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INCLUSION OR EXCLUSION? THE ROLE OF HOUSING SUBSIDIES AND BENEFITS

John Hills¹

Abstract

This paper explores the reasons why the UK has ended up with such an extensive system of intervention in the housing market, particularly through providing subsidised council and housing association housing, and through Housing Benefit. The most important justification which remains valid is to enable those who would not otherwise be able to do so to afford to live in housing of acceptable quality, and doing so while avoiding the area polarisation which would result from the operation of the free market. However, the way in which social housing and subsidies operate in Britain today often reinforces rather than counters social polarisation and divisions. Looking ahead, as society becomes more affluent, including on an optimistic scenario those with low incomes, these problems may become even more acute as housing quality and consumer choice become more important. Systems of rationed provision with little tenant choice or control and no trade-off between cost and quality or location will look increasingly outmoded. The paper explores what could be done to reinvent the way in which we subsidise housing.

1. Introduction

Donald Robertson, the founder of *Urban Studies* and someone deeply concerned with the problems of renewal of our great cities, would, perhaps, have been disappointed that this subject remains such a topical one even in a new century. National income per head in the UK has grown by two-thirds in the thirty years since he died in 1970, the housing stock has grown by more than a quarter, and the most acute post-war housing problems of basic amenities and over-crowding have been largely eliminated (Hills, 1998; DETR, 1998). And yet throughout the UK, problems of social inclusion and exclusion are at the top of the political agenda, and are seen as intimately connected not just with low income by itself (although that is obviously central), but also with where people live, with area decline and polarisation. Urban renewal and regeneration is again a central focus of policy, and a much-needed one (DETR, 2000a, 2000b; SEU, 2000).

What I discuss this paper is a paradox: the possibility that the instruments which in the past did so much to solve the problems of urban decay – provision of subsidised low rent housing by councils and then housing associations and the benefits we now know as Housing Benefit – have become part of the problem. This is not, for reasons

¹ This paper was presented as the Donald Robertson Memorial Lecture at the University of Glasgow in October 2000. The author is Director of the ESRC Research Centre for Analysis of Social Exclusion, London School of Economics. Parts of the paper are drawn from an earlier discussion paper published by the Institute for Public Policy Research (Hills, 2000). The author is grateful to Stephen Duckworth, Paul Gregg, Chris Holmes, Alex Marsh, Pete Redman, Christine Whitehead, Steve Wilcox and the IPPR Forum of the Future of Social Housing for comments on the ideas developed there, to Peter Kemp for very helpful comments on an earlier version of this paper, and to ESRC for funding.

I shall make clear, to argue for their abolition. Rather, it is time for a careful look at why we have such extensive intervention in the housing market, what is going wrong, and at options for reducing some of the perverse effects and moving towards a system which would be more attuned to the demands of the country in 15-20 years' time.

The following sections of this paper examine four topics: the aims of specific housing subsidy and benefit; problems with the current situation in Britain; modest steps towards a more rational system; and, more fundamentally, how much redistribution should be directly linked to housing? The general issues discussed apply across the UK, as do specific issues connected to Housing Benefit, but some aspects of subsidy arrangements for social housing vary between territories, and comments made apply more specifically to England.

2. What are we trying to achieve?

The impact of housing subsidies and benefit is extensive, with a direct effect on more than a quarter of the population (for detailed discussion see: Hills, 1991; Gibb and Munro, 1999; and Wilcox 1999). As these households are drawn disproportionately from the poorer half of the population, any changes to existing systems have important distributional effects, not just in financial terms but also in the choices and opportunities open to people.

While a wide variety of aims has been put forward to justify or explain state intervention of this kind, the core aim which remains most relevant is *to support those who would not otherwise be able to afford an acceptable standard of housing*. In its traditional formulation, this is the aim of “a decent home for all at a price within their means”.

This aim involves the *combination* of two factors: one partly to do with social inclusion, there being a *minimum standard* set by society for housing; and there being a distributional aim – the core target for support is those with *low incomes*, rather than housing consumption in general.

The aim of minimum housing standards is the main reason why we do not simply redistribute cash via the tax and social security systems and leave people to buy their own housing in the free market. Faced with a market choice, some people with constrained resources would opt for a very low standard of housing (over-crowded, low quality) and higher consumption of other kinds. Implicitly this justification involves some form of paternalism: to protect other household members (e.g. children), neighbours and the neighbourhood, or people's own future interests, we are prepared to support a different consumption pattern with higher housing costs than people would have chosen for themselves given the cash.

Although this is not a new reason, it fits with the current rhetoric of social inclusion – being part of society is not simply about cash – there are other dimensions to people's lives too. There is another side of this, however, which is that emphasis on inclusion focuses attention on how people are treated by state systems, to which I shall return.

