Access to Housing and Direct Subsidies: Lessons from Latin American Experiences

by Gerardo M. Gonzales Arrieta

INTRODUCTION

A recent study published by the United Nations Economic Commission for Latin America and the Caribbean provides statistics showing a huge housing deficit existing in Latin America and the Caribbean (Schweitzer, 1996). The estimates establish that in 1995 the quantitative deficit—defined as the difference between the number of households and the number of permanent housing units—was 28 million units. The qualitative deficit—defined as the number of permanent housing units with a deficient supply of services—totaled 26 million existing housing units.

Considering that the region has about 113 million households, it can be asserted that one out of every four Latin American families lacks a housing unit and, if we add the housing units that require some type of rehabilitation, almost half of the families of the region live under unsatisfactory conditions.

This statistical verification not only sheds light on the sizable housing deficit problem that affects all the countries of the region to a greater or lesser extent, but also on the ineffectiveness of the housing policies and residential financing that have prevailed in the past. Furthermore, this huge existing housing deficit is highly concentrated in the low-income population, which, in spite of constituting a significant potential demand, has no possibility of achieving an adequate housing solution.

Historically, the main obstacle to solving the housing deficit of low-income families has been their lack of access to affordable financing. There are three fundamental causes:

1. The lack of enough purchasing power to transform potential demand for housing into an effective demand.

2. The lack of satisfactory guarantees to qualify for available mortgage loans.

3. The difficulty for those families belonging to the increasingly important informal sectors to demonstrate permanent earnings.

The necessity of solving the problem of housing access for the lowest income population demands innovations in prevailing housing and housing finance policies. In this paper, we will focus on how to empower this sector with an adequate purchasing capacity in order to create an effective demand for housing.

This paper is aimed at analyzing the experiences of Latin America in the application of direct subsidy regimes which feed the demand for housing for the lower income population. The policy context is one in which the state acts as a facilitator and as a subsidiary of sectoral development, while the private sector actively intervenes in the construction and financing of housing under market conditions.

The next section of the paper describes the role of direct demand subsidies for housing as a mechanism intended to create an effective demand for a housing supply which is provided by the private sector under market conditions. A special emphasis is put on its attributes as a focused, progressive, transparent and measurable mechanism which is compatible with the operation of a market economy in the real estate and housing finance sectors.

The importance of linking the subsidy with families’ savings, as an expression of the effort made by the families to reach a housing solution through the benefit of the direct subsidy, is strongly emphasized.

In the last section of the paper the principal lessons derived from Latin American experiences are discussed, highlighting the conditions that could become necessary, as well as the relevant features needed to reach a successful application of the direct demand-side subsidy for housing.

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This discussion can serve as a policy recommendation for those countries that, as a part of sectoral reforms, are considering the application of, or the improvement in, the use of direct demand-side subsidies for housing.

**ECONOMIC RATIONALE FOR DIRECT DEMAND-SIDE HOUSING SUBSIDIES**

**Housing Policies and Public, Private Sector Roles**

The housing and housing finance policies that generally prevailed in the past in Latin America were characterized by a preeminent participation of the state and, at the same time, a very limited participation by the formal private sector. As a part of this policy, the state acted in the role of a regulator in the markets and in the operations of the intervening agents. For example, the state established ceilings on interest rates in the housing finance systems. The state was also used to assume a direct, proactive role in the construction and financing of housing. A principal feature of the interventions was the use of indiscriminate subsidies via interest rates on mortgage loans or via sale prices set below costs.

The results, however, were completely self-defeating, as reflected in the huge housing deficit accumulated in the countries of the region. In practice, such policies gave rise to construction and housing financing schemes that were unable to satisfy the profitability aspirations of private builders and financial intermediaries. This resulted in limited formal private investment in the housing sector.

The active intervention of the state as the producer of housing units bureaucratically defined their characteristics, prices and allocation mechanisms, and eliminated the operation of the market mechanisms for the lower-income sectors.

**Insufficient Credit for Housing**

Such policies also resulted in insufficient credit availability for the construction and purchase of housing in comparison with the requirements in Latin America. While in the developed countries more than 90% of the housing originates with mortgage loans, the countries of the region hardly reach 30% in some cases (Zawadzki, 1993, p. 33). Furthermore, there has been little development of long-term financing mechanisms and inadequate access for the majority of the population, especially those with a limited payment capacity.

