Housing Finance in Hungary and Russia: A Framework for Measuring the Movement to Market

by Robert Buckley and Eugene Gurenko

OVERVIEW

This article examines the housing finance reforms taking place in Russia and Hungary. As is well known, these are two of the many countries which recently dismantled their socialist economic systems. What is perhaps less well-known is that almost all the reforming formerly socialist economies have given considerable attention to housing and housing finance reforms as part of this reform process.

This paper shows how the housing finance reforms in these two countries can be used to suggest a simple framework for considering reforms in the other transitional economies. Russia and Hungary are interesting case studies in this regard because, in many respects, they represent the polar extremes of the reforming systems. Russia was perhaps the most centralized, classical socialist system; whereas Hungary was closest to a market-based economy. Corresponding to these different starting points have been very different reform programs and macroeconomic circumstances which in some important ways cover the spectrum of the reforms being pursued.

The first part of the paper develops a framework for comparing the movement to market of housing finance systems in transitional economies. It shows that while there are important differences across countries, there are, nevertheless, some remarkable similarities in both the existing systems and the reforms being pursued. The framework provides a means of drawing together the highly-nuanced institutional changes in both a summary and relative fashion. It also helps to emphasize the points about reform which we, following McKinnon, consider to be the most important for the development of sustainable housing finance.

The second part focuses on the specific housing finance reforms in Russia and Hungary in the context of their transition from an "administrative" to a "market-based" sys-

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We apply the framework developed in the first section to review the state of housing finance reforms in Russia and Hungary with respect to:

- the level and flexibility of household savings that can be allocated by households;
- housing's tradability and marketability; and
- the degree of separation of subsidies and finance. We also discuss why these policy issues play such an important role in the
transition process.

The third section draws out some tentative conclusions about the overall state of housing finance reforms in Russia and Hungary. It also identifies which reforms are the most strategic for a particular context, and how that context can be affected by various kinds of macroeconomic constraints.

A FRAMEWORK FOR COMPARING THE MOVEMENT TO MARKET

The ongoing economic and political transformations of the former socialist countries have major implications for the systems of housing finance and the housing sector. A key question that has been posed by almost all the transitional economies has been: how do we move from a statist, hypercentralized model of housing delivery to a "market-oriented" one? The unanticipated severity of what Komai refers to as the "transformational recession" further complicates this question by adding to it the concern of how these rather basic reforms can be pursued while there is substantial turmoil in the economy? Together these two questions constitute the reform agenda.

In the best of circumstances this reform agenda is not an easy one. But, the transformational recession has made reform in this sector even more difficult. Over the 1992-3 period, GDP in the transitional economies fell by one-third, and while inflation has tempered in most places, in 1994 it is still forecast to exceed 20 percent per annum in all the economies except the Czech Republic. In such a context, the difficulty of undertaking very basic reform of the financing of one of the, longest-lived goods in the economy is compounded.

Macroeconomic conditions clearly have fundamental implications for the structure and timing of market-oriented reform programs. Nevertheless, we think it is important to abstract from the macroeconomic concerns to consider the basic motivation for undertaking reform. Then, when the objectives are clear, the effects that the macroeconomic constraints place on the reform can be spelled out.

We think clarity about objectives is important because housing finance systems are often complicated, and usually require some fundamental changes in the role of the government in the sector. Without such changes the system cannot become the spontaneous and durable sort which characterizes market economies. Further, without clarity as to why these changes are necessary and beneficial, it is all too easy to ignore them. We attempt to show how such a result can have costly consequences for the successful prosecution of the reform program, as well as for the sector.

With only slight exaggeration, the broad reforms in former socialist countries can be viewed as an attempt to shift from an "administrative" system to a "market based" one. For housing finance this means changing the financing for what is the longest-lived and often largest single existing form of wealth. While there is no economy nor housing finance system in the world that can be described as either a pure market economy or a pure administrative one, a continuum of sorts can nevertheless be described which gives a sense of how far along a country is with respect to these processes. On one end of the spectrum we place a stylized version of the old administrative regime; at the other extreme is an "ideal," if non-existent, market-based one.

