to be inefficiencies that will be reflected in higher than

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[‡] If government is fully compensated on the basis of some accepted measurement of social rate of return, it is not a subsidy, but merely a policy that brings the market to the point of efficiency. If government takes on more risk than the private sector could do, simply because it can diversify risk better and there is no additional expense involved in doing so, the intervention is also not considered a subsidy.

necessary costs of lending and limited access to loans. Monopoly structures can exist with state-owned or private housing finance institutions. Subsidy policies can only be of limited help to correct such structural problems, but often contribute to their formation.

Many countries have systems dominated by *state housing finance funds or banks* that have tax and funding advantages and do not have concerns about return-on-equity to the owners. Private lenders will not be able to compete in the market segments dominated by state lenders, and when there are no or few other competing state institutions with similar advantages, state-owned or sponsored institutions often become monopoly or duopoly systems. The (often hidden) subsidies to state housing finance institutions need to be reformed or eliminated as a prerequisite to create a more competitive and efficient housing finance system. This is often an extremely difficult task particularly when these institutions are the largest mortgage lenders or sources of funds for housing finance.[§]

In some countries, *the private mortgage industry itself may engage in anti-competitive behavior* (e.g., price-setting, collusion not to enter in certain sub-markets), which makes credit unnecessarily expensive or inaccessible to certain groups or neighborhoods. Government's first priority will be to improve competition and system efficiency through *regulation*. In many countries there is a lack of clear rules guiding market conduct and structure (no disclosure standards, competition rules, bankruptcy laws). The danger imbedded in addressing anti-competitive tendencies through regulation is that regulators often focus on financial repression to reach social goals for housing finance (e.g., ceilings on interest rates, quotas for lending to special groups, privileged licensing or tax concessions for certain institutions). This can create an undesirable system of hidden subsidies, which may be more costly than the anti-competitive behavior regulations intended to address.

Addressing funding risks. Even if a country has vibrant primary lending institutions, these institutions may not have access to financial markets capable of shifting or managing important funding risks. These risks arise because borrowers want long-term loans often at fixed rates which can be prepaid when interest rates increase, conditions that do not match the funding options, thus creating liquidity risk, interest rate risk, or prepayment risk. Hypothetically, the market place might create institutional arrangements to best manage these risks. However, for a variety of reasons markets may need some assistance to do so, especially in countries where financial markets are relatively small and underdeveloped, or where there is a *history* of macro-economic instability and lack of trust in government's fiscal policies, exchange rate policies or legal enforcements of contracts (system risks). The state may see value in intervening to help individual institutions to manage their funding risks even when the players do not see the benefits to themselves as exceeding the costs.

[§] The Government Housing Bank of Thailand is one of the few state housing finance institutions that have successfully transformed their operations in the mid 1980s to stimulate a greater participation of the private sector in housing finance.

Table 1: Examples of System Subsidies to Develop and Expand Housing Finance

Functions and Risks/Cost Constraints	*Possible Subsidy Measures*	*Additional Support/Issues*
Funding constraints		
• Limited /costly equity funding	• Equity capital for (part) state-owned housing lenders, w/o dividend obligations.	• Costless recapitalization can lead to operational inefficiencies
• Limited access to or high costs of funds for lending	• Subsidizing cost of funds through government credit lines, special tax funds or debt funds • Cash subsidies to the cost of funding for housing finance • Tax subsidies for funds channeled to housing finance (e.g., bonds, savings) • Cash-flow guarantees for debt funds channeled to housing lenders	• This class of subsidies is often provided through special government-sponsored institutions, adding to the cost of the subsidies.
Lending costs and risks		
• Liquidity risk	• Access to (part) government-sponsored liquidity facility or secondary mortgage market	• For all or a certain class of lenders (e.g., Savings and Loan institutions, micro-finance lenders)
• Interest rate risk (Asset / Liability mismatch)	• Shift funding risks to government-sponsored agency	• Obvious government risk exposure
• Credit risk	• Shift credit risk to a (part) state-sponsored entity • Pay for premium of private mortgage insurance • Guarantees for social rental housing loans • Provision for borrower education on home-maintenance and mortgage credit procedures, rights and duties.	• Credit bureau • Property information systems • Improved foreclosure methods • Neighborhood investment plan to mitigate neighborhood risk (see below)
• High transaction costs for loan origination and servicing	• Subsidize transaction cost of lender for selected loans; cash payment or compensation for higher interest rate (phase out when information systems and credit risk management systems improve)	• Improving underwriting and servicing methods (see also under credit risk)

