Which Housing Policy Is Best?

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**Abstract**

This paper argues that many widely referenced studies on the cost effectiveness of alternative assistance programs were conducted at a time when rental housing markets were depressed. Recent increases in rent appear to have reduced the apparent cost advantage that demand-side subsidies hold over supply-side interventions. In addition, the nonsubsidized poor increasingly must compete for a dwindling supply of low-cost privately owned housing. Housing vouchers or similar demand subsidies may be appropriate in some contexts, but economic theory and recent empirical analysis suggest that such subsidies are “not the best at all times and under all situations.” Rather, the “best policy” depends on program targeting and the nature and extent of program-induced price increases and externality effects. Since funding limitations currently block the creation of an entitlement housing assistance program, housing policy must balance the often competing goals of expanding the ability of participating low-income households to pay for decent housing while at the same time working to limit the adverse effects that rent increases and the loss of low-cost nonsubsidized stock have on households falling outside of the housing assistance safety net.

To meet the growing need for housing affordable to low-income Americans, the Task Force recommends a significant increase in the supply through new construction, rehabilitation, preservation and acquisition of existing stock.1

The problem for the poor is not the unavailability of housing, but a lack of sufficient funds to pay for housing. Vouchers give the poor the funds that make this private housing affordable. The demand for quality housing created by vouchers would stimulate construction of private housing where necessary. As such, vouchers should become the new President’s primary program of housing assistance for the poor.2

Since the 1930s housing policy analysts have debated how best to spend limited housing assistance resources to aid the poor. The issues are numerous, but over the years the policy discussion has focused on whether it is more effective to intervene on the supply-side — via subsidized housing production — or on the demand-side
via provision of a voucher or rental certificate that enables a low-income household to secure decent housing in the private market.

These issues were at the heart of a series of national housing policy reviews beginning in the early 1970s with the Experimental Housing Allowance Program (EHAP) and culminating in 1982 with the Report of the President’s Commission on Housing. Empirical work continues, but housing policy discussions still rely on data generated by these studies, data that are now more than a decade old.

This study reviews these historical studies, as well as the more recent literature on alternative housing intervention strategies, most notably the early findings of the Freestanding Housing Voucher Demonstration Program. This review is timely for several reasons. The substantial increases in the rent burden of the poor and the growing number of homeless families have sparked renewed interest in housing assistance efforts. After a period of relative inactivity, Congress now appears ready to consider major new national housing legislation.

The worsening housing situation of the poor is of more than political significance. Many of the basic studies of the cost effectiveness of alternative assistance programs were conducted at a time when rental housing markets were depressed. Recent increases in rent appear to have reduced the cost advantage that demand-side subsidies hold over supply-side interventions. In addition, the nonsubsidized poor increasingly must compete for a dwindling supply of low-cost, privately owned housing. An important question is whether the current demand-side efforts — operating as they do on a nonentitlement basis — may add to rent pressure at the low end of the market, in effect aiding some of the poor at the expense of the non-subsidized poor.

The move to vouchers

Following decades of reliance on subsidized new construction targeted to low- and moderate-income households, rent certificates or vouchers emerged as the centerpiece of housing assistance efforts under the Reagan Administration. Drawing on the EHAP and related evaluations of the Section 8 Program, the 1982 President’s Commission on Housing concluded:

The high costs and relative inefficiencies of new construction programs reinforce the desirability of a consumer-oriented
Housing Payments Program which relies primarily on the existing housing market to serve low-income households. (Ibid., 15).

*The President’s Commission on Housing: new directions for housing assistance*

In advocating greater emphasis on demand subsidies, the President’s Commission on Housing contrasted the situations of tenants participating in 1979 in the new construction and existing housing components of the Section 8 Program. Table 1 indicates that tenant rent payments in the Section 8 Existing Housing Program were almost identical to payments made by tenants participating in the Section 8 New Construction Program and that the two programs served tenants of similar income. Department of Housing and Urban Development (HUD) subsidies differed sharply, however, as the average gross rent for the newly constructed units was $362 per month, while that of the existing unit was $240. Under Section 8, gross rent, or payment to the property owner including utilities, equaled the sum of tenant payments plus direct HUD subsidy. Total program costs also included costs of local program administration and federal revenue losses that result from the special tax treatment of newly constructed subsidized units.4