A related argument is that housing is a “merit good” – voters are more prepared to support redistribution to the poor if it is in kind than if it is in cash. While arguments of this kind are usually unattractive to economists, in political terms they may be very important as one can see from analysis of public attitudes to public spending (Hills and Lelkes, 1999; Patterson, forthcoming).

Overwhelmingly people have continued since the late 1980s to say that they would rather have more spending on health, education and “social benefits” even if it means higher taxes. Hardly anyone wants less spending on these items. But within “social benefits” people distinguish between different groups – in particular being unhappy about increased cash benefits for the unemployed. For instance, more people in the 1998 *British Social Attitudes* survey favoured lower than favoured higher spending on benefits for the unemployed, contrasting with attitudes towards other groups. This is not, I would argue, because of a simple distinction between “deserving” and “undeserving” poor, but because people think the system for the unemployed is badly affected by fraud and disincentives; instead they want the government to guarantee jobs for all. So while not necessarily inherently desirable, support for specific services like housing may offer a more politically acceptable route towards a more equal society than cash transfers.

In the past, the drive for minimum standards has taken different forms – getting rid of overcrowding, ensuring basic amenities, getting rid of slums, ensuring safe environments, etc. Those minimum standards have risen over time – but not as fast as overall living and housing standards. The proportion of the population who can now afford an acceptable standard of housing without specific support is higher than it was.

With rising affluence one would expect this proportion to rise further. At present housing subsidies and Housing Benefit are concentrated on the poorest 30 per cent of the population. Looking 15 years ahead one might hope, for instance, for an increase in this group’s living standards by a third – or in less time if the Government succeeds in reducing relative poverty. An increase of this amount would carry the real incomes of half of them above the current cut-off for the poorest 30 per cent.²

In other words, with this rise in incomes, the proportion below that real cut-off would be halved – a further sixth of the population would move from a position where they are very likely to receive housing support to a real income where today they would be most likely to be expected to get by without specific housing subsidies. Of course, rising minimum standards and/or real housing costs would slow this process. However, given the length of time which reform in this area will inevitably take, the design of any reform has to allow for this kind of development.

Looking backwards over the last 20 years, one could even suggest that the growth in inequality and very slow growth in incomes at the bottom in the 1980s and early 1990s sustained the need for specific housing support longer than might have been expected. As a corollary, a more equal distribution of market income or greater

² Using figures from the *Households Below Average Income* series, after housing costs for 1998-99 (see DSS, 2000, figure 2.1).

redistribution through the general tax and benefit system would be expected to reduce the need for specific housing subsidies.

It should also be noted that the core aim does not in itself imply any particular *form* of support out of the possibilities – subsidised direct provision, housing benefits, subsidies for house purchase, etc – although some may give better value for money than others. There are vulnerable groups for whom direct provision may be justified on the grounds that they could not otherwise cope with the (non-trivial) organisational burden involved in being an owner or finding a private tenancy. However, this group is much smaller than those currently living in social housing.

As one measure, the 1998 *British Social Attitudes* survey reports just 10 per cent as saying that being an owner-occupier would be “just too much responsibility”, and only 3 per cent “strongly agree” with this statement. When the Institute for Public Policy Research asked people in England about their aspirations for children or grandchildren in 20 years time, nearly nine out of ten said they would hope that they would be home-owners (IPPR, 1999). Again, it is important not to ignore this context.

There is a key rider to this core justification for housing subsidies, that is that an increasingly important objective is the need to combat social exclusion and promote inclusion by creating and sustaining communities and areas which include a social mix. It is not acceptable to meet the aim of affordability through supporting housing which is only in low income ghettos, or only in certain parts of the country, even if physical building standards are high. To put it the other way round, we want to ensure that some people with low or modest incomes can afford to live in London, the South East of England, outside the poorest parts of Britain’s towns and cities, and in rural areas. This means that support with housing costs will be needed for those with higher incomes in high cost areas than elsewhere. It may also mean trying to avoid incentives for people to leave particular areas as soon as their circumstances improve.

This objective is reflected in what people want themselves. In the same IPPR (1999) survey, when asked about the kind of area people would like to live in, only 6 per cent said one where most people rented, against 47 per cent for both mixed areas or mostly owned areas.

Having said all this, many of the other arguments which have been used to justify housing subsidies and their particular form in the past look much weaker than they once might have done. Several of these – arguably obsolete arguments – explain how we reached our current position:

- In the past, a key reason for direct provision of subsidised (council) housing was to ensure that available resources went into increased supply, rather than simply bidding up rents or land prices. This argument is far less strong nationally given the better overall balance between housing supply and households since the 1970s.
- At the same time, a far smaller proportion of the population was in a position to afford the investment component of owner-occupation than now. There were also perhaps capital market failures in terms of the ability of those with moderate incomes to borrow against their future incomes. Again, this has changed.