These factors limit the size and stability of the effective demand for housing and mortgage credit. As a result, private builders and financial intermediaries concentrated on meeting the housing demand of the higher income segments, giving rise to a double perverse effect: on one hand, a shrinkage of the formal markets and a growing inhibition of private investment in the housing sector; and, on the other hand, the growth and increasing importance of informal channels for construction and financing of housing. In the region, the construction carried out by the formal sector annually covers a small part of the need, while the informal sector mobilizes a considerable volume of resources (Arruagada, 1996, p.119).

**New Policies Change Outlook**

Recently, some countries in Latin America have adopted outstanding housing financing policies. The annual production of housing has responded to the new demand that is generated every year as a result of the population growth and of the formation of new households. This means that these countries have begun to reverse their accumulated housing deficits.

The model of housing policy and housing finance which supports this kind of result has as a common denominator the adoption of a clear-cut political willingness to undertake sectoral development based on the market, compatible with the general pattern of economic and social development, and encompass the instruments and the appropriate resources to meet the housing necessities of all income levels.

This approach is one in which the state plays a facilitating role, giving room for an active participation of the private sector in the production and financing of housing, and a subsidiary role in which it provides equality of opportunities to purchase housing generated under market conditions to those families that have lacked such opportunities.

The result can be a decisive expansion in the number of families that enter the formal markets to buy housing. This equality of opportunity supposes the use of mechanisms that make it feasible for any family, regardless of its economic condition, to have the opportunity to solve its housing problem through the market. The state supports the demand of these families through direct subsidies which, in addition to the families' own effort (e.g., previous savings) and a mortgage loan under market conditions, provide the purchasing capacity sufficient for the acquisition of housing.

**Use of Demand-Side Subsidies to Create Housing Demand**

Within this model, the resources that can be, used to purchase a housing unit can come from three sources: (1) the previous savings accumulated by families, whether it be cash or property; (2) long-term mortgage loans granted under market conditions and compatible with the payment capacity of the borrowers; and, (3) in cases where the two previous sources are insufficient, the state's contributions via direct subsidies.
In general terms, the direct demand-side subsidy for housing is an explicit, non-reimbursable, once-and-for-all contribution to allow beneficiaries to have access to housing compatible with their economic possibilities. Certainly, it is part of the public policy to grant priority to the neediest segments of society.

However, it is necessary to emphasize that an option of this nature should not mean a lack of concern for stimulating access to housing for upper levels of incomes, because if these segments do not find suitable mechanisms of attention, the most probable result is that the opportunities originally designed for the poorest segment will be swallowed up by the surrounding strata.

A direct demand-side subsidy for housing is a mechanism of direct support by the state that allows the transformation of the potential demand for housing into an effective demand, by endowing the beneficiaries with a purchasing power beyond the possibilities provided by their current income. The favorable effects that the use of direct housing subsidies can produce are numerous (see Dominguez, 1954b). Indeed, direct housing subsidies contribute to an increase in the potential real estate market by creating an effective purchasing capacity for the housing supply generated by the private sector, with subsequent favorable effects on the growth of the economy as a whole.

The direct housing subsidy also acts to reduce the risks involved in the construction of housing, since when it is definitely known that the demand will be accompanied with purchasing power, private builders will have more security in selling housing. The housing supply will in this way be more stable in the medium term. In an atmosphere of free competition, it will favor, in turn, a quality improvement and a price reduction for housing.

Direct housing subsidies also stimulate growth of the potential market of mortgage borrowers by reducing the total amount of indebtedness necessary to pay the price of the housing to be acquired. Therefore, direct housing subsidies allow beneficiary families to become, with the same income, eligible to mortgage loans for amounts compatible with their permanent payment capacity. Also, the smaller indebtedness leads to better quality loans, because the debtor assumes an easier repayment obligation, given his level of income. Less indebtedness increases the amount of the guarantee coverage (equivalent to the amount of the subsidy).

Change in Attitude Required

Direct housing subsidies involve the abolition of the traditional paternalistic attitude of the state in its attention to the neediest groups. Subsidies must also abolish certain clientelistic practices, substituting for them an approach that stimulates and supplements the efforts of these families on the basis of objective and depersonalized procedures.

In addition, they improve the possibilities of reaching a housing solution whose characteristics agree with the real economic possibilities of the beneficiaries. The direct housing subsidy strengthens the linkage between the citizen and the state, taking advantage of the market economy; it allows the beneficiary to choose the solution that is best suited to his needs; and it is an effective means of promoting the community organization.