Comparing the gross rents charged for subsidized units with gross rents for similar, nonsubsidized units provides a measure of the efficiency of alternative housing assistance approaches. As indicated in table 1, the estimated average market equivalent gross rent for units in the Section 8 New Construction Program in 1979 was $291 compared with $231 for the Section 8 Existing Housing Program. These market equivalent rents were estimated using an hedonic regression that included both structure and neighborhood attributes. These regressions were then applied to sample units subsidized under the Section 8 New Construction Program. (Wallace et al., 212-14). These estimates imply that it costs $1.41 to produce each dollar of market equivalent rent ($410/$291) with the Section 8 New Construction, while for the Section 8 Existing Housing Program, $1.15 generates $1 of market equivalent rent ($266/$231).

Though providing a simple measure of tenant benefits, the comparison of market equivalent rents with tenant payments in table 1 may overstate the tenant benefits for both the Section 8 New Construction and the Section 8 Existing Housing Programs. Unlike a program of unrestricted cash transfers, the Section 8 Existing Housing
Program constrains households to live in what the program defines as minimally adequate housing. The Section 8 New Construction Program, of course, further constrains participating households to live in the relatively high-quality housing units produced by the program. To the extent that these restrictions are binding, they may force a recipient to “overconsume” housing relative to other goods and may reduce program-related increases in tenant well-being, at least as compared with benefits achieved with an unrestricted cash transfer program.  

Table 1. Components of Costs and Benefits in the Section 8 Program (Average Monthly Costs, 1979)

<table>
<thead>
<tr>
<th></th>
<th>Section 8 Existing Housing</th>
<th>Section 8 New Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Allocation of Cost</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tenant payment</td>
<td>$110</td>
<td>$112</td>
</tr>
<tr>
<td>HUD subsidy</td>
<td>130</td>
<td>250</td>
</tr>
<tr>
<td></td>
<td>= Gross rent</td>
<td>240</td>
</tr>
<tr>
<td></td>
<td>240</td>
<td>362</td>
</tr>
<tr>
<td>Gross rent</td>
<td>240</td>
<td>362</td>
</tr>
<tr>
<td>Other/indirect costs</td>
<td>26</td>
<td>48</td>
</tr>
<tr>
<td></td>
<td>= Total cost</td>
<td>$266</td>
</tr>
<tr>
<td></td>
<td>26</td>
<td>$410</td>
</tr>
<tr>
<td><strong>Allocation of Benefit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tenant payment</td>
<td>$110</td>
<td>$112</td>
</tr>
<tr>
<td>Tenant benefit</td>
<td>121</td>
<td>179</td>
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<tr>
<td></td>
<td>= Market value</td>
<td>231</td>
</tr>
<tr>
<td></td>
<td>231</td>
<td>291</td>
</tr>
<tr>
<td>Market value</td>
<td>231</td>
<td>291</td>
</tr>
<tr>
<td>Excess rent</td>
<td>9</td>
<td>71</td>
</tr>
<tr>
<td></td>
<td>= Gross rent</td>
<td>$240</td>
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<tr>
<td></td>
<td>9</td>
<td>$362</td>
</tr>
</tbody>
</table>

The President’s Commission further argued that the high cost and relative inefficiency of new construction programs produced numerous inequities. Costly new construction programs serve only a fraction of the households that could be served by allocating the same dollars to an existing housing program. Moreover, the commission contended that new construction programs were inherently unfair — under new construction programs, recipients generally were able to live in units that were superior to the housing occupied by moderate-income families not eligible to participate.6

Demand programs also may have costs that exceed the market value of participating units in the program. Under the Section 8 Existing Housing Program, tenant payments are largely determined by tenant income, while subsidy payments increase as gross rent increases to a program-specified Fair Market Rent limit. In this program, there is little incentive for households to limit their housing expenditures, and there is the increasing likelihood that a property owner will raise rents without necessarily raising the quality of the housing provided. Concern about these “perverse incentives” led the Reagan Administration to propose a switch from the Section 8 certificates to vouchers.