The Role of the State in an "Administrative" System of Housing Finance

Perhaps the key distinguishing feature of an "administrative" system of housing finance is the dominant role played by the state in the process of intermediation between "savers" and final recipients of housing. In this case, the state has virtually a monopolistic control over household savings. It appropriates these savings through lower wages and what amounts to a tax on profits, and then returns part of them in the form of free but non-tradable housing and other social services. In the limit, households have no savings to allocate. Their portfolio decisions are taken by the state or the enterprise acting on behalf of the state.

The stylized limit was not often achieved. In all reforming economies the state also ran a state-owned system of savings banks to capture any residual savings not directly captured from the enterprises. In some of these economies, such as Russia, households were not permitted to borrow from these savings banks to finance housing purchases. But, in most others, and most expansively in Hungary, the state permitted such household borrowing.

Of course all private banking was also proscribed in classical socialism. Banks served mainly as conduits to carry out state-determined investment programs. In consequence, there was no independence of the financial system from the fiscal system, and the differences between housing finance and budgetary transfers (subsidies) were impossible to discern. The lack of financial discipline, and correspondingly accountability, turned the state into a huge and inefficient conduit of savings and implicit tax revenues. These flows were allocated for housing construction to state-owned construction companies. Then, the housing was administratively allocated to individuals selected by the government or the enterprise.

Rather than providing subsidies to some, which were financed with taxes on all, the state provided subsidies to all. These subsidies were regressive distributed and financed through implicit taxes on all. Further, the state controlled the use of the housing, placing severe restrictions and in some cases complete prohibitions on exchange of units. These restrictions created a "grey market" in subsidized housing services. This restriction on trade amounts to providing property rights in use but not exchange to all tenants, a topic we shall return to below.

In sum, the polar form of the administrative system gave households no savings, no
property rights, and made it impossible to discern the difference between finance and transfers. Among the most common outcomes of the "administrative" system of housing in which the state provides the housing and finance for it are: very low rents - in Russia, the same rent level applied for over 50 years - but also, chronic housing shortages, low quality of housing stock, significant inefficiencies in the bureaucratic redistribution of untargeted subsidies and taxes, impeded labor mobility, impaired economic growth, and distorted urban economic development.

The Role of the State in a "Market-Based" System of Housing Finance

In a "market-based" system of housing finance the role of the state declines considerably. On the one hand, the state becomes accountable to taxpayers for housing subsidies. On the other, the state gives up the direct administrative control over household savings and wages which are competitively allocated. In the market system, households are paid a wage from which they must put aside some portion in savings.

How much they put into savings and into what uses it is put are portfolio decisions of the household. The idealized norm, however, is clear. First, households allocate all rather than none of their savings. Second, they allocate their savings so that risk-adjusted rates of return are equated on their alternative investments. That is, so that they maximize their wealth.

To make this wealth maximization feasible, financial institutions have to compete for household savings and be able to allocate them efficiently. The transition from being mere financial conduits of the state to market-oriented, risk-taking financial intermediaries requires the development of a new type of financial discipline. This discipline, in turn, is generated by the mutually restrictive interests of depositors/investors, borrowers, and the institution's shareholders. When in place, this discipline induces financial intermediaries to compete for resources while prudentially managing the risks they take in that competition.

On the supply-side, the involvement of the state into housing finance narrows to providing insurance and liquidity to the institutions. On the demand-side, the state relies on fiscal instruments such as subsidies and tax policies. But, again in the ideal, these instruments are clear, well-targeted, and provided by efficiently mobilized taxes.

Finally, the state plays an important role in ensuring that the rules of the game are fair, enforced, and easily and transparently understood by all. In other words, it ensures that property rights are clearly defined so that resources are put to their highest and best uses. For this clarity to have the maximum effect on improving economic welfare, the rights should be with respect to exchange as opposed to just use.

The Role of Housing and Housing Finance During the Transition

Pressures to create a market-oriented system can be expected to emerge spontaneously in reforming economies. These pressures arise not because reformers want them to, but because when given the choice, individuals tend to select an approach that gives them more options. Greater discretion about how to allocate their earnings and their savings can be one of the most important options. Further, housing can play at least two important roles in determining whether households can exploit this option, and thereby rely on the housing sector to contribute to the breakdown of the old system.