In this way, direct housing subsidies, by transforming potential demand for housing into effective demand and by accentuating the functions of the market economy, generate forces that stimulate an increased housing supply and greater opportunities for housing financing, all of which allows an improved access to the market by lower income families.

Therefore, the state’s contribution to the system is framed within a context of growing transfer to the private sector of the state’s role in housing finance. The direct housing subsidy has proven to be a much more effective mechanism of the state’s intervention in the solution to housing problems than previously implemented policies.

Why Are Direct Subsidies Preferable?

Why are direct subsidies a preferable approach to addressing the needs of housing for the poor? Direct housing subsidies present several advantages in relation to other alternatives such as indirect subsidies via mortgage loans with subsidized interest rates and the subsidies disguised in the supply of housing, produced either by the state or by the private sector.

A first argument in favor of direct housing subsidies is that, contrary to indiscriminate subsidies, they allow a better focus on the target population and, therefore, are more equitable. The incidence of indirect subsidies in mortgage loans with interest rates below market levels is highly regressive, since in the absence of a price allocation of credits, a mechanism of rationing of the available resources prevails. In this context, those with more access to the available financing are usually the population sectors with more influence or a greater payment capacity.

Thus, the population with larger economic possibilities crowds out the poorest population in the access to the state’s support. The indirect subsidy via the interest rate is highly inequitable; it not only does not reach the target population, but the irony is that those who obtain more credit are those who receive larger contributions or subsidies from the state. On the other hand, the direct housing subsidy is characterized by its progressiveness; the smaller housing values are, the greater subsidies will be in general.
thereby providing the poorest with a proportionately greater benefit.

One can refer to numerous examples that testify to this reality. For example, in Costa Rica, the publicly owned institutions that existed prior to the creation of the National Housing Finance System based their performance on the direct construction of housing and the granting of mortgage loans with subsidized interest rates. In such a manner, they ultimately focused most of their resources on the higher-income population. Indeed, more than 95% of the resources applied in the housing operations formalized by two of these publicly owned institutions were directed to the population with the highest 39% of income, while the allocation of resources in favor of the population with the lowest 32% of income was practically nil (Arroyo, 1995, pp. 44-45).

The progressive character of a direct housing subsidy used by the National Housing Finance System can clearly be seen in that 53% of the resources dedicated to direct subsidy went to the population with the lowest 32% of income while only 21% of the subsidies went to the upper-income population (top 39%). In this way, the direct housing subsidy has allowed the allocation of more resources to the neediest sectors, contrary to what happened with the indirect subsidies via interest rates, where the benefits vanish among the population groups that generally are not the neediest.

**Improved Efficiency**

A second argument in favor of direct housing subsidies is that it is a more efficient mechanism. The indirect subsidies via interest rates below market levels introduce distortions in the operation of the housing finance systems that do not allow the recovery of loans in real terms. This contributes to the decapitalization of the financial intermediaries and, as a result, the decrease or disappearance of the housing finance alternatives.

This distortion generates a perverse effect of considerable proportions, because it impedes the recovery and the sustainability of the resources dedicated to housing, affecting the prospective homeowners, especially the poorest, whose opportunities for housing financing are more limited to start with. The direct housing subsidy has the feature of supplementing a mortgage loan under market conditions; furthermore, the counterpart of a direct housing subsidy should be a mortgage loan operation under such conditions. Therefore, the effectiveness of the mechanism of direct housing subsidy is perfectly compatible with the operation of a housing finance system with real interest rates, encouraging the formation of savings and the granting of credits. Also, it stimulates the flow of financial resources toward the low-income sector as well as to the capitalization of the financial intermediaries.

The inefficiency of indirect subsidies via interest rates is also reflected in the fact that the state is not able to clearly measure the quantity of subsidized resources that it grants. Worse still, it is not possible for the beneficiary to achieve a clear perception of the benefit that he is receiving. Direct housing subsidies cannot only be measured accurately in terms of the magnitude of the involved fiscal expenditure (for example, a certain percentage of the public budget), but also, when measuring the effort of the families as they approach eligibility for the subsidy, the beneficiaries acquire a real perception of the benefit that they are receiving.