Under vouchers, tenants have greater incentives to resist increases in rents not linked to improvement in housing services, since any additional dollar of rent is paid by the tenant. Evaluation of the Section 8 Program noted that one common example of rent increases without corresponding increases in quality involved tenants who previously received an implicit subsidy in the form of below-market rent payments to a friend or relative. The voucher formula reduces these “distortions” because the size of the subsidy does not depend on rent paid, and there is no gain to collusion (Wallace et al. 1981).

**Housing allowance supply experiment**

In dismissing claims that a voucher program would trigger major rent increases, the President’s Commission referenced the EHAP findings, especially those of the Supply Experiment. 7 The Supply Experiment evaluated a “housing gap, minimum standards” housing allowance program, where the subsidy is set equal to the “gap” between the cost of standard housing and some fraction of the recipient’s adjusted annual income. Income-eligible households receive this subsidy if their dwelling unit meets certain “minimum standards” for health and safety. Households living in units that already meet program standards can receive benefits “in place,” but
those living in units not meeting initial program standards must negotiate an improvement with the property owner or move to a unit that meets program standards.

The “housing gap, minimum standards” program was also one of the options evaluated in the Housing Allowance Demand Experiment (HADE) in Pittsburgh, Pennsylvania, and Phoenix, Arizona. In the Supply Experiment, the Housing Payment Standard was set at 25 percent of household income adjusted for certain allowances for childcare and health care. The current Certificate and Voucher Programs set the payment standard at 30 percent. The various programs also differ in terms of specific definition of minimum standards. Minimum housing standards in the Supply Experiment were somewhat more stringent than those used in the Demand Experiment.8

Based on analysis for the Green Bay, Wisconsin, and South Bend, Indiana sites, RAND researchers concluded that the rents in an area served by such a program might increase by 2 or 3 percent, but even this effect would diminish as the market supply responded to the change in demand induced by an allowance. RAND researchers asserted that because housing supply was relatively elastic in the long run, the long-run effects on rents would be even lower, with prices at the end of ten years being increased by only 1 or 2 percentage points.9

Several reasons explain why the Supply Experiment allowance caused only small housing price increases. First, a “housing gap, minimum standards” housing allowance, operating in Green Bay and South Bend in the mid-1970s, generated only small increases in market demand. Overall participation was low, and participating households spent only a small share of their allowance to increase their housing expenditures. After three years, participating renters had increased their rent payments by only 8 percent. (Lowry, table 5.10).

RAND analysts argued further that the increase in demand was diffuse, rather than concentrated in a narrow market segment. Moreover, much of the substandard housing that initially failed to meet program standards could be easily brought up to standard condition. Under these conditions, the relatively small housing allowance-induced increase in demand could be readily accommodated in the market without triggering significant price increases. (Ibid., chap. 6).
To many, the estimates of the income elasticity demand for housing derived from allowance data — as low as 0.2 in many cases — were most surprising. These elasticity estimates were admittedly consistent with other facts about allowance recipients. Prior to the program, many recipients were already paying rents sufficient to cover the costs of standard housing, and most already lived in standard housing. When offered cash assistance, most households chose to lower their housing rent burden rather than increase housing expenditures.

Predictions made before EHAP suggested that households would pay as much as 50 percent of a housing allowance subsidy to purchase additional housing. To better understand how households would spend a housing allowance, the Demand Experiment offered participation in an unrestricted cash transfer program to a randomly selected group of low-income renter households in Pittsburgh and Phoenix. As was true with the Supply Experiment, participants in the Demand Experiment spent only a small share of their income on housing. In Pittsburgh, renters participating after two years in an unrestricted program spent 6 percent of their subsidy on housing, while those renters participating in a “housing gap, minimum standards” program devoted 9 percent. Phoenix households spent somewhat larger shares of their subsidy for housing — 19 percent of unrestricted cash grant and 27 percent of “housing gap, minimum standards” housing allowance went to increased housing expenditures.

The low elasticity estimates suggested to some, however, that the Supply Experiment had failed by specifying too low a set of minimum standards. Others suggested that the experimental nature of the allowance program affected recipient response. Since many households must relocate to increase housing expenditures, transaction costs may inhibit short-run housing consumption adjustments. Given their limited prior experience with housing allowances, arguably landlords were resistant to participating in the program, further raising the transaction costs. Moreover, the experimental nature of the program may have led recipients to treat the allowance as a “windfall,” rather than as a permanent addition to income. To the extent that a housing allowance or other income subsidy is not viewed by recipients as a permanent addition to income, the effect of any transaction cost is magnified and demand response limited.