First, individuals will prefer to work for firms which will pay an amount that eliminates the implicit tax on the portion of their earnings which finances state-provided services. Because housing is the biggest component of these state-provided services, and correspondingly the largest component of the implicit taxes that finance them, the ability to sustain the movement away from the old firms will be affected by household ability to purchase or rent housing services outside of the enterprise or state system. In other words, the movement away from the old system will be affected by wage earners' ability to convert the implicit tax they have been paying for housing services into better housing by paying for it themselves.

Second, as long as individuals feel they can exploit their savings in a better way than can the state, they will prefer to be outside an administrative system which prohibits such decisions. Because housing accounts for such a significant share of the existing wealth in these economies, the ability to access this savings - either through liquidation or as collateral - can be expected to be an important driving force in sustaining the movement to market.

These changes amount to a change in the identity of who is who maximizes return in the market system it is the individual; in the administrative system it is the state. The evidence is clear and unambiguous that the former type of system leads to far superior growth, as well as more individual discretion. But, this clear system superiority does not lead to these changes occurring overnight or spontaneously. In very basic ways the rate of shift is affected by the reform of the institutions and procedures necessary to support individual oriented decision-making.

For household savings to be allocated by individuals rather than the state, the ability to make portfolio choices about how to allocate savings must be matched by the ability to exercise these choices in simple but expedient ways. For instance, in a market economy asset owners must have property rights and the ability to exercise those rights quickly and easily. For reforming economies an important question is how quickly can a system be established to identify the rights of individuals and procedures for transferring those rights among individuals?

As recent experience suggests, both types of systems can reside together in a "halfway house" of neither capitalism nor social-
ism for what appears to be a very long time. Unfortunately, this half-way house can deliver neither the growth of market-based systems, nor the pervasive safety nets of the administered ones. As Kornai has observed about Hungary “simply to await the spontaneous, self-engendered forces of the economy to lift the economy out of the trough... could result in a low-level equilibrium trap.” To consider how housing finance reforms fit into contributing to such a “trap”, we examine the link between the state’s role in housing finance reforms and the broader reform process.

Evaluating the State’s Role During the Transition

The preceding discussion suggests three “all-or-none” dimensions of state involvement in housing finance according to which one could define a pure market or pure administrative housing finance system. Either the state does:

- all the saving for households - administrative system - or none of it - the market system;
- all of the allocation of houses - the administrative - or none of it - the idealized market system; and
- all of the financing - administrative - or none of it - market.

Figure 1: The Savings - Portfolio Dimension

Obviously, again, in no state is the all or none achieved. But, we hope to show that the location of a country on a range between these extremes can yield useful ways to think about the role of the state in the transition. In particular, we want to suggest that these “all or none” dimensions can be arrayed to give a sense of the movement and location of a particular country as it goes from something approximating complete state control to the opposite. In what follows we present one of these graphical presentations, and briefly discuss the other two.

Household Savings

As a result of treating housing as a “social” good rather than an “economic” one for many decades, former socialist countries confront a shortage of housing. But, besides the physical shortage of units, housing is also an attractive investment because of the lack of other domestic savings vehicles which protect investors against inflation. Thus, in transitional economies, for a number of reasons, housing is an attractive investment, offering a relatively high rate of return as compared to other assets.

To fund this high return investment, the level of household savings is of critical importance. But, in the beginning of reform from a stylized socialist system, such as is the situation in Russia today, household discretion with respect to the use of their savings is close to zero. Unlike an ideal market system in which households have control over all their savings, and risk-adjusted rates of return on alternative investments are equated, the administrative system has both zero savings, and a ratio of rates of return on alternative savings instruments that is on housing which approaches zero.

Figure 1 plots out these two dimensions of household savings for Russia, Hungary, and the U.S. The horizontal axis measures the potential share of savings that households can allocate. The vertical axis measures the relative rates of return on other savings instruments relative to housing. In a perfect market system both measures approach 1; in a socialist system both approach 0. In other words, in the former type of system, rates of return are equated, so that they equal 1, and households are able to allocate all their savings, so that the horizontal axis also equals 1.

The U.S. figure of 0.8 for the share of savings allocated by households reflects the fact that about 20 percent of household savings are taken in a pay-as-you-go social security system which is financed by taxes. The tax revenues, rather than household saving, finance the old age expenditures of retired households. We conjecture that for Russia the comparable figure on the portion of potential household savings at the beginning of the reforms was approximately 0.1, whereas for Hungary our estimate is that it was on the order of 0.5.