- An important past justification for social rents well below market levels was that, without this, social tenants – generally poorer – would be in a far worse position than owner-occupiers, whose long-run costs were substantially reduced through favourable tax treatment. This has changed for three reasons: lower inflation (and hence borrowing costs which are much closer to real interest rates); the withdrawal of mortgage tax relief; and the much less *unfavourable* tax treatment of other widely available assets like tax-free Individual Savings Accounts (ISAs). Low council and housing association rents were needed in the past in order not to violate fairness or “tenure neutrality”. This is not currently the case (Hills, 1998, pp.177-9).
- Housing subsidies have been given a number of macroeconomic justifications: for instance, investment as a means of reflation without sucking in imports, or subsidies as a way of keeping down inflation. Whether or not good arguments in the past, they do not chime well with contemporary economic policies.
- Finally arguments for *general* housing support on the grounds that there are “externalities” – benefits to neighbours – from keeping property in good repair and so on are much weaker given the higher level of overall housing standards, although they obviously still have force in particular neighbourhoods (and underlie a large part of regeneration activity).

In summary, then, the reason why we continue to provide housing with below market rents and to have a system of Housing Benefit is not just to do with the distribution of income. If that was the only reason we could achieve it simply through more generous Income Support, pensions, tax credits and tax allowances, and leave people to find their own housing in the market (although there would, of course, be major problems of transition from where we are now). But for broader reasons we want to ensure a minimum standard of housing, and to avoid the deep area polarisation which would be thrown up by the unfettered market.

3. Four problems with where we are now

Having set out the aim, I now to look at some of the problems with the current British situation, concentrating on just four given the space available (see Hills, 2000, for more extended discussion).

A. Social polarisation

First, while it is argued above that the aim of inclusion is central, the British housing system and its financial structure are characterised by three forms of polarisation. First, there is acute polarisation on the ground, in terms of estates which are predominantly low income and have high levels of worklessness.

The roots of this lie in tenure polarisation. Figure 1 shows how things changed over the 20 years from 1979. Council and association housing used to be occupied by people from all income groups, including those from higher income groups on the right of the diagram. But this changed dramatically over the 1980s, and 72 per cent of those in social housing now come from the poorest 40 per cent of the population (although this is actually slightly smaller than five years ago).

Geographical polarisation results from the *combination* of tenure polarisation, the way in which much social housing is in large single-tenure estates, and the way allocations have been made *within* social housing. It would after all be possible to have social housing which was only occupied by those with low incomes, but was pepper-potted, without it causing geographical polarisation.

But that is not the position. For research at CASE, colleagues devised an index of “poverty wards” in England and Wales – the 3 per cent of wards with the highest worklessness and overall deprivation in the 1991 Census (Glennister *et al.* 1999). Of those wards with more than 60 per cent social housing, two-thirds come into this tight definition of area-based poverty; where social housing is 70 per cent or more of the ward’s stock, five-sixths are “poverty wards” (Lupton and Power, forthcoming).³

This polarisation is not just a problem for social exclusion, but is also one of failure to meet what people want and their aspirations for the future. It is ironic that social provision whose best justification is to avoid the kind of polarisation which one would expect in a free market, has evolved in a way which in fact has generated polarisation.

Second, the current system polarises the way in which people can make choices over their housing and have control over where they live. Social tenants receive a rationed allocation of housing with a fixed quality and price. As a result of the Housing Benefit system, for many this is free and, for most, variations in price at the margin do not matter. Ability to move between areas is highly constrained (except through very occasional transfers, or through leaving and losing the subsidy from the social tenancy, or through exercising the Right to Buy and then selling).

In terms of a basic aim of access to affordable housing, this usually achieves its aim for those within the system. The same could be said of supplying food parcels instead of cash to benefit recipients, but that would hardly be acceptable in terms of denying people the ability to make their own choices about what they eat. Of course, food is different – similar quality food can be bought at much the same price in most parts of the country. The same is not true of housing – but coping with what Beveridge (1942) called “problem of rent”, should be one of the long-term aims of any far-reaching housing finance reform.

With the mass housing problems of the past greatly reduced, the “food parcel” approach to subsidised housing also looks increasingly unacceptable, and will become more so with rising affluence. One of the great divides in British society is now the difference between the level of control which the more affluent majority has over how they are housed and the often low levels of control of the minority. This is very different from the universal parts of the welfare state such as the NHS and state education. Part of the low level of control reflects low incomes, as with other kinds of consumption. But part reflects the way in which the housing system operates, both with a high degree of rationing and in many places with effective local monopoly suppliers of social housing.

There is a third way in which the housing market is polarised, that is the kinds of choices people can make between the different components of the housing “package”.

³ [**How much of all social housing is in such wards?]