The elasticity of housing demand

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The relative size of the short-run and long-run expenditure elasticities depends, therefore, on the size of subsidy relative to the transaction costs of adjusting housing consumption and on the extent to which households view the subsidy as permanent. Over time, expenditures increase as households fully adjust to the subsidy, but in the short run, most of the subsidy may go to reducing the recipient’s rent burden.

Using data for Green Bay, Mills and Sullivan estimate that with full adjustment, allowance-induced increases in aggregate rental payments may be three times as large as the short-run estimates presented earlier. Similarly, Cronin estimated a dynamic model of housing consumption adjustment that generated a long-run income elasticity of demand of .68 for Pittsburgh and .47 for Phoenix.

The findings further fueled the debate concerning the efficacy of housing allowance as a tool for improving the well-being of the poor. Data from the Housing Allowance Program suggested that efforts to expand housing consumption came at the expense of low participation rates among eligible households. In effect, the presence of significant inertia in the consumption adjustment of households produced what some labeled the “participation-consumption tradeoff.” As Marc Bendick and James Zais observed in 1978, “The imposition of more stringent housing standards does increase consumption of housing by participants, but reduces the number of households participating.”

Others noted the tradeoff and suggested that a housing allowance program would differentially serve “better off” households, already living in standard housing or housing that required little renovation to meet program standards. Moreover, efforts to increase the poor’s housing consumption by imposing higher minimum standards could have the adverse effect of screening out those households that most needed assistance.

If housing allowances did little to increase housing consumption, some argued that housing allowances must be supplemented with other direct supply-side initiatives that could be more directly targeted to those living in inadequate housing or to large families, rural poor, minorities, or others who might have difficulty meeting program standards in the open market (Bendick and Zais, 20-22). Others questioned the very goal of seeking to expand housing consumption of the poor. These analysts argued that the housing allowance program should be replaced by a consolidated income transfer program to aid the poor. Housing consumption could be increased by imposing more stringent minimum housing standards.
on recipients, but many economists quickly noted that such an effort would undermine the efficiency of the transfer. As Mills and Sullivan observed:

Coercing the poor to spend transfer incomes on housing when they view their most urgent needs elsewhere is hardly the way to improve conditions for the poor. (p. 260)

**Demand subsidies and market prices**

Because the Supply Experiment stimulated such a limited demand shift, it provided little insight as to how individual neighborhoods or housing submarkets would respond to a more substantial demand shock. Some argued that the limited demand and price responses resulted from the choice of study sites. The RAND study design called for the operation of a metropolitan area-wide, full-scale or entitlement housing assistance program for as long as ten years.

Green Bay and South Bend were criticized as being nonrepresentative in terms of rent levels, overall housing conditions, and the extent of concentration of poor and/or minority households in declining inner city neighborhoods.¹⁴

Budget restrictions prevented RAND from operating its Supply Experiment in one of the larger, older, and more densely settled metropolitan areas of the Northeast or Midwest, study sites that would have required offering payments to a substantially larger number of households than was required to simulate a full-scale program in a smaller metropolitan area.

Because housing market dynamics vary considerably from one metropolitan area to another, choice of study area obviously mattered. To assist in the efforts to generalize the EHAP findings, HUD contracted with the National Bureau of Economic Research (NBER) and the Urban Institute to develop microsimulation models that could evaluate the likely market effects of a housing allowance program in differing housing market contexts. These modeling efforts suggested that a housing allowance could indeed trigger significant price increases for both recipients and nonrecipients, as well as encourage disinvestment and abandonment of units that do not meet program standards.

Unlike the efforts of RAND analysts to estimate a single supply elasticity that applies to the entire market area, the NBER model (and to a lesser extent the Urban Institute model) recognized that
the responsiveness of housing investment to changes in rents will vary from one location to the next within a single market area. In addition, the NBER model recognized that this responsiveness is influenced by a number of market imperfections, ranging from the inability of property owners to secure financing for projects in blighted areas to neighborhood externalities that link the profitability of any given household investment to a range of neighborhood amenities beyond the control of individual property owners. In effect, the NBER effort builds from the premise that housing market dynamics are best viewed as a series of short-run supply adjustments that by their very nature tend to lag behind underlying shifts in demand.