Our conjecture as to the location of Russia on this scale is based on the pre-reform effective prohibition on private ownership of housing. Indeed, prior to reform, the very term private ownership was condemned by the state. As a result, households were prohibited from realizing one of the most common forms of household saving - the capital gains on ownership.

Although households assumed limited user
rights, reflected in the concept of "personal ownership", they were denied a right to realize the value of their state-allocated savings in the form of housing. All but trivial forms of savings were confiscated through implicit taxes. Hence, the low figure for Russia at the beginning of the reforms. In Hungary, in contrast, households were permitted to own housing, and the savings bank which financed these units accounted for a similar share of GDP as did the U.S. savings and loan system.

Besides the far more constrained starting point, the inflation which has accompanied the Russian transition amounted to a confiscation of most of the remaining household savings. The Hungarian post reform inflation has also been high - reaching 35 percent per year - but it has been much more modest. As a consequence, because the Russian reform program has been accompanied by such high rates of inflation, the household position deteriorated further from its already low base.

The U.S. rate of return measure exceeds 1 because the tax subsidy given to housing raises its rate of return relative to unfavored investments. Because the tax code has induced so much additional investment in housing, the return on housing is lower than that on other investments. As a result, according to this measure, the ratio of returns could exceed 1, that is, other investments have a higher pre-tax rate of return.

The comparable figures for Russia and Hungary are guesstimated to be 0.2 and 0.75 respectively. The former figure reflecting both Russia's extreme shortage of housing relative even to those of shortage constrained socialist systems, and housing's ability to serve as a substitute for capital flight. On the other hand, in Hungary in the later years of the communist regime housing production was relied upon as one of the sectors in which the state permitted individual initiative. When this unloosening of individual incentives was combined with the presence of the remaining subsidies for input materials, the result was that, on a per capita basis, Hungary became one of the world's leading housing producers. Indeed, one could argue that Hungary began the reform with the luxury of very little physical housing shortage, so that rates of return on housing and alternative investments were quite similar.

Clearly, when the task ahead for reforming economies is viewed as going from the origin at the bottom left to the one at the top right, the situation for Russia is far more daunting than is the Hungarian one. Much more domestic savings are needed, macrostability is more distorting, and finally, in Russia bidders for credit must compete with a government whose borrowing needs absorb a greater share of GDP than is saved by the entire economy. Discussion of housing finance reform in such an environment seems premature to say the least.

On the other hand, in Hungary, opportunities exist. Furthermore, financial innovations have already occurred. These innovations - such as the emergence of a commercial paper market - can address the existing interest rate distortions observed in the banking system. Given that from a macroeconomic and financial perspective that these opportunities exist, the question arises as to the nature of constraints on being able to use the finance for the asset. That is, how marketable is housing?

**Housing's Marketability**

Housing's marketability constitutes a critical precondition of a "market-based" system of housing finance, as well as an important constraint on the mobilization of the national wealth. Once again, Hungary, which had widespread homeownership, about 80 percent, before the recent reforms, approached the reform process at a considerable advantage relative to Russia, where ownership was almost outlawed. But, as part of the reforms, Russia implemented a far-reaching almost give away program for housing. This program, in principle, should address the ownership issue at the stroke of a pen. It allowed the housing stock to be privatized for almost nothing. However, the process, while remarkably fast by some notions, by no means resulted in a completely privately owned stock. Fortunately, the issues of marketability of that ownership, as well as the incentives for owning cannot be resolved as quickly as the change in ownership title.

By marketability we mean the amount of the asset value that must be expended to convert an asset of a given appraised value into currency. For example, in the U.S. it costs on the order of 6 percent of house value to have a property listed with and sold by a realtor. It costs an additional amount to have the property appraised and with title insurance and general closing costs, it takes 8 to 10 percent of a house's value to realize the house's monetary value. In the U.S., then, housing, with its durability, locational specificity, possible legal encumbrances, and complexity of characteristics has, in effect, a bid-ask marketability spread of about 8 to 10 percent of market value.

Over the last two years, Russia has managed to privatize as much as 50 percent of its housing stock. However, despite a significantly increased number of privatized units, the real estate market did not witness an outburst of transactions. For instance, in 1993, Moscow realtors recorded only 2,200 transactions, i.e., the number of titles on properties officially changed hands. For a city with about 9 million population this represents an astonishingly low figure.

