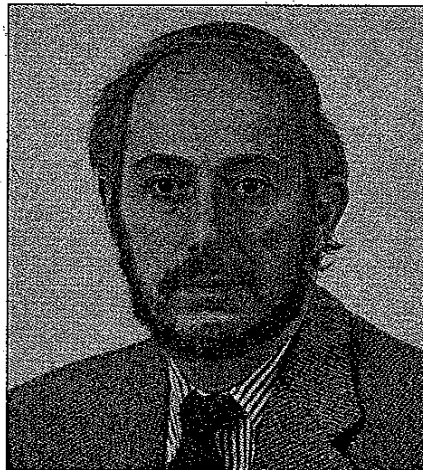


# Housing Finance in Reforming Economies : The Joint World Bank USAID Experience

by Michael A Cohen and Peter Kimm

**A**t the beginning of 1989, the former Soviet Union and the East European countries embarked on the way of major economic restructuring that brought to life a series of new, more intensive requests for international assistance for housing finance. These requests were very different in nature from those that characterized the typical requests made to international donors over the years by developing countries. Instead of seeking to develop systems to help house rapidly expanding, often very low-income urban populations, the reforming countries sought new approaches to one of the most centrally planned components of the old systems. These countries were already highly urbanized, and had higher incomes than typical developing countries. However, they also had pervasive housing shortages, inequities and inefficiencies in the distribution of housing, the recognition that the housing delivery systems were major impediments to rapid reform, and a strong sense that something had to be done about these problems.

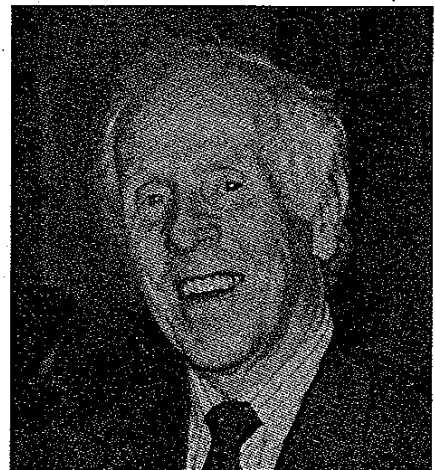
In almost all of the reforming economies of Europe the World Bank and the United States Agency for International Development (USAID) began a series of lending and technical assistance programs to support the movement to market-based systems. In many of these countries the Bank and USAID worked together. The papers collected in this issue reflect some of the joint efforts that were undertaken. For USAID, Sonia Hamman, Sean Walsh,



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Steven Giddings, David Leibson, and David Ollinger of the Office of Housing undertook the efforts needed to redefine how USAID could respond to these requests. The Bank efforts were undertaken by those who have authored the papers in this issue.

One of the most fundamental questions that has repeatedly been asked was how should housing finance systems be restructured to replace the mechanisms of the old regime.



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This question was particularly interesting in these countries because the inflation which accompanied the reforms had effectively decapitalized their existing housing finance institutions. Consequently, in many respects, reforms and new systems were being sketched out on a blank sheet of paper. New systems not marginal changes were and still are being considered. The question: What should a well-functioning, market-oriented housing finance system

look like? was no longer just an interesting academic question. Rather, it was a fundamental part of an economic restructuring program.

The series of papers collected here shows how USAID and the World Bank have worked with the reforming economies to begin to answer this question. The papers do not cover all of the economies where these institutions are working separately, but they do reflect those countries where joint work has taken place and has either lead to or is in the process of attempting to develop lending operations to support the reforms. The countries considered are: Albania, Hungary, Poland, Russia, and Slovakia. The authors of the papers are World Bank staff and the USAID consultants that worked on the specific studies or lending operations.

The first article by Gian Carlo Guarda resulted from a project in Albania which enabled about 4,500 individual households to purchase flats as private property under very affordable mortgage arrangements. Originally aiming at completing and putting on the market a substantial share of the unfinished rental housing, the project also facilitated the national housing reform, particularly the reform of the Albanian system of housing finance.