In metropolitan areas characterized by significant disinvestment in selected neighborhoods, a housing allowance program could further destabilize the housing market by further inducing households to move out of areas with high vacancy rates and low-quality housing and move into areas with low vacancies and strong upward pressure on rents. In this context, a housing allowance arguably could both add to abandonment pressures in some neighborhoods and stimulate excess demand pressures in other neighborhoods and still not evoke, at least in the short run, a positive supply response that would limit price increases.\textsuperscript{15}

**The continuing voucher debate**

The 1982 *Report of the President’s Commission on Housing* marked a turning point in national housing policy. The 1974 Housing and Community Development Act initiated the Section 8 Program, ending some 40 years of near exclusive reliance on subsidized housing production programs. Since 1982, the movement toward demand-oriented programs has accelerated. The Congressional Budget Office indicates that since 1982, more than two-thirds of all newly authorized commitments for rental housing assistance were for Section 8 Existing or Voucher Programs.\textsuperscript{16} While the demand-oriented approach has won the upper hand in recent funding decisions, recent policy studies raise doubts about the validity of earlier findings concerning the likely market effects of housing allowances or vouchers. In light of the deteriorating housing situation of the growing number of low-income renter households, these studies call into question the efficacy of the current reliance on demand-oriented housing assistance.
Recent trends in rental housing

After a sharp jump in 1981 to 1986, rent increases slowed, thanks to record levels of new apartment construction (and record vacancy rates in overbuilt areas). Nevertheless, since 1981, contract rents increased 16.6 percent faster than the rate of inflation and now stand at their highest levels in more than two decades. Gross rents increased somewhat less because of the slowdown in energy price inflation but still increased 13.6 percent faster than general inflation between 1981 and 1988.\textsuperscript{17}

The increase in real rents parallels the more than decade-long decline in the low-cost rental stock. Measured in 1988 dollars, the number of privately owned, unsubsidized units renting for less than $300 fell by nearly 2.9 million from 1974 to 1985. During the 1980-85 period alone, the number of units renting for less than $300 dropped by slightly more than 1.6 million.

Over the period 1974 to 1985, the loss of low-cost, privately owned unsubsidized stock was tempered by a considerable increase in the number of low-cost subsidized units. Increases in the number of households receiving subsidies have not been sufficient, however, to offset declines in the number of privately owned, unsubsidized units renting for less than $300, which fell by one-third, from 8.5 million in 1974 to 5.7 million in 1985.

According to the 1985 American Housing Survey (AHS), subsidized units account for 33.1 percent of the 8.5 million units with gross rent of $300 per month. In the AHS, some households may report their own rent payment rather than total gross rent inclusive of subsidy payments; hence these figures may overstate the number of units with market rent of $300 or less.\textsuperscript{18}

In interpreting the loss of stock figures, it should be recognized that the term “low-cost” housing is a relative concept. Depending on the market area and the income of potential renters, any given rent may be viewed as “high” or “low.” In this paper, “low-cost” is related to the ability of a representative poverty-level family of four to make rental payments. Currently, the poverty threshold for this family is approximately $12,000; hence using the 30 percent of income standard, this family can “afford” to spend up to $3,600 per year, or $300 per month, for rent. For families with incomes at or below this poverty threshold, loss of units renting for at or below $300 per month constitutes a loss of “affordable” housing.
The $300 figure also has significance in terms of housing supply. In many market areas, a rent of $300 or less is not sufficient to cover the basic costs of maintaining and operating standard rental housing. As a result, if a property owner is unable to rent the unit for an amount higher than this figure, the unit will fall into disrepair, become vacant, and be removed from the inventory. The exact point at which rents fall below some minimum threshold required to sustain the property will vary from market area to market area, but the $300 figure provides a useful benchmark. Unsubsidized units renting for less than this $300 figure experienced loss rates that were more than double the losses recorded for units renting for more than $300 and nearly triple the loss rates recorded for owner-occupied housing.