Paying for housing is not just about buying one thing: it involves paying for somewhere to live, getting repairs done and organised, and can involve making a particular kind of investment, or receiving care and support which goes beyond just accommodation. But people largely have to buy one package of these different things as a tenant, or another as an owner. This means, for instance, that:

- The only way to “get into the housing market” (for instance, if you do want to buy eventually but worry about future prices) is buying, almost always a whole flat or house (apart from a small number of “shared ownership” schemes).
- The only way for, say, a poor elderly owner to get someone else to look after and organise repairs for them is by becoming a tenant. Some “care and repair” schemes are available, but the owner would not be eligible for Housing Benefit on this part of their costs if they had a low income, unlike tenants.
- Elderly owners find it hard to realise *part* of their housing equity to provide either a regular income or to defray care costs – “home income plans” have not been very good value for money.
- Meanwhile, it is hard for social tenants to do what many owners can do on retirement, and move to a lower cost area, and even if they can negotiate a rare transfer, there is little gain from doing so, in contrast to the capital which owners free up.

To get round these problems, I will argue later for what I call “fuzzy tenures”, which break down the different parts of the housing package.

B. The quality and reputation of social housing

There is little doubt that the reputation of social housing has deteriorated. As Jo Dean and Annette Hastings (2000) report, once an estate has acquired a stigma, it is hard to remove. The same applies to the sector as a whole – and its reputation would not be improved simply by changing what we call it,⁴ *unless* a change in terminology reflects a change in the perceived reality.

Part of the poor reputation of parts of social housing is to do with the polarisation problems described above. But part reflects its physical condition. Not enough money has been invested in the local authority housing stock to maintain its condition. As a result a substantial repairs backlog has built up. This is not just a matter of the trade-offs which have been made between low rents and low quality in some areas, or constraints on the volume of resources which have been allowed to local authorities; it is also to do with the way the finances of council housing have been run, effectively on an annual “cash book” basis, rather than as relating to a long-term asset:

- Rather than being able to put aside money from rents each year to cover depreciation (or equivalently to carry out or provide for periodic major repairs), councils have been expected to come back to central government to get permission to borrow (credit approvals) every so often to catch up with their major repairs.

⁴ As, for instance, with the change to “community housing” proposed by the IPPR Social Housing Forum (2000), of which the author was a member.

- Once a council is allowed to borrow, subsidy (in England and Wales, at least) is adjusted to cover all the costs of the new borrowing. Councils have every incentive to maximise the scale of their repair problems when arguing for permission to borrow. At the same time they have had no way of planning for repairs on a long-term basis.

This contrasts with the financial position which non-profit housing associations now find themselves in, where planning for major repairs and their financing is now crucial, and where trade-offs can be made over the timing of repairs, maintenance and initial building standards.

All this matters for three reasons:

- The disrepair problem means that many council tenants are having to live in low quality housing and environments.
- The Government has not been taking proper care of one of the largest assets for which it is responsible. In effect, it is guilty of a failure of stewardship of its assets. Ultimately, neglect means loss of the asset altogether. This is not just a problem for government; it also means the loss of part of the existing housing stock, and the need for a new house somewhere else, increasing pressure on green-field sites and making it even harder to meet future housing needs.
- Unless the quality – in terms of what people value, which may have as much to do with environment as that of individual dwellings – is high enough, people with any kind of choice will not live in council housing. This increases the social exclusion problems resulting when the only people living in an estate or neighbourhood are there because they are on benefit and have no choice.

C. The Housing Benefit system

The third problem is Housing Benefit. The advantage of Housing Benefit should not be forgotten: it means that no matter how low someone's income is, a tenancy will always be affordable (unless a private rent exceeds various ceilings set for each area or applying more widely for single people under 25). Its drawbacks are, however, well-known, as for instance laid out in Peter Kemp's studies (1998, 2000) or the recent report from the House of Commons Social Security Committee (2000). Let me list just ten:

- **Administration.** Some councils (particularly in London) simply are not coping at present. Delays in payments hit both landlords – such as housing associations now having to make large write-offs for arrears that will never come back – and tenants, who are plunged into arrears by payment delays. This has been worsened by frequent changes to the system and some anti-fraud measures.
- **Fraud.** The difficulty of running Housing Benefit and evasion of its means-tests leave the system open to fraud. Some control measures have worsened administrative problems. Immediate adjustment of entitlement on “change of circumstances” creates large amounts of petty “fraud” with little reason for treating it as such.