**Reduced Administrative Burden**

Another argument in favor of the direct housing subsidies is that the state incurs a smaller administrative burden and, thus, achieves economies in the use of fiscal resources. In this type of subsidy, the state's responsibilities are limited to regulating the regime; to summon, process and select the beneficiaries; to publish the relationship of beneficiaries; and to pay the subsidies.

Since it is a contribution that is awarded for only a single time, the state does not assume long-term administrative commitments, as is the case with mortgage loans with subsidized interest rates granted by the state. In this latter case, the administrative costs of recovering a mortgage portfolio which depreciates in real terms over time come to account for a larger share of the recovered value.

Direct housing subsidies are based on the search for the largest economic and social productivity possible from scarce available fiscal resources. It is important to highlight the efficiency and effectiveness for the public good that can be obtained with the application of a mechanism like the direct housing subsidy, because that can help to increase support for the amount that is annually allocated toward this end within the public budget. Furthermore, to the extent that the direct housing subsidy allows an increased activity level in housing and linked sectors, the state will be able to recover either partially or totally these resources via taxes generated.

In conclusion, it can be categorically asserted that direct subsidies to the demand for housing are not in any way in conflict with the pattern of a market economy, because they foster access to housing, focusing on a target population. From the state's point of view, they are transparent and clearly measurable, not hidden; the state knows who benefits and by how much. Similarly, the beneficiaries know how much they are receiving. Such subsidies do not generate distortions in the financial system, as is the case with subsidized interest rates; and they do not displace the private sector in the
housing market, but conversely attract it by transforming the potential demand in hous-
ing into effective demand.

**HOW SAVINGS AND SUBSIDIES WORK TOGETHER**

Housing constitutes a durable good, perhaps the most important physical asset of most families, the price of which is usually several times greater than potential buyers' income. For this reason, the acquisition of housing in the majority of cases only becomes viable by means of the availability of a long-term credit, allowing the family to make payments over time, easing the burden on the family's income and, therefore, making possible the purchase of such an expensive asset.

The acquisition of housing for a family is not only a purchasing decision that will cover many years of use, but also usually is an important motivation for the family to save its earnings, postponing present consumption for future consumption. In developed countries, the family savings are usually deposited in formal financial institutions that comprise the main source of funds for housing credits (USAID, 1987, p. 39).

Properly channeled through formal financial institutions, the application of direct demand-side subsidies for housing can serve as an important catalyst to promote the formation of family savings.

As has been pointed out, the direct housing subsidy acts as a mechanism of the state's aid to lower income families that have expressed their commitment to purchase a residence but lack enough purchasing power to do so. Although this contribution comes without the requirement of restitution, the motive for this mechanism is to demolish paternalistic assistance practices that have dominated housing policies in the past.

**Importance of Savings History**

Its purpose is to stimulate the effort of the families and reward the sacrifices they are willing to endure in order to afford a house. The typical expression of this effort and sacrifice on the family's part should be a previous pattern of accumulation of savings that, complemented with the direct subsidy and, where applicable, a long-term mortgage loan, allows the family to obtain suitable housing.

The family's savings history, whatever the amount of the savings may be, may constitute the most powerful means for shaping a system with clear and objective criteria for the eligibility and allocation of the direct housing subsidy. The subsidies should be aimed at rewarding the amount, the age and the permanence, as well as the consistent nature of the previous effort at saving.

Furthermore, a process of eligibility based on a savings requirement is not only virtuous, but, as practical experience indicates in some countries, turns out to be an easier and less expensive allocation approach than, for example, a process of eligibility based on the level of income. Certainly, the requirement that a previous pattern of savings be present in order for a family to qualify for a direct housing subsidy should take into consideration different levels of incomes, housing prices and family burdens, among other criteria, so that the state's aid focuses a high-priority attention on lower income families that, by definition, have a smaller savings capacity.

**Other Qualifying Criteria**

However, as practical experience indicates, the effort of families that aspire to the direct housing subsidy cannot always be expressed in terms of monetary savings. It is therefore useful, especially for lower income families, to express their contributions in terms of such commodities as lands, materials or labor. The most important aspect of this endeavor is the idea that the direct housing subsidy rewards the effort of the families and is not simply charity.

As noted, experience shows that the application of direct housing subsidies can be an important stimulus for the formation of savings dedicated to obtaining housing and channeled through the formal financial system. In Chile, for example, the pattern of previous savings being an indispensable condition in order to apply for direct housing subsidies produced during the '90s a notable increase not only in the number of savings accounts for housing in the financial system but also an important real increase in accumulated savings and in agreed savings (Domínguez, 1994).