Addressing incompleteness of housing finance systems. An increasingly accepted subsidy objective for housing finance is to lower the opportunity costs of agents in either the primary or secondary markets to enter more risky or less profitable sections of the mortgage market when these markets are incomplete (i.e., when it is politically or economically difficult to price differentially for more risky and costly customers or transactions). This type of government support be effectively channeled to community-based or alternative housing finance institutions as well. Well targeted system subsidies, can gradually improve efficiency and reduce the threshold for formal unsubsidized lending. *Ideally, once these risks are better understood and controlled, government should reduce its role.*

Addressing weak resale markets (particularly for low and moderate income housing). Another type of market that is of critical importance to both households and lenders is the resale market for existing housing. Without lenders supporting that market, home-owners can only sell their house for the amount potential buyers can obtain in cash or through consumer credit. But individual lenders will not be willing to lend in such markets if other lenders, and other aspects of the housing finance system, are not supportive of the resale market. The role of the resale market to create asset value in the house for owners (and lenders) is critical for any subsidy policy.

Of all the risks mentioned above, credit risk (the risk of a default and the potential loss in case of default) is indeed the most fundamental constraint in expanding lending in low and moderate income markets. Seldom will a partial mitigation of the credit risk be sufficient to provide lenders with the confidence to make loans in marginal neighborhoods. Much broader institutional support is often required that goes well beyond financial sector incentives.

Table 1, shows some of the funding constraints and lending costs and risks, and the possible housing finance system subsidies that could help alleviate them.

5. Subsidies that Modify Housing Finance System to Reach Social Goals

Many of the actions we mentioned above that can be taken to improve the housing finance market can be pursued further to seek a variety of social policy goals, including redistribution and increasing homeownership or to alleviate the impacts of macro-economic problems on the housing market. Interventions such as the subsidization of a mortgage insurance company, a secondary market funding institution, or in some cases even a state mortgage bank, may possibly be an effective and even efficient way to address various other goals of subsidization.

Importantly, however, when interventions are designed to go beyond correcting flaws in markets, they must be carefully assessed with respect to the specific purpose that is being served, and how efficiently and transparently they achieve these goals, and with what effect on equity. Even more important is to anticipate the ripple effects of such distortions on other aspects of the system over time.

6. Individual Finance-linked Subsidies

This class of subsidies intends to increase the willingness and the ability of households (or investors in rental housing) to consume (or produce) better housing or housing of a particular type through leveraging their ability to obtain a housing loan or lowering the cost of the loan. Such individual subsidies are favored when the objective is to improve fairness and justice in society through the housing system, or expand home-ownership.

Types of household constraints with a bearing on housing finance. Households face varied constraints in accessing housing finance or home-ownership in general: (i) they may have difficulty saving for the down-payment while still paying rent, (ii) their income may be volatile or too low relative to the price of a standard house, (iii) they may only be able to afford a house in a neighborhood where future house values are highly uncertain or where property rights are not clear, and (iv) they may simply lack experience dealing with financial institutions and/or home-maintenance. Investors in medium/lower income rental housing face other, but related problems: there may be a gap between production, financing and maintenance costs of rental properties and the rents that potential beneficiary households can afford.

Types of individual subsidies. Frequently used individual finance subsidies are (i) up-front grants tied to credit or savings for housing, that can be applied to closing costs on a loan, the down payment, the premium for private mortgage insurance or payments into a guarantee deposit account, or to reduce the loan, (ii) subsidized mortgage insurance to lower the down-payment requirements, (iii) interest-rate subsidies to lower the monthly payments for housing, (iv) housing allowances linked to monthly mortgage payments and income levels[**], and (v) tax-benefits that lower the effective recurring cost of housing finance payments, but are external to the housing finance system. The last three types of subsidies allow beneficiaries to increase the amount of the loan they can obtain or to increase other housing expenditures, while the first two mostly lower the upfront savings requirement.

Which type of subsidy is chosen depends, ideally, on the specific constraints faced by the targeted beneficiary households and on the efficiency and equitability of the type of subsidy (See Hoek-Smit and Diamond, 2003 for a critical discussion of these different subsidy types). Intuitively, the case for assistance to individual households through housing finance appears easier to make than for system subsidies. However, this type of subsidy is often politically unpopular, particularly in countries where compassion for the poor is not a political priority. Another reason is that many traditional individual finance subsidies are known to have been inefficient and inequitable, but are politically difficult to change and policy analysts are reluctant to deal with them. For example, interest rate subsidies are often unnecessarily costly, and non-transparent. Deductions of interest payments from taxes are regressive and can quickly become very costly when a country industrializes and a larger proportion of its labor force files income tax returns. Mortgage insurance, if structured as a government guarantee, can induce moral hazard and become extremely costly.

The current preference for individual subsidies is for upfront subsidies linked to savings or credit, and up-front payments for private (or public/private) mortgage insurance or guarantee deposits that can be use when a beneficiary misses a payment due

[**] Housing allowances are more frequently applied to rental housing.

to unforeseen circumstances. Table 2, offers some examples of household constraints and possible types of subsidies to address them.