- **Lack of take-up.** Not everyone who should get it. Non-claimants are likely to fall below what is supposed to be the State's safety net.
- **Non-dependant deductions.** The amounts which other members of the household (such as grown-up children) are assumed to contribute to the rent have increased substantially over time. They create more scope for fraud, but also family tension and pressure for young people to leave home, adding to household formation, adding to pressure in high demand areas.
- **Work disincentives.** The steep "tapers" (withdrawal rates for benefit as income rises) in Housing and Council Tax Benefit are an obvious contribution to the poverty trap (but remember that if they were made shallower, more would be affected by them and by the rest of system). But also widespread ignorance of entitlement in work skews perceptions of returns from work downwards (Marsh and McKay, 1993). On the other hand, *knowledge* and experience of (now more common) administrative delays adds to the perceived risks of taking work.
- **Owner-occupiers.** Low income tenants have their repair costs met through HB payment of rent. Poor owners – nowadays between a third and a half of the poorest income groups – get no equivalent help. This can be seen as inequitable (Wilcox, 2000).
- **Housing Benefit pays 100 per cent of rent at margin.** The way Housing Benefit is calculated – a pound higher rent means a pound higher benefit – can reduce the marginal cost of housing to zero: it doesn't matter what your rent is. Or at least, it would not if it was not that to avoid the "blank cheque" this creates, the Department of Social Security imposes "cliff edge" restrictions through the rent ceilings, above which people get no extra help at all. Where tenants cannot adjust, they face painful "shortfalls" to be met from what may be very little money for other purposes (and landlords may withdraw from letting to HB cases).
- **Social landlords can face a "soft budget constraint"** for the same reason – tenant pressure for good value for money can be reduced if rent levels don't matter to most tenants. Again to avoid this, sharp rent caps have been imposed (in England at least) on social landlords. But this means there is no scope in the system for landlords to offer a trade off between service levels and price, or for efficiency pressures to come through that route.
- This structure is part of reason why housing for the poor is run on a **rationing system**. The rest of society choose can the cost/quality trade-off, but the poor get a "food parcel". Basing benefit on 100 per cent of rent is ultimately incompatible with more choice-based systems.⁵ This is exacerbated by widespread "rent direct": many tenants do not even know what rent is.
- **Shopping incentives.** Finally (and by no means the only problem with this structure), although the evidence is not strong, there is some sign of the effects on

⁵ As called for in the Housing Green Paper for England (DETR, 2000a), or the by the IPPR Social Housing Forum (2000).

demand which economists would expect when something is free at the margin, such as less adjustment of housing as circumstances change.

Some of these problems with basing benefit on 100 per cent of actual rent are less serious than they might be if provision for those with low incomes was not dominated by rationing. But as part of a housing system which *did* have more choices and options for tenants or which was intended to increase productive efficiency pressures on landlords, the current system would be bizarre.

D. The structure of social rents

At the same time, social rents are now subject to a bewildering array of conflicting principles through which their levels are determined, most of which bear little relationship to the value of the housing being provided.

When colleagues and I discussed the current system with a range of English social landlords in 1998 *not one* could identify the equity aims of the current financing systems – indeed most were baffled at the idea that fairness or equity had anything to do with housing subsidies at all! (Glennerster *et al.*, 2000) This was in stark contrast to other sectors like the NHS or education. It is, however, hardly surprising. Abstracting from the effects on rents of varying efficiency, the rents paid by social tenants in England can reflect at least *seven* different underlying financial principles. These differ not just between councils and associations, but also within each sub-sector, and many of them are driven by the level rents happen to have been in the past when the music of some part of the subsidy system was stopped, rather than any deeper logic.

For tenants actually paying the resulting rents, the effect of this is that the amounts paid for two identical properties run by landlords with identical efficiency can be completely different. The accident of where someone was allocated by a housing department can lead to them paying different amounts for the same thing.

For most tenants, of course, because of the way Housing Benefit is calculated, gross rents do not matter at all for their net incomes (although they do affect their position in the unemployment and poverty traps). However, the Government has hinted from time to time that would like – for the kinds of reason just described – to move towards a Housing Benefit system which did not adjust fully for rent variations at the margin. If this happened *without* consistency in the principles determining social rents, the result would be to extend the unfairness of the existing anarchy in social rents to a larger and more vulnerable group. It is this problem which led the Housing Green Paper in England (DETR, 2000a) to argue for coherence in social rents before changing the structure of Housing Benefit (although this has not been such a major focus of policy in Scotland, despite moves towards a single social housing tenancy).

The lack of coherence of rent structures is not only an equity problem. It also means that there is no way for tenants or others to use the level of rents as a consistent measure of the relative efficiency of their landlord. An efficient landlord running a good service may be able to do so for costs a few pounds a week less than another. But this difference can be swamped by the variations which result from the different financial regimes.

4. Steps in the right direction

Before turning to the big issues – how much should social rents be subsidised and how much should Housing Benefit depend on actual rents – there are a number of changes which could be made regardless of major reform.