It is estimated that savings for housing accounts for 16%–17% of the total deposits in the Chilean savings market. The larger volume of resources generated through the savings for housing not only fosters the growth of the financial system for housing and for housing construction, but also, when seen as a long-term reflection of resources, serves to stimulate a greater integration between the financial system for housing and the global financial system.

**Requirements of the Macroeconomic Environment**

The achievement of such a result demands more than a favorable macroeconomic scenario. It also requires that a certain set of conditions cause the appearance and consolidation of those savings for housing.

In the first place, for such savings to fulfill the task of covering part of the price of housing over a period of time, they should also enjoy a positive profitability in real terms that not only protects against their depreciation but also makes them preferable to other options.
This is a very important element, since in inflationary scenarios such as those that have prevailed in the recent past in Latin America, it has been uncommon for savings for housing to be expressed in money and deposited in financial systems. Rather, such savings have been invested in the acquisition of land and materials that have acted as a better investment at the time.

Secondly, these savings should constitute financial assets that are sufficiently liquid for their holders, are empowered with governmental guarantees (mainly for small-sized savings), and also have the backing of a properly regulated and supervised financial system.

In short, the acquisition of housing supposes a private decision, as well as a long-term effort in the form of family savings. This element of the system grants to the families the role of protagonist in the solution of their own housing problem. The directed housing subsidy cannot achieve its objective only by endowing purchase capacity to low-income families, but also acts as a catalytic factor to revalue and reward a sustained attitude toward savings, contributing to the pattern of not consuming but of accumulating to invest. For this to happen, it is necessary to incorporate and maintain this attitude toward savings firmly in the objective criteria for eligibility.

LESSONS AND POLICY RECOMMENDATIONS

The advantages of direct demand-side subsidies for housing over traditional subsidies, such as below-market interest rates or discounted housing costs, are clear from both a conceptual and practical viewpoint. The enormous advantage in terms of equity and efficiency of the fiscal effort, and the benefits to the financial system that the direct housing subsidies provide in comparison to the traditional subsidies, can clearly be seen.

Once these aspects have been revealed, it is worthwhile pointing out the conditions that should prevail for, and the characteristics that can allow, a successful application of the direct housing subsidies.

Necessary Conditions for Success

The successful application of a direct housing subsidy regime requires it to be put into a broader perspective as an integral part of the housing policy and as a mechanism to foster access to housing for the lower-income population. We can highlight the following considerations:

1. The direct housing subsidy is a mechanism that is designed, on the basis of a subsidiary intervention of the state, to facilitate the low-income population’s access to the opportunities generated by the prevalence of a market-oriented sectoral policy. It is, therefore, a mechanism that incorporates a completely different view from that underlying the formulation of traditional housing policies, which is that housing is a fundamental right.

If the latter supposition were recognized, it would demand the identification of the party that would have the obligation of providing the housing. As is logical, this recognition would lead the population to consider it to be an obligation of the state, which, most certainly, would be an impossible obligation to meet. More important, it supposes a housing policy that minimizes the effort of families, which is completely contrary to the emphasis of the direct housing subsidy.

What the state is then forced to do is to guarantee an equal access to market opportunities to all families that are willing and committed to obtain a housing solution, regardless of their economic condition. The direct housing subsidy, by contrast, serves the state as a tool to facilitate such an access for the low-income population by compensating and rewarding families’ efforts to improve their quality of life.

2. The direct housing subsidy should be an integral part of a housing policy that eradicates two erroneous policies of the past:
   - First, that the housing sector is almost exclusively a social sector.
   - Second, that the problem of housing is to be solved by undertaking massive projects of housing construction.

The prevalence of these errors leads to the design of mechanisms that prevent housing from being developed, driving away private investment, losing opportunities for long-term financing and leaving the sector at an actual activity level diminished in relation to its potential. On the contrary, the reasoning of the direct housing subsidy is based on allowing a state’s intervention that gives room for the market economy and for private investment, in such a way that the resources can flow to the sector, thereby contributing to economic expansion.

3. For a direct housing subsidy program to have possibilities of success, it must be part of a comprehensive housing policy and not an isolated mechanism. It supposes, first, that the sectoral development model is compatible with the general model of economic and social development, in such a way that both are reinforced by each other.