An explanation for such an abnormally inactive market stems from the costs of the highly unreliable, cumbersome, and sometimes even risky process of title transferring. In this process neither the buyer nor the seller can fully rely on legal institutional practices for the protection of their interests. The buyer cannot be sure he has not acquired a title on already sold (perhaps many times) property because of the obsolete system of title registration, the seller is exposed to all kind of risks associated with entering a hundred percent cash transaction (no trust funds or title companies exist). Moreover, the existing real estate tax law is
such that it forces the seller to cite a lower than real sales price of the property in the contract to avoid tax which approaches 100 percent of the capital gain (which makes him even more vulnerable before the buyer).

Uncertainty of contract obligations along with a highly questionable enforceability of legal contracts constitutes another serious obstacle on the way to a "market-based" system of housing finance. When the debtors might not pay their debts, and the contracts cannot be enforced by legal means (the eviction procedure, for instance, is virtually unresolvable through courts), the use of housing finance becomes highly problematic.

The result is that even though Russia effectively gave away the housing stock so that the ownership rates should have gone from effectively 0 to 1, the marketability costs are still so high and the exchange rights so low, that most households, much less potential landlords, do not yet want to engage in real estate transactions. Further, at present, households know that ownership can mean obligations - for maintenance costs, property taxes, etc. - whereas tenancy does not. In other words, under the current system tenant rights to use of property are equal to or perhaps even more advantageous than that of owners'. Consequently, until these are clarified many will be happy and perfectly rationale to remain as tenants who cannot realize the value of their housing in any way other than living in it.

Separating Subsidies from Housing Finance

Both the Russians and the Hungarians have made major steps to separate subsidies for housing finance from the interest rate charged, with the responsibility for the subsidy being placed on the government budget. To contrast their actions we again develop our all or nothing schema. In a perfect market system the cost of borrowing equals the cost of resources, and for transparency, any divergence between these costs - particularly policies which cause the cost of borrowing to be lower - should appear completely on the government's budget. In our stylized administrative system the opposite is true: the cost of borrowing had no relationship to the cost of resources, and budget items reflected nothing of any such differences that occurred.

In our perspective neither Russia nor Hungary has achieved financial efficiency, but Hungary has succeeded on fiscal transparency while Russia has not. At first glance this result is somewhat surprising because in the last few years Russian policy has made substantial progress in the separation of state housing subsidies and finance. The vehicle through which this was done, "Program Housing," mandates a separation of up-front, one time subsidies from the financing of housing. But there are a number of serious concerns which can prevent transparency from being achieved.

In particular, although interest rates in the financial system have exceeded 200 percent, because of the high rates of inflation, the real return on such savings was deeply negative. As a result, even if loans with such rates are repaid in full, they essentially confiscate savings. This result is obviously not an attractive proposition for savers who are, as a recent World Bank study (by Easterly and da Cunha) shows, implicitly and heavily taxed by such a system. As the stock of savings that can be taxed in this way disappears, these instruments will have to be financed through even higher inflation. Hence, in this kind of environment, a major objective of the program - transparency of subsidy and finance - is not accomplished. The finance would be heavily subsidized and ultimately not sustainable.

Financial instruments that yield negative returns are not going to be voluntarily introduced by a well-functioning financial intermediary. Their use will require either explicit or implicit use of directed credit at subsidized rates. Unfortunately, one of the chief reasons for Russia's disrupted and unsustainable financial situation is the broad use of directed credit schemes. The elimination or very sharp reduction in the use of these schemes is a prerequisite to financial adjustment. Hence, introducing another such scheme is to work against the adjustment. While difficult to measure exactly, it appeared that by the end of 1993 positive interest rates have been realized. If so, and these rates can be maintained, then the beginnings of the separation of subsidies and finance will have begun.

In some situations innovations in the form of mortgage instrument can have a substantial beneficial effect on the economy. They can replace government transfers with finance, and simultaneously help satisfy housing and employment needs. This appears to be exactly the situation which characterizes Hungary at present where similar instruments have just been introduced, as Diamond describes. But, this is not yet the case for Russia, and hence the lower ranking on transparency of subsidies. Russia, unlike Hungary, cannot achieve fiscal-financial transparency until its financial macroeconomic situation improves. Quite simply, finance does not work when inflation rates reach levels approaching 1,000 percent per year, as it did in Russia in 1993.