First, in a rationed market, tenants do not have what economists have called the “exit” power which people have for other commodities when they receive a poor or poor value service (Hirschman, 1970). Financial structures have a role to play here in underpinning resident empowerment achieved through other routes, which strengthen their “voice”. This includes:

- Organising and budgeting for day-to-day services locally, on a scale which may be much smaller than appropriate for capital operations;
- Setting clear and consistent guidelines across the social rented sector for what day-to-day spending is expected to be and for how spending relates to rents so that tenants and others can judge efficiency. This should preferably be between several landlords operating locally – not just one large landlord, running most of the social housing in a large city like Glasgow or Birmingham (an objective which may be lost in some current models of transfer of council housing to new landlords); and
- Ultimately ensuring that tenants have the power to “exit” on level financial terms to another social landlord or to self-management.⁶

A second need is for landlord financial structures which are clearly separated from other local authority finance (in the case of council landlords) and allow adequate resources to plan and provide for the long-term maintenance of the stock. In effect this means moving local authority housing onto a financial basis which looks much more like the current structure for housing associations. This could be done through a series of stages, rather than only applying to those councils which opt for immediate outright transfer of their stock.

Third, a corollary of this is the provision of enough resources from central government for council landlords to eat into the backlog of repairs. By way of return, central government would be reducing its ultimate long-term liability which this backlog represents. Like local authorities, central government itself needs to move from financing social housing on a cash book annual basis to thinking of it in balance sheet terms (and there are some signs it is beginning to do so, in England at least, through current moves towards “resource accounting”).

Fourth, I would argue for a set of consistent principles underlying rents and subsidy throughout the social sector. My own preference is that we should set subsidy rules in a way which allows rents to cover reasonable management and maintenance costs and provision for major repairs, and to leave a consistent “capital element” calculated as a

⁶ Council tenants do already have the “right to manage” under 1990s Conservative legislation, but this is very cumbersome to implement.

percentage of current capital value (Hills 1991, 2000). It is the size of this capital element which determines the degree of subsidy in economic terms.

Fifth, there is a very strong case for at least modest reforms of the Housing Benefit system, including immediate action to try to simplify its administration, followed by changes which would fix benefit amounts for a longer period, rather than changing it every time circumstances change. This would be essential anyway if the system was integrated in some way with the Working Families Tax Credit for low income families in work or the Pensioner Credit proposed for low income pensioners by 2003. And there would seem to be distinct advantages in reversing the rises in non-dependant deductions.

Sixth, if we are serious about creating more mixed neighbourhoods, but face the issues of expectations and affluence discussed at the start of the paper, we need an expanded strategy for a range of housing choices which are less sharply differentiated between tenures and locations. These could include:

- Continuation of new mixed tenure developments with some low cost home-ownership;
- But also, where there is demand, there is a case for advertising and renting out existing properties in some currently solidly council rented areas at market rents. This is obviously easier in high demand parts of the country, but even where demand is more moderate, this could help estates which have not yet been hit by major problems of low demand;
- Similarly, offering “equity sharing”, part-buy, part-rent for existing properties rather than just in new developments;
- Both of these would generate resources which could be used to diversify the location of social housing into somewhat higher cost areas; and
- Opportunities for owners to sell part of the equity in their property – to “staircase down” – to meet various needs.
- A wider spread of equity sharing and the proposed structure for social rent setting would open up the opportunity for a balancing market in “housing bonds”, where people could buy a financial asset whose value was related to future property prices, without having to become a full owner of a particular property (Yates, 1989).

5. The big trade-off: How much redistribution via housing?

Faced with the catalogue of problems discussed earlier, for some the solution is simple: get rid of all of the machinery of specific housing subsidies, including abolishing both social housing (by privatising it or transforming it into non-profit bodies competing in the market without subsidy) and Housing Benefit; let the market take care of allocating housing; and use more generous cash social security benefits and adjustments in the tax system (say, more generous income tax allowances and tax credits) to compensate for the losses to those with low incomes which the other measures would cause (for a recent example, see King, 1999).

Getting there from here could be partly dealt with through different kinds of phasing in, but would still be difficult:

- Even if a package of tax and benefit changes meant that *on average* those with low incomes were compensated for other changes, there would be very large gains and losses for individual households. This could be ameliorated by a general improvement in benefits and so on, but only at a substantial net public spending cost, and still leaving some significant low income losers.
- Where people did make large losses, it could take time – and cost – to move somewhere cheaper. Phasing in changes – or “grand-fathering out” subsidies by limiting them to existing recipients – could help with this, but to avoid disincentives to move or take a job, people would have to in some way “take their old subsidy with them” as they moved, increasing the cost.
- The disappearance of social housing subsidies which people currently retain as their incomes rise would inevitably worsen the unemployment, poverty and savings traps. In other words moves designed to help the housing market would harm the labour and savings markets. Again, the changing tax rates and tax credit withdrawal could ameliorate the *depth* of the poverty trap – but only at the cost of extending it higher up the income distribution. There are clearly real problems here – although it does seem perverse that the housing market should be as comprehensively distorted as it is, if it is the labour market which is the real objective.