Second, it supposes that the housing policy encompasses the different needs and possibilities of all population sectors, so that the appropriate instruments exist with their corresponding resources to address each of them.
Third, it supposes that housing policies are based on the inevitable intervention of the state, but this intervention should promote the participation of the private sector by creating the conditions for profitability, competitiveness and stability so that private sector agents invest their own resources and assume the inherent risks as they would in any other sector of the economy.

4. The direct housing subsidy can only serve as an effective contribution to solve the problem of the housing deficit as far as it stimulates savings for housing and the availability of long-term mortgage finance. In this way, the subsidy serves as a complementary and subsidiary mechanism to the access for housing.

For this to occur, it is absolutely necessary that market conditions prevail in the sector. This requires the abolition of traditional policies of maintaining negative real interest rates in the housing finance market. The interest rate is a key device to promote savings for housing, properly channeled through the financial system. It also allows a recovery of the long-term mortgage loans in real values, thereby consolidating the prevalence of suitable financing opportunities to the population sectors with payment capacity. Ultimately, it is a key element to ensure the permanence and depth of the financial intermediation for housing.

5. Although the use of the direct housing subsidy constitutes a special effort by the state to give a preferential attention to lower income sectors, the state should not neglect attention to the availability of financing options for the middle-income groups and for the higher income levels. Otherwise, the middle-income groups that could not find proper financing opportunities for housing might seize the benefits that have been designed for the lower income groups, thereby crowding these out and causing these fiscal resources to become defocused and diluted.

Since the middle-income groups with enough payment capacity can find adequate options in the market, it is possible to set limits on the target population and to focus the limited fiscal resources, thereby maximizing the social benefits of the public expenditures.

6. Even properly considering all the aspects mentioned above, it should be clear that direct housing subsidies are only one of the mechanisms that should be used to address the problem of low-income housing. Other complementary instruments that can be used to empower the effectiveness of the subsidy include the legalization of informal property, endowing commercial value on informal housing and transforming it into satisfactory guarantees acceptable to the providers of mortgage credit.

It is also important to facilitate access to housing to the sizable and growing informal sectors that, even when they have enough capacity to pay in order to assume long-term debt obligations, do not have the possibility of demonstrating a permanent flow of income in order to be eligible for a mortgage loan.

7. The expected benefits of direct housing subsidies crucially depend on the prevalence of two basic conditions: on the one hand, the sustainability of resources devoted toward such an end, and on the other hand, the credibility of the system. The direct housing subsidies demand an effort of fiscal resources that are generally limited by budgetary constraints. It is important that once a program of this type is launched, it can be sustained over time so that it contributes to stabilizing the demand for housing; in such a way private investment can develop its long-term capacity to supply housing in a competitive form.

It is completely counterproductive to begin a program of direct housing subsidies that creates expectations for potential beneficiaries as well as for the private investors that, perhaps after only a short period of time, has to be discontinued because of the exhaustion of resources. It is not only necessary that the resources of the system be sustainable over time, but it is also required that the operation of the system merits credibility, thereby stimulating the functioning of the markets and not promoting political favoritism.

For this to happen, the system of direct housing subsidies should work on the basis of absolutely clear and objective criteria, and procedures that eliminate to the largest extent possible the political handling of the system by governments.

Relevant Features of Successful Programs

The experiences in the application of direct housing subsidies in Latin America suggest a number of features necessary to attain effectiveness and efficiency in aiding low-income housing. Of course, such programs must be shaped properly, taking into account the particular reality where they will be applied.

1. The housing subsidy should constitute direct state aid, dedicated exclusively to create purchase capacity for a housing solution. In other words, it is a benefit to the demand for housing and not to the supply. This feature will be useful to ensure that the intervention of the state will be focused on the neediest. Also, it will
attract, and not crowd out, private initiatives toward the housing sector, because it will not introduce distortions (i.e., prices or interest rates below the market values) in the real estate and housing finance markets.

2. The direct housing subsidy should be without a requirement for restitution, unless the beneficiary does not meet the established conditions of residency and use of the acquired housing solution. Also, the fact that it is not reimbursable relieves the state of the inherent administrative costs involved in the recovery of funds. To a great extent, these funds will return to the state through a larger tax collection from the direct and indirect impact of greater activity in the housing sector.