In most of former socialist economies, particularly in Albania, the transition from an "administrative" to a "market-oriented" system of housing finance is inseparable from the context of national housing reform. The article establishes the role and the place of the housing finance reform in the process of restructuring the Albanian housing sector as a whole.

Douglas Diamond's article describes the current situation of housing finance in Hungary, and the new directions contemplated for the near future. The Hungarian system is now far removed from the old non-market, heavily subsidized sector under Communism. Yet it still has far to go to achieve the full benefits of the efficient market-responsive systems. Hungary is now embark-

ing upon a multi-phase process that was begun with a joint Bank-USAID study, and which continues with the support of both USAID-sponsored technical assistance and Housing Guaranty loan funds.

Begun as a part of the Housing Project for Poland, the article by Margret Thalwitz brings a strategic prospective on the reform of the housing sector in general and housing finance in particular in Poland. As compared to most of the reforming economies, the reform of the housing finance sector in Poland presents a double challenge. On the one hand, as in any other former socialist economy, the success of the reform hinges on the creation of new market-based institutions and improvements in the rate of country saving, housing marketability, and separation of housing subsidies from finance. On the other hand, however, the reform of the housing finance in Poland becomes impossible without restructuring the subsidies for long-term mortgage loans.

Written as a part of a World Bank study of the Russian housing sector, the article by Bertrand Renaud gives a comprehensive profile of the "administrative" type of housing finance under the Soviet regime and identifies the major impediments on the way to a market-based system of housing finance. In his analysis of the Russian system of housing finance, he emphasizes the role of new financial institutions and financial sector reform in general for a successful transition from an "administrative" to a "market-based" system of housing finance. In the view of the author, the issues of housing finance reform are contingent upon macroeconomic stabilization and legal reform. Once again, a joint Bank-USAID effort is now in process that is attempting to develop a lending operation for the Russian housing sector.

In their joint article, Robert Buckley and Eugene Gurenko develop a framework for comparing housing finance reforms in the former socialist countries. Using Russia and Hungary as extreme examples of the

reforming economies, they suggest three perspectives within which housing finance reforms might be considered in all the reforming economies:

- level and flexibility of household savings;
- housing marketability; and
- the separation of subsidies and finance.

The article presents a cross country perspective on the state of housing finance restructuring in transitional economies, and discusses the issues of the sequencing and facilitating further the reforms of housing finance in other transitional economies.

Another article, that is useful when discussing the work being done in the Russian housing finance sector, is one contributed by Raymond Struyk for the March 1993 edition of *Housing Finance International*. Dr. Struyk is an Urban Institute Senior Fellow and Resident Advisor for the USAID Housing Sector Reform Program. The article summarizes the state of the Russian housing finance sector, the changes that have occurred in the sector since 1989, and the actions being taken by the Russian Federation to address the fundamental problems of long-term mortgage lending.

In the final article James Follain, Michael Lea, and Maris Mikelsons describe housing finance issues in Slovakia, one of the most recently established reforming economies in Europe. They lay out the prerequisites necessary to develop a sustainable housing finance system and discuss conditions in the Slovakian economy relative to these conditions. They place particular emphasis on setting up institutions which can avoid what they call the "principal-agent" problem that has lead to difficulties in developed economies, and suggest some ways this might be done in Slovakia.

To sum up, housing finance reforms in reforming economies are a new and difficult agenda for the countries involved as well as the multi-lateral and bi-lateral institutions attempting to help them. The disruptions in

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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. ■

## ALBANIA ...

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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 draft *Land Use Law* has not been approved yet but 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

<sup>1</sup> Albania has an average of 7.5 square metres of living space per capita and very poor sanitation levels, against 15m<sup>2</sup> 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%.

<sup>2</sup> 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).

<sup>3</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> 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).

<sup>6</sup> 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.

<sup>7</sup> 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., PADCO, January 1994.

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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-