However, it is important to be clear about the fundamental objections to this approach, even if some useful reforms would go partly in the same direction. Crucially, it would not achieve the core aim of supporting people with what would still be low incomes to afford a minimum standard of housing or of allowing a social mix in higher cost areas. Faced with high costs in particular areas, tenants would be left with the choices of moving elsewhere (to a lower cost region, if the flat rate adjustments to social security were nationally set), reducing quality including through over-crowding, or making drastic cuts in other forms of consumption. Greater area polarisation, new slums and substantial hardship are not attractive outcomes. To observe that current arrangements allow many people to make *no* trade-offs of this kind, and could be reformed to introduce them to some degree, does not imply that the only alternative is the full force of the market.

Such arguments suggest that the “pure market plus cash redistribution” model should be rejected, even as a long-term aim. But enough problems have been outlined above to suggest that we should move away from where we are – particularly from the rationed “food parcel” approach. This means moving towards systems which give those receiving housing support: more choice; more control and sense of ownership; more trade-offs over costs, quality and location. If we don’t do this we are facing the problem that a valuable national asset – the social housing stock – becomes the equivalent of so many black and white TES in an age of colour, or even digital.

At this point it is worth returning to the main initial justification for the combination of sub-market rents and housing benefits whose size is directly related to actual costs. The key issue is affordability of “decent” housing by those with low incomes. We do not want to leave things entirely to the market because of the dangers of very low quality housing and extreme area polarisation which would result. We do not want to load everything onto the Housing Benefit system because in some areas this would cause very deep unemployment and poverty traps. Flat rate allowances as a

replacement for even a small part of Housing Benefit in high cost areas would create hardship for some.

But these problems have one thing in common: they all relate to the difficulties in *high cost* areas and regions. They do not rule out a system which has lower levels of economic subsidy (and so less reliance on rationing) and greater relative reliance on a flat rate element within Housing Benefit in low and medium cost areas.

A first implication of this would be that in setting subsidy rules and grant rates for councils and housing associations, the return on current capital values (that is, the amount of rent left over after other costs) could vary depending on the value of the property. Net rents would be a higher percentage of capital value in low cost areas, but a lower one in high cost areas. This could be done using regional variations, but this both creates discontinuities at regional borders and still leaves a problem within high cost parts of low cost regions. An alternative might be to set a “low subsidy” required return up to, say, the national average capital value of social housing, but a lower return implying a higher level of subsidy for the excess of values above that.

Politically, it may be more likely that we shall see further changes to other benefits, tax allowances, and tax credits which “float” higher income recipients clear of Housing Benefit entitlement (as did the introduction of the Working Families Tax Credit), rather than reform of Housing Benefit’s structure.

However, in the long run there might be moves away from basing Housing Benefit on the whole of actual rent towards a “hybrid” structure of benefit involving a flat rate element and only a proportion of actual rent. In other words, the system could be reformed to introduce what have been labelled “shopping incentives” (although as made clear earlier, the incentive issue is only part of the problem caused by the current structure).

If there was structural reform, I would argue for incorporating a *national flat rate housing costs element* into benefit rates and tax credit structures, with *locally varying* percentages of rent covered by explicit Housing Benefit. This would be an alternative to the idea of, say, benefit being based on 80 per cent of actual rent everywhere with locally varying flat rate amounts which has been described by Peter Kemp (1998, 2000) and others.

For example, if the flat rate element was £20, and local average rents were £50, Housing Benefit would be based on 60 per cent of actual rent. If local rents were higher, the local percentage of rent used would be higher.

The effect of this would be that Housing Benefit would no longer be based on 100 per cent of rent in any region, so there would be “shopping incentives” across the country – the corollary of trying to introduce more choice. However, even in the lowest cost regions, low income households would still be receiving significant specific assistance with their actual costs. Again, higher subsidy at the margin on actual housing costs would be concentrated on the areas where affordability problems were greatest.

As an important corollary of such reforms the need for the crude rent ceilings currently set for benefit claims, and the rent caps for councils and associations would be reduced, if not eliminated. It would be much better to end up with a system that incorporates *some* incentives for all rent levels, than one with none for most people and then very sharp cliff edges and big shortfalls for those above particular thresholds.

But for those who are not currently beyond the cliff edges, would such modest incentives *worsen* the area polarisation described above, as the poorest tenants moved to make gains from living in cheaper areas? If we were dealing with a sealed social housing system where low and moderate income households had no option but the current rationed system, and if that rationed system did not itself often reinforce polarisation, that might be the largest effect (albeit offset by the effects of ending the current potential for big shortfalls). However, the argument through this paper has been that there is an expanding group who increasingly *will* have the option to go elsewhere. Unless we develop finance and lettings systems⁷ which better match the wishes of this group, including systems compatible with greater flexibility and choice, more of them will be outside the social housing system altogether, and the sector as a whole will become even more residualised, and social polarisation virtually automatic. The debate over rents and Housing Benefit has to be seen in the wider context of trying to limit tenure polarisation and reduce area polarisation given that social housing is not a sealed system.