3. They should be granted on a once-and-for-all basis to families that are not already owners of a housing unit. In this way, the direct housing subsidy will be an expression of the solidarity of the state and of the society, channeled to the poorest population that is willing to make an effort, inside the boundaries of its own possibilities, to obtain a housing solution.

4. It should complement, not substitute for, the efforts and possibilities of the family to contribute in terms of previous savings and indebtedness. The actual effectiveness of the subsidy will depend, to a great extent, on the existence and expansion of savings and mortgage credit availability. Indeed, the possibility of a subsidy beneficiary to obtain a mortgage loan to complete the value of the housing has been a decisive factor in making an effective use of the subsidy.

For example, the case of Costa Rica shows that a direct housing subsidy directly tied to a mortgage loan can be beneficial to the subsidy beneficiaries. On the other hand, the case of Colombia shows that the obstacles that beneficiaries of the subsidy can face in trying to have access to a mortgage loan can severely limit the use of the approved subsidies.

The use of the mechanism of mortgage refinancing seems to be one of the ways in which the state can promote a greater participation by private financial institutions in granting long-term mortgage loans for housing to the beneficiaries of the direct housing subsidies, by providing the former a greater liquidity for their loans. It is evident that one of the main problems to be solved with the direct subsidy system is the limited participation of the private financial sector in the supply of small-sized mortgage loans, so that there can be financing options for lower income sectors sufficient to meet their sizable needs.

5. The direct housing subsidies should be based on the use of clearly measurable public resources. Among other advantages, this will allow the state to quantify its effort in the development of low-income housing, while the attention remains focused on the poorest. Although not necessary, it is highly advantageous if the direct housing subsidies are to be financed with a budgetary share that does not make distinctions as to the source of funds. In this sense, the sustainability of the system will depend crucially on the health of the public finance of the country in question.

However, the dependence on the public budget will introduce an important stimulus factor for the efficient allocation of such expenses, because this will be a key element in the annual budgetary analysis when evaluated in comparison with the other public expenditure alternatives.

6. The amount of the subsidy should be explicitly known by those who receive it, which will create in the beneficiary an exact awareness of what they are receiving. This is not always possible when the state's aid is expressed through disguised subsidies. For this purpose, the direct housing subsidies should be expressed in the form of funds (or, their equivalent, as is the case of the certificates that are used in several countries), in order to promote a free choice of the housing solution in the housing market by the beneficiary families.

When the attention is focused on the poorest sector, and the state is compelled to generate housing for them or the subsidy provided is practically equivalent to the value of the housing, the state should summon bids from the private sector to supply low-cost housing stimulated by the direct housing subsidy. This is another problem to correct in some countries.

7. Ranges should be established to differentiate the amounts of the subsidies based on income levels and the value of the housing, emphasizing the criterion of progressiveness; that is to say, lower income and lower housing values should be related to a larger subsidy, so that the state's aid to the poorest is not only larger relative to the value of housing, but also in absolute values.

Also, it is convenient if these values are indexed, for example related to the rate of inflation. This mechanism will have the practical advantage of making unnecessary the discretionary readjustment of monetary values, particularly to the established ones for the subsidy, and also provide protection in the face of an eventual erosion from inflation.

In practical terms, focus of the state's aid on the poorest sector can result in a
complex and expensive program. The experience indicates that the use of the income level as the key variable for subsidy allocation may be subject to important margins of error. Therefore, it is helpful in focusing the aid that other relevant elements should be taken into account as has been the case in a number of countries.

- First, in systems that are oriented to provide initial, rather than finished, housing solutions for the lower income levels, a more objective approach to focus on is the current deficit of the housing unit that is intended to be improved with the housing subsidy.

- Second, the establishment of ranges that relate such variables as income, housing values, maximum subsidy and minimum savings, which establish limits for the standards of available housing to which beneficiaries can aspire according to their economic possibilities, also contributes to the promotion of an auto-discrimination process.

8. Transparent procedures should be used for the subsidy allocation. The procedures should be well-known and intelligible for the applicants, beneficiaries and the general public. The approaches used for the selection of beneficiaries should be objective, giving consideration to all variables or factors that can be measured and depersonalized (for example, through a points system) and would, therefore, disregard discrete and subjective elements from consideration.