Considerable attention has focused on preserving the existing stock of subsidized housing, but stemming the loss of privately owned, unsubsidized low-cost units is also essential. Analysis of 1985 AHS data suggests that some 30 percent of the nearly 5.7 million privately owned, unsubsidized units renting for less than $300 are physically inadequate and at risk of loss. These low-quality units appear to be increasingly concentrated in depressed inner city neighborhoods and to represent the final stage of the process of disinvestment and abandonment outlined above. If this view is correct, the loss of low-cost units is likely to persist in the future.

Assessment of AHS data for 1974 and 1983 suggests that structurally inadequate housing, though still common in rural areas, is increasingly concentrated in central city neighborhoods. Further analysis of AHS data indicates that some 1.4 million units (or 16 percent) of the unsubsidized occupied stock renting for less than $300 in 1974 were removed from the housing inventory by 1983. In addition, units that remained in the inventory were being upgraded to command higher rents, while others “filtered down” from a rent level greater than $300 to a rent level less than $300. Over the period 1974 to 1983, upgrading was the dominant dynamic and resulted in further net loss of 830,000 units.19 For further discussion, see Apgar “Recent Trends,” 1989; id., “Nation’s Housing” and “Recent Trends,” 1990; Apgar et al., State of Nation’s Housing, 1990.

The increasing rent levels and loss of low-cost stock pose special problems for the growing number of poverty-level renter households. Today, some 7.7 million renters have incomes at or below the poverty level, an increase of 56 percent from the 1974 level. Single-parent families accounted for a large share of the increased number
of renter households living in poverty; this finding is consistent with the declining real income of this group.

The growth of poverty households in the face of a declining stock of low-cost units is a clear prescription for trouble. In 1985, 5 million poverty-level renters lived in unsubsidized housing, an increase of 40 percent from the 3.5 million in 1974. Increasing numbers of poor households must compete with the near-poor for a dwindling supply of low-cost housing. This competition has forced up the price of housing and boosted the number of unsubsidized poverty-level renters paying more than $300 per month in rent from 1.3 million in 1974 to 3 million in 1985.

**Recent evidence on the market effects of demand subsidies**

As indicated in table 2, the decade-old EHAP findings may no longer provide an adequate basis for evaluating the likely market effects of an expanded Voucher Program. In the Demand Experiment, recipients increased their rental payments by as much as 19 percent, but this increase was associated with lower participation. Participation was somewhat higher in the Supply Experiment locations, but higher participation was associated with smaller increases in housing expenditures. The 1979 evaluation of the Section 8 Certificate Program produced results that were broadly consistent with EHAP, a combination of modest participation rates and small increases in housing expenditures.

In the current Voucher or Certificate Programs, households contribute 30 percent of net adjusted income for housing. The Supply Experiment set this contribution at 25 percent of adjusted income. The Section 8 Certificate Program limits households to units that rent for less than a Fair Market Rent ceiling. In the Supply Experiment and the current Voucher and Certificate Programs, households must meet certain “minimum housing standards.”

Recent findings from the Freestanding Voucher Demonstration Program suggest that the apparent tradeoff between participation and expenditure increases appears to have weakened by 1986. These results imply that today a demand-oriented program may achieve both a higher level of participation and induce a greater increase in housing expenditure than was the case of similar programs that were evaluated in the 1970s, according to Stephen Kennedy, principal investigator on the Demonstration Program.20
Table 2. Comparison of Alternative Demand-Oriented Housing Assistance Programs

<table>
<thead>
<tr>
<th></th>
<th>Supply Experiment 1970s (Percent)</th>
<th>Demand Experiment 1970s (Percent)</th>
<th>Sec.8 Certificate 1979 (Percent)</th>
<th>Housing Voucher 1986 (Percent)</th>
<th>Sec.8 Certificate 1986 (Percent)</th>
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</thead>
<tbody>
<tr>
<td>Participation rate for applicants</td>
<td>56</td>
<td>47</td>
<td>46</td>
<td>61</td>
<td>60</td>
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<tr>
<td>Percent of participants who move to qualify</td>
<td>28</td>
<td>36</td>
<td>56</td>
<td>63</td>
<td>61</td>
</tr>
<tr>
<td>Percent increase in program rent over preprogram rent</td>
<td>8</td>
<td>19</td>
<td>19</td>
<td>57</td>
<td>51</td>
</tr>
</tbody>
</table>


There are several reasons why the results from the 1986 Freestanding Voucher Demonstration might differ from the EHAP findings of the 1970s. First, 1986 program participants had somewhat lower real incomes than their counterparts of the 1970s. Measured in 1986 dollars, recipient net household income averaged $6,426 in the two EHAP sites, compared with approximately $5,600 in the Voucher Demonstration. EHA utilized a somewhat more generous definition of eligibility; hence the higher income of EHAP participants is understandable. At the same time, the declining income of renter households relative to owner households ensures that large shares of renters qualify for assistance even under the more tightly targeted rules.