CONCLUSIONS

To sum up, what do these perspectives individually and collectively suggest about the reform programs being undertaken in Russia and Hungary? And further, can we use these results to draw any conclusions about sequencing issues with respect to reform?

Marketability

On the one hand, the Russians have implemented one of the most aggressive housing privatization programs of all the reforming economies. At a stroke, they have attempted to move from almost complete public to complete private ownership, and significant progress has occurred. However, serious problems remain. Indeed, so serious are these problems that even though the Hun-
garians' housing privatization program appears to have stalled, it seems that Russia is still many years behind Hungary on establishing a vibrant housing market. Although, it appears that significant progress has been achieved in Russia over the last two years on issues relating to the institutional mechanisms and procedures that affect real estate transactions, the lack of housing's marketability continues to remain a major impediment to the development of long-term housing finance.

While Hungary also has difficulties in this regard, it is worth noting that, in many respects, following years of emphasizing homeownership, its ownership patterns are already similar to many other OECD countries. In other words, in many respects, Hungary has already established a functioning housing market. Accordingly, since it has a much less distorted housing delivery mechanism, one where price signals are reasonably credible, the Hungarian housing market could effectively make use of housing finance.

**Fiscal Transparency and Financial Efficiency**

As was the case with privatization, the Russians have pursued an aggressive fiscal reform program to improve accountability and targeting of housing subsidies. However, according to our perspective the benefits are slight and may even be misleading. This lack of results is even more disconcerting when one considers the improvements in this regard realized by Hungary which followed a conceptually quite similar tack. Hungary has achieved much more in this regard, and again its efforts appear to be on a par with if not exceeding OECD performance.

While both countries have implemented fundamental changes in the accounting for transfers to mortgage borrowers, in the Russian case, the macro-economic situation makes transparency impossible. Unfortunately, the implementation of an efficient system of housing finance does not depend on decisions that can be made by housing or even by financial sector policy makers. Consequently, the same type of effort as in Russia taken by the Hungarian reformers in the housing sector has also yielded little or no benefit. Perhaps the key lesson here is that fiscal transparency affords little gain if it is accompanied by unsustainable credit programs, even if those programs are cleverly designed to increase the share of costs borrowers can repay.

**Savings Availability**

Once again, the Russians have a very long way to go, and the Hungarians are much further along. And once again, the constraint placed on Russian progress by the macroeconomic situation is difficult to exaggerate: government deficits are so large, households began the reform with so little individual savings, and very high levels of inflation have both eliminated the value of all their non-housing savings and inflated the value of their housing. In such a context, it is impossible for a market system to provide housing services at what appears to be a lower cost than that afforded by the old administrative delivery mechanisms.

For Hungary, in contrast, more savings are available, relative rates of return are less distorted, and state subsidies to mortgage borrowers, while still present, are clearer. A basic problem for Hungary is that financial efficiency is relatively low and many of the bases of a market system are still missing. In this kind of environment, if housing finance could be developed it would be expected to contribute to the competition for resources in a productive way.

**Housing Finance and the Broader Transition**

Perhaps the clearest messages of these perspectives are:

- the importance of financial stability as a prerequisite to achieve durable progress on housing finance reforms; and
- the importance of actively assisting the development of the new institutions required by a market economy.

Without stability, funding - as opposed to technical assistance - for housing finance is at best misdirected and may well be counterproductive. For Russia, this instability unfortunately offsets many of their very striking efforts to reform the housing and housing finance systems. For Russia, stability is the clear and essential prerequisite for housing finance to contribute to the transition.

For Hungary, a country that has achieved reasonable stabilization, the story is more complex. For example, we argued earlier that the development of housing markets can provide at least two of the forces that power and sustain the movement to market of the entire economy.

First, in a functioning market housing can be purchased much less expensively by individuals placing their demands on private suppliers rather than on the state or public firms which are unresponsive to individual demands. If such a delivery mechanism is available, individuals will have incentives to leave their firms for more productive, market-oriented employment.

Second, in reforming economies housing is an enormous source of national wealth that could be liquidated by individuals or used to collateralize investments throughout the economy. But, for this to occur more than just simple pronouncements about privatization are necessary. The apparatus governing real estate transactions is too often taken for granted as a simple institutional development. It is not simple; in market economies it reflects years of property law development and resolution about conflicts that are quite reasonably not very well understood in reforming economies.