The credibility of the system of direct housing subsidies and, in consequence, its permanence and effectiveness in assisting the poorest sectors, will directly depend on this transparency of procedures and objectivity of criteria for choosing the beneficiaries. The improvement of the transparency and objectivity of the system should be a permanent task in the search for a better focus of the direct housing subsidies. Therefore, the results and norms should periodically be assessed and, when necessary, adjustments should be made, keeping in mind changing situations.

9. It is very important to put emphasis on previous savings, methodically accumu-

lated, as a requirement for the subsidy allocation. This saving is not only the expression of the effort that the family is committed to make in order to achieve a housing solution, but it would also work well as an objective approach for determining eligibility of the beneficiaries (for example, granting points depending on the amount and duration of savings, among other factors).

It will reinforce the housing policy's success where the family is the main protagonist in the search for its housing solution and not the mere recipient of a charity from the state. In most of the assessed cases, consideration of previous savings or some other expression of the effort of the families is an indispensable requirement for attaining the subsidy.

It has been argued many times that requiring savings as a key factor for the subsidy allocation can in fact disfavor the poorest families, whose incomes are smaller and, therefore, have fewer possibilities for saving. However, as the reviewed practical experiences indicate, procedures exist to put families with different incomes on the same level of competition.

Also, the requirement of previous savings in the case of lower income groups cannot only be expressed in terms of money but also in other assets (e.g., land). Moreover, as in the case in El Salvador, a more eclectic option can be used, in which “previous effort” considers the sacrifice a poor family accepts in leaving its marginal residence zone, where it has established all of its economic relationships, in order to settle down in another zone where it will have to reconstruct such relationships.

Another extremely notable argument to establish previous savings as a requirement to be eligible for the subsidy is that
it serves as a powerful stimulus to the growth of savings properly channeled through the financial system.

10. The structuring of a system of direct housing subsidy demands an important definition regarding whether the subsidy will apply only to finished housing or whether it will similarly apply to an initial housing or improvement of the existing one, susceptible to a process of gradual and later improvement, depending on the economic possibilities of beneficiaries. With no doubt, a key element for the final determination will be the source and amount of the resources available to be allocated to the subsidy regime.

When the application of the subsidy is toward the acquisition of finished housing, it is important that the proportion of the total sale price of the housing that is covered by the subsidy is large enough so that the approved subsidies end up becoming paid subsidies. On the other hand, the approach of applying the subsidy to initial housing and improvements can be very useful, particularly as a housing solution for the lower income population. Besides involving a lesser amount of resources, this approach will be compatible with the true possibilities and priorities of the family, and will therefore avoid eventual difficulties in fulfilling an adequate maintenance of the housing unit.

As for the possible allocation of the subsidy, it is also important to formulate a definition regarding whether it will only be allowed for the acquisition of newly finished housing or whether it will also be possible for the beneficiary to acquire a used housing unit. The possibility of applying the subsidy to the latter option can contribute notably to the formation of a secondary market of low-income housing.

This would facilitate those families that are already homeowners and whose income improves to sell their used housing in order to acquire other, better quality, higher value housing. It should be kept in mind that a very high percentage of the stock of existing housing in a country is used housing, and that the neutrality in the subsidy application between new and used housing would correspond to this reality, ensuring an effective demand for the existing housing on the part of new beneficiaries of these subsidies.

In this manner, lower income groups can initiate their access to housing on the basis of the existing low-value stock, having their current occupants move to higher value housing units. This focus is the one that has recently been implemented in Chile, where the subsidy was preeminently applied for the purchase of new housing in the past.

Another important lesson derived from these practical experiences is the importance of stimulating collective, and not solely individual, applications. At least in the cases that involve the lower income population, it becomes useful for two reasons: first, it promotes the participation of community institutions that support the organization of the housing demand and, in this way, improves the possibilities and the capacities of that part of the population.

Second, and very much related to the above, a more effective use of the subsidy is achieved because the housing search process of the family that will be awarded the subsidy, and the access to the mortgage credit, are both strengthened by a specialized and properly organized technical support that contributes to placing the housing demanders or the mortgage credit borrowers on a better standing with respect to housing and credit suppliers.

REFERENCES


NOTES

1 For a detailed analysis of the topics mentioned in this paragraph, see Gonzales Arrieta (1995a).

2 See Gonzales Arrieta (1997) for an assessment of the application of direct housing subsidy regimes in several Latin American countries: Chile, Costa Rica, Colombia, El Salvador, Uruguay, Paraguay and Ecuador.