Table 2: Examples of Individual Finance-Linked Housing Subsidies and the Constraints and Risks They Address

Constraints/Risks	*Possible Subsidy Support*	*Additional Support*
Household Constraints		
• Savings constraints	• Support with closing/titling costs • Contribution towards owner's down-payment • Payment for mortgage insurance to lower LTV • Soft second loan	• Access to savings facilities • Savings programs linked to subsidy programs
• Income/employment volatility(payment irregularity)	• Blocked deposit available for temporary loan repayment • Borrower education	• Flexible mortgage, line of credit
• Income constraint (relative to standard house price and cost of finance)	• Contribution towards loan amount or cost of land/house • Partial coverage of monthly payments (buy-down) or interest due • Tax subsidies for loan repayments	• Payroll deduction
Asset Risk (non-systemic)		
• Lack of property title/maintenance /housing risk	• Support for title registration • Home-maintenance education or service for first-time homeowners • Contribution towards owner's equity (lower LTV) • Community home-repair fund	• Community support organizations/systems
• Neighborhood risk	• Cannot be easily mitigated by individual subsidies/ major reason for lack of resale finance in low-income neighborhoods	• Disclosure requirements/ consumer protection against discrimination • Local government agreement on investment plan for infrastructure and services
• Default/Foreclosure risk	• Borrower education • Payment for mortgage insurance premium	• User-friendly servicing • Improved foreclosure procedures • Community negotiations in case of default

Limitations of individual finance-linked subsidies. There are several reasons why this type of subsidy is often unfeasible or inefficient.

- *Finance-linked individual subsidies only work for households that can (with support of a subsidy) access private credit (or accumulate savings)*. If neither the neighborhood nor the occupant or owner would qualify for a mortgage loan, credit-linked subsidies may be tied to unsecured micro-finance or construction loans. Only some of the subsidies discussed above would be suitable for unsecured credit (e.g., guarantee deposits, upfront subsidies). However, if non-secured lending is not widely available in a country, individual housing finance-linked subsidies for that particular group may not be the right program.

  Many governments are tempted to take on the lending for this "non-qualifying" group themselves, taking all the credit risk. This scenario nearly unavoidably leads to disaster, since governments are the worst loan collectors. Cases from Chile, Sri Lanka, to the USA show the poor loan performance, high administrative costs, and other inefficiencies when governments do the lending for these high-risk groups.

- *When the housing finance system, public or private, is small and does not reach moderate or low income households*, *or is grossly inefficient and therefore unnecessary costly,* individual housing finance subsidies may not be the right choice, at least not initially. Measures to improve the efficiency of housing finance systems may be needed first or be part of an integrated subsidy package, before individual finance-linked subsidies can be effectively applied by themselves.

- *When real markets do not produce rental or ownership housing for the targeted income group* because of land and regulatory constraints, these programs obviously fail to deliver. In fact, pressure on the housing market by increasing the demand for specific income groups, while developers cannot produce the houses, may drive up prices. Cumbersome program procedures that make it difficult for developers or lenders to assemble beneficiaries into a project may have the same result.

Under most of these circumstances, the provision of serviced plots, or upgrading informal housing areas that have sprung up in response to the inability of formal markets to deliver housing, would be an obvious choice, at least in the shorter term.

7. Summary and Conclusion

The most difficult part of housing policy formulation may be the process of defining clear objectives for subsidy programs, and disentangling which particular problems in the housing system can be addressed by regulation, which require new subsidies or reform of existing ones, and what type of subsidies. This process requires analyses of housing and housing finance outcomes, the demand and supply parameters of the housing market, including issues related to property rights and registration, subdivision, planning and building standards and the regulatory system, the structure of the housing finance system, its regulation and legal underpinnings and procedures and the particular lender and borrower constraints that prevent expansion of or access to housing finance. An evaluation of the effectiveness and efficiency of existing housing finance subsidy interventions or programs and their effects on the sector will yet be another critical input.

Housing finance subsidies are by far the most prevalent across emerging economies, but have traditionally distorted and limited housing finance markets, from East and South East Asia, to Africa and Latin America. Rather than denouncing all housing finance linked subsidies, however, we have shown that there is an important case to be made for finance-linked subsidies, both to improve housing finance systems and to assist individuals to improve the quality of their house or become home-owners. The core lessons are that they have to be designed to stimulate the participation of private lenders and housing producers and leverage household resources, while limiting the exposure of the state to future liabilities. Where subsidy solutions for lenders and households overlap, as in the case in many of the subsidies related to mitigating credit risk, a win-win situation can be created. This paper focused on the framework for subsidy rationales and choice. A detailed assessment of the efficiency, transparency and equity characteristics of different subsidy instruments is provided in another paper (Hoek-Smit and Diamond, 2003).

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