I’m happy to be here today to discuss housing policy in developing countries.

I should begin with several disclaimers. First, I don’t know anything about the effects of housing policies in developing or developed countries on the rate of economic growth. I don’t even know whether there is a literature on this topic. The literature on housing policy with which I’m familiar focuses on the effect of housing policies on the levels of well-being enjoyed by residents of a country at a point in time. Second, my knowledge of the housing policies pursued in developing countries and their effects is modest. It’s based largely on reading a small fraction of the writings of Steve Malpezzi and a few other present and past World Bank employees such as Bob Buckley and Bertrand Renaud. They are the world’s leading experts on this topic. My expertise concerns housing policy in the U.S., especially low-income housing policy and rent control.

Based on my limited reading, the situation in developing countries differs in important respects from the situation in the U.S. As a result, some of the most important housing policy issues in developing countries have not been issues in the U.S. for many years. For example, I’ve been led to believe that many developing countries have not yet established well-defined property rights to the land in their countries. This obviously will deter investment in housing. More broadly, many developing countries have not established a well functioning legal framework that would allow the private unsubsidized housing market to operate anywhere near its capacity to produce desirable outcomes. This includes the legal framework for housing finance. My general sense is that almost all residents of developing countries would benefit if their governments focused their efforts related to housing to establishing the preconditions for a well functioning unsubsidized private housing market and making good decisions about the location and quality of infrastructure investments such as roads and sewer lines that affect private housing decisions. However, I would be the first to admit that these views could be badly off-the-mark.

Despite my impressions about the primary housing problems of developing countries, I’ll focus my remarks on the main lessons for developing countries from the U.S. experience for delivering housing subsidies to low-income families because this is my area of expertise. I’ll also mention arguments for housing assistance that you should view with skepticism based on the evidence available.
Description of U.S. System of Low-Income Assistance

To provide housing assistance, the United States government has developed a wide range of low-income housing programs.

At one extreme, the U.S. government has funded the construction of public housing projects that are owned and operated by local housing authorities established by local governments. Local housing authorities contract with private firms to build these projects. However, the housing authority’s political appointees and civil servants make all of the decisions that are made by businessmen in the unsubsidized housing market. The occupants of the projects pay below-market rents that depend primarily on their income rather than the market rent of the apartment occupied.

At the other extreme, the U.S. government operates a voucher program that authorizes low-income families to find apartments in the private market that meet specified housing standards and provides a subsidy to occupy these units that depends primarily on the family’s income.

Finally, the U.S. government contracts with private parties to build or rehabilitate housing projects and rent their units to low-income families. This is the largest part of the system of low-income housing assistance in the U.S.

The U.S. government has also had two large programs to subsidize low-income homeowners. One provides subsidies directly to low-income families who find their own units; the other provided subsidies to selected sellers of houses who sold the houses to eligible buyers. The latter program suffered from scandals and high default rates and was terminated two decades ago.

Recipient-Based versus Unit-Based Assistance

Based on the evidence on program performance, the most important distinction between low-income housing programs is whether they are recipient-based or unit-based. Recipient-based assistance allows families to use their subsidy to rent or buy from any supplier who provides housing meeting the program’s standards and they can retain their subsidy if they move. The S8 Housing Voucher Program is the largest program of this type in the U.S. The other broad type of housing assistance is unit-based assistance. If the subsidy is attached to a rental dwelling unit, each family must accept the particular unit offered in order to receive assistance and loses its subsidy if it moves.

Cost-Effectiveness of Different Types of Housing Assistance

There have been empirical studies of many effects of most of the large programs of low-income housing assistance in the U.S. The largest and most immutable difference between low-income housing programs concerns their cost-effectiveness. The evidence is unanimous that it costs much more to provide equally desirable housing with unit-based than with recipient-based assistance.

Four major studies have estimated both the cost per unit and the mean market rent of apartments provided by housing vouchers and HUD’s largest older production programs, namely Public Housing, Section 236, and Section 8 New Construction.
These studies are based on data from a wide variety of housing markets and for projects built in many different years. Two were expensive studies conducted for U.S. Department of Housing and Urban Development by a respected research firm. The studies with the most detailed information about the characteristics of the housing provided by the programs found the largest excess costs for the production programs. One study estimated the excessive cost of public housing compared to housing vouchers for providing equally desirable housing to be 64% and 91% in the two cities studied and the excessive cost of HUD’s Section 236 to be 35% and 75% in these two cities. Section 236 is HUD’s second largest program of privately-owned subsidized projects. Another major study estimated the excess cost of HUD’s largest program of private subsidized projects the Section 8 New Construction compared to recipient-based Section 8 Vouchers. Its estimates of the Section 8 New Construction Program’s excess cost of providing equally good housing ranged from 44% to 78%.