Consequently, when housing cannot be readily rented, built, or serve as collateral, many of the basic incentives to move to market are muted if not completely undermined. In this kind of context, it is not
the reforming economies compound the problems associated with establishing the basic property rights that must underpin real estate transactions. Nevertheless, the need for reform is very real, and its successful prosecution can play an important part in providing typical households with some of the tangible benefits of moving to market. These gains go well beyond important objective of improving the functioning of the sector.

This reform program is a topic that will require years of effort and we present these papers to give readers of Housing Finance International a sense of the beginnings that have been made, and the agenda before those interested in housing finance.

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transferred considerable authority over urban development matters to the new local councils, but it still remains to be defined what services should be provided by the local governments and what sort of fiscal autonomy they will enjoy in paying or levying charges for them. The craft Land Use Law has not been approved yet but it is needed to better define the powers and authorities concerned with territorial and urban land use planning and zoning regulation, with the occupation of land for construction, with the issuance of building and demolition licenses, as well as with guidelines for environmental protection and pollution control especially in coastal, tourist and vacation areas.

NOTES

1 Albania has an average of 7.5 square metres of living space per capita and very poor sanitation levels, against 15 m² for Romania, 17 for Bulgaria, 20 for Poland and 26 for Hungary. Dwellings with piped water are 84% in Hungary, 85% in Poland and 59% in Romania. In Albanian cities, 63% of dwellings have piped water, but for the entire country, the figure is only 5%.

2 Public housing used to be allocated to beneficiaries by local committees following 3 basic criteria:

- loss of dwelling (e.g. because of emergencies, requisition or demolition by public authority);
- insanitary living conditions;
- disproportionate household size (over 90% of the applications for alternative housing fall in this category).

3 Rent is calculated on the basis of 1 percent of the recorded (subsidized) cost of construction plus insurance modified by several coefficients relating to the amenities, location and floor space of the dwelling and to the building type. Rents varied little in the past 45 years. They were doubled in August 1992, bringing the base rate from 0.36 to 0.72 leks per square metre. Current estimates put the average rent in the order of 1.55 to 3.0 percent of household income and the cost of utilities (electricity, water and telephone) in the same order of magnitude.

4 Originally the operating costs of the maintenance enterprises accounted for about 25% of the rents they collected. However, the recent escalation of their current expenditures relative to the poor yield of rents leaves less and less room for maintenance activities.

5 The average annual production in the 1981-1990 decade was about 14,700 DU's of which 7,900 were financed by the state (3,300 for enterprise workers) and 6,800 by the private sector. During the whole decade only 2,470 privately financed dwellings were built in cities or towns (an average of 250 per year).

6 Old waiting lists exist with each district housing agency also for this category of dwellings but their validity is arguable once it is decided that the State can no longer afford to invest in housing unless the beneficiaries are willing and able to pay for its cost.

7 By the end of 1993, payment had been made on 187,000 flats (97% of the total) and the equivalent of US$ 16 million had been deposited in the accounts of the National Housing Agency. The whole process was carried out in about seven months, leaving only about 6,000 units in public ownership nation wide. An excellent account of this success story has been written by Ira Lowry in Housing Privatization in Albania, Washington D.C., PADO, January 1994.

TRANSFORMATION

surprising that acute observers of the reform process, such as Kornai, now suggest that due to the lack of market-oriented institutions in the housing sector that a low level macroeconomic equilibrium trap may well have been achieved in Hungary.

Macro conditions in stabilizing economies always necessarily constrain housing demand. However, when this result is as long lasting as it has been in Hungary it can cause a vicious circle to occur. In this cycle the stabilization-induced secular decline in housing conditions generates less legislative momentum to create the kinds of institutions that reward individual decision making. This result, in turn, may then lead to a further deterioration in macro circumstances, as fewer job shifts occur and less savings can be mobilized. Then, because of this result, the cycle regenerates itself in further macroeconomic deterioration.

There are, of course, no simple ways to break this cycle, but Kornai's basic conclusion "it is desirable for a sizable part of the savings by households to be used for financing housing construction," is consistent with our perspective. Exactly how market-based institutions can be developed to accomplish this objective is an important issue with consequences that go well be-