As mentioned above, one can make a case on both horizontal and vertical equity grounds for a modest flat rate housing costs allowance to go to low income owner-occupiers as well as tenants. This would allow the flat rate amount simply to be built into benefit and tax credit rates, but would of course increase the public spending cost substantially (which makes it more plausible to contemplate as part of general redistributive policies, rather than just for Housing Benefit reform reasons).

It would be sensible to approach such changes in stages, not just because this allows adjustment on the part of tenants, but because it also allows experience with the effects of the changes to build up – and if there are problems to adjust what is being done. Thus, the move towards higher net returns on capital values could be phased in by annual steps. Starting in the lowest cost parts of the country, social housing would then gradually move onto a low subsidy regime until the “rising tide” reached areas with average capital values. Similarly, a national flat rate housing costs element could be built up over time – perhaps starting with an initial amount that would be meaningful and then in smaller steps until the target was reached.

The end result of this would be a logical solution to the fundamental objectives of policy and the constraints under which it operates. General subsidy to social tenants (in economic terms) would be modest in low and medium cost areas, allowing much more fluidity in the housing system and more realistic opportunities for choice and mobility. But subsidy would remain high in areas (including higher cost parts of cities in low cost regions) where it was needed to allow a social mix and to avoid severe labour market problems.

⁷ Reform of letting and allocation systems to introduce more choice for tenants and prospective tenants while protecting those in greatest need raises issues which go beyond the scope of this paper, but which are obviously crucial corollaries of the financial issues raised here. See IPPR Social Housing Forum (2000) for discussion of some of the issues involved.

The Housing Benefit reform could be introduced with no net distributional effects – the average case in each area could be left unaffected (and the national flat rate element proposal keeps the scale of gains and losses around this tightly constrained⁸).

But an increase in the capital element of social rents in the way suggested would mean a significant rise in real council rents by the end of the transition period, and hence real losses for existing tenants who were not receiving Housing Benefit (but again, these would be no higher in high cost than in median cost areas). One way of protecting existing tenants might be a radical extension of some of the “fuzzy tenure” ideas mentioned earlier. As rents rose, tenants could be granted an equity share which increased over time. This equity share could both give a rent reduction (a discount from the general level of rents), and could be realised on moving, and indeed left to heirs (see Hills, 2000 for more details). A structure of this kind could also replace the Right to Buy and other discount schemes. It would give a whole new meaning to the idea of tenants having a “stake” in their homes.

6. Conclusions

The summary in Table 1 brings together some of the options described above. The aim would be to help create more mixed communities, greater tenant voice and influence, long-term viability of social landlords, coherence in social rent structures, and less polarisation in housing choices.

On the big issues of rent levels and Housing Benefit, we need to recognise that the problems we are dealing with are different in high and low cost areas. The key objective of housing subsidies is to support those who would otherwise not be able to afford an acceptable standard of housing while avoiding social polarisation. To achieve this, the degree of specifically housing-related subsidy needs to be much higher in high cost areas (including those within low cost regions). In low to medium cost areas there is much more scope to use general measures of redistribution and less reliance on specific housing subsidy, allowing an escape within such areas from many of the problems resulting from rationing.

Running through the lecture has been a theme that we are still prisoners of decisions taken in the 1940s. Beveridge failed to integrate housing costs into his otherwise comprehensive plan for social security because of what he described as the “the problem of rent” – housing costs which varied widely between and within regions in a way which could not be dealt with by flat rate allowances. In contemporary discussions we are no further on – perhaps because we are always, like Beveridge, looking for comprehensive solutions rather than identifying a series of partial ones. Decisions taken in the 1920s and immediately after the second world war established council landlords as the main route (apart from assistance from benefits) for supporting the housing of those with low incomes. This left us – particularly Scotland – with a landlord structure very different from those of most of our European neighbours (Power, 1993).

⁸ For instance, if the flat rate element was as much as £20 someone paying an actual rent which was 50 per cent higher than the relevant average would pay £10 themselves; if actual rent was half the average, they would gain £10. This would apply whatever the appropriate average for the area.

These decisions may well have been appropriate solutions to the housing problems of fifty years ago. Indeed, in pointing to contemporary problems it is important not to forget the huge improvement in housing conditions to which they have contributed. But that very success means that the nature of the problems has changed, and with them appropriate solutions. We are no longer dealing with gross housing shortages across the country or widespread overcrowding or lack of basic amenities. We are also dealing with a much more affluent society, albeit a more unequal one. Furthermore, any wide-ranging reform of housing finance is almost bound to take effect over a long period – adjusting from current arrangements would otherwise be too painful. In setting objectives we therefore have to look at the needs of Britain in 2010, rather than just focussing on 2000.

This need to look at reforms which are geared to a long-term goal has a political downside: the benefits will also arrive in the long term while some of the upheavals required will come more quickly. But if we never make the first moves towards a system better attuned to contemporary needs we shall forever be giving the answer that to get there we should not be starting from here.

[8,470 words]

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