U.S. General Accounting Office provides similar results for the major active construction programs in the U.S. These are all programs of unit-based assistance. The excess total cost estimates range from 12% to 27%. However, these results greatly understate the excess cost of the programs of unit-based assistance relative to recipient-based assistance due to the omission of important costs of the construction programs.

There are good theoretical reasons to expect that programs of unit-based assistance will be less cost-effective than recipient-based vouchers.

The programs that involve construction or substantial rehabilitation always provide incentives for the use of a subset of the inputs involved in the production of housing services and this leads to too much of some inputs and too little of others from the viewpoint of efficient production.

Programs that allocate a fixed budget to selected private suppliers inevitably lead to excess profits. If a subsidy were provided to selected producers without any strings attached, these producers would charge market prices and they would make excessive profits (that is, greater than a competitive rate of return). Restrictions on the suppliers reduce the excessive profits. If the restrictions were too severe, the selected producers could not earn a competitive rate of return and hence would not participate in the program. If the program’s entire budget is used, the restrictions are clearly not that severe. If many more firms want to participate than can be accommodated with the program’s budget, we can be fairly certain that profits are excessive. This has always been the case for programs that subsidize privately owned projects in the U.S.

The absence of important incentives facing administrators of public housing is another source of inefficiency. Under the public housing program, government employees make all of the decisions that are made by managers of firms in the private market. These include the exact specifications of the project to be built and exactly what maintenance and renovations to undertake. These decision makers also must monitor the performance of the employees of the housing authorities. The government managers do not have the same financial incentives to operate efficiently as owners of private rental housing. If they make good decisions, they are not rewarded financially. If they make bad decisions, they suffer no financial consequences over a wide range of bad decisions. Indeed, they cannot easily learn whether they have made good or bad decisions. Due to the subsidy, they will not lose their tenants unless they make extraordinarily bad decisions.
The evidence does not tell us the relative importance of each source of excessive cost, but it does tell us the net effect. Unit-based assistance of each type studied has incurred much greater cost than recipient-based assistance when equally good housing is provided. The main lesson of the U.S. experience with low-income housing assistance for developing countries is to avoid unit-based assistance of any type.

**Rationales for Housing Assistance**

I’ll close with a few words about arguments for low-income housing assistance that you should greet with skepticism.

In the decades leading up to major U.S. government involvement with low-income housing assistance and for many decades thereafter, advocates for housing assistance claimed that it would produce many desirable outcomes such as better health and higher earnings for recipients. Convincing evidence about these effects was not produced. When careful studies were eventually undertaken, the results did not support these claims.

This is not to say that housing assistance to the poorest people in developing countries today would not have some of these effects. The housing conditions of these households are surely much worse than the housing conditions in the absence of assistance of the households in the U.S. at the time of the studies involved.

Still too many people have been too willing to accept uncritically alleged benefits of housing assistance to recipients. The World Bank should not repeat this mistake.

There are many alternative ways to help the poorest members of a society. Recipients of assistance prefer cash grants with no strings attached to housing subsidies with the same cost to donors. Therefore, *housing assistance* cannot be justified unless other citizens who provide the assistance receive tangible benefits particularly related to the housing of the recipients or care about them but think that the decision makers in these families undervalue housing.

The discussion about whether to provide housing assistance, and if so, how much to provide usually fails to make the crucial distinction between benefits to recipients as they judge these benefits and benefits to others. For example, if better housing led to better health for recipients, what is the relevance of this fact for the decision to provide housing assistance? If recipients understood this relationship, they would take account of it in deciding how to allocate their income between housing and other goods. Is the relevance of a positive relationship between housing and health that non-recipients care about recipients but believe that recipients do not recognize this relationship and hence devote too small a share of their income to housing? Is its relevance that non-recipients care about recipients, believe that recipients do understand the relationship between housing and health, but feel that recipients undervalue their own health? Or is it relevant due to more tangible external benefits from better health on the part of the poorest members of society? For example, does better housing for the poorest families lead to a lower incidence of contagious diseases among these families and hence to better health for the middle- and upper-income people with whom they come in contact?
In my experience, decisions about how to help the poorest families rarely reflect careful thinking about the rationales for providing assistance to them. We will do much better in serving the interests of the poorest families and those who want to help them if we give this matter much more thought.

**The Importance of Policy Experiments**

I also think that it would serve the best interest of the poor and those who want to help them to conduct controlled experiments of alternative methods of providing assistance before launching large new programs that are based on little more than hunches about program effects. The poor who are offered assistance in these experiments would be helped immediately and this avoids implementing programs that perform poorly but are nevertheless difficult to terminate. Poor performance is not always, or even usually, obvious to the naked eye.