Moreover, by the mid-1980s, demand-side subsidies were no longer an “experiment,” but were a widely utilized component of national housing assistance efforts. After a decade, recipients were more familiar with housing demand subsidies, local housing authorities were more adept at helping tenants secure housing that met program standards, and property owners were more familiar with program regulations. Growing familiarity with the demand-side subsidies lowers the transaction cost of program participation and increases the probability that recipients will view the subsidy as an increase in permanent income. In either case, these changes increase the willingness of households to adjust their housing consumption as a result of receiving the housing assistance payment.
More significantly, preliminary data from the Voucher Demonstra-
tion suggest that at least some of the differences in participation 
and expenditures result from the changing housing situation of 
recipients. As indicated in table 3, the cost of standard housing in 
the Supply Experiment sites in the 1970s was equal to only 
50 percent of participant household income. In 1986, the cost of 
standard housing was nearly equal to participant income. Mea-
sured as a share of preprogram income, the housing subsidies in the 
1986 Voucher and Certificate Programs were nearly twice as large 
as the Supply Experiment subsidies.

In contrast to the EHAP results, subsidies in the 1986 Demostra-
tion were not only higher as a share of income, but a relatively 
larger share of the subsidy went to increased housing expenditures 
— 60 percent for 1986 vouchers and 58 percent for 1986 certificates, 
compared with only 20 percent for housing allowances. Participants 
in both time periods devoted high shares of their preprogram in-
come to housing, but in 1986, this preprogram effort left households 
well short of expenditure levels sufficient to secure what the pro-
gram defined as standard housing. Thus, unlike the EHAP partici-
pants, who were fairly well housed before entering the program, 
1986 Voucher and Certificate Program participants appear to have 
had significant incentives to use the housing demand subsidy to 
expand housing expenditures.

The data in table 3 imply that expenditure elasticities may be some 
three times greater in the 1986 Voucher or Certificate Program 
than was the case in EHAP. The growing pool of very low-income 
eligible households, the increased rates of participation, and the 
associated increased expenditure elasticity among participants 
imply that the Voucher and Certificate Programs of the 1980s have 
the potential to trigger a greater increase in demand than the 
EHAP program of the 1970s.

In reviewing the potential inflationary impact of vouchers, it is 
important to distinguish between expenditure increases that pay for 
increases in the amount of housing consumed, as opposed to expen-
ditures associated with increases in price paid for a given amount of 
housing. Previous analysis of the Certificate Program in 1979 
suggested that additional expenditures produced little increase in 
housing services consumed. The explanation offered was that the 
presence of the Section 8 Fair Market Rent acted as a “floor,” rather 
than as a ceiling, to rents. Because, for the most part, additional 
rent payments under Section 8 up to the Fair Market Rent ceiling 
were paid by the government, there was little incentive for house-
holds to work to limit their housing expenditures.
Table 3. Comparison of Supply Experiment and Voucher Demonstration

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<tr>
<th></th>
<th>Supply Experiment</th>
<th>Voucher Demonstration</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Green Bay</td>
<td>South Bend</td>
</tr>
<tr>
<td>Recipient net annual income</td>
<td>$7,357</td>
<td>$5,496</td>
</tr>
<tr>
<td>Recipient gross annual income</td>
<td>$8,864</td>
<td>$7,046</td>
</tr>
<tr>
<td>Cost of standard housing</td>
<td>$3,562</td>
<td>$3,329</td>
</tr>
<tr>
<td>Subsidy payment</td>
<td>$1,864</td>
<td>$2,068</td>
</tr>
<tr>
<td>Subsidy payment as percent of:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income</td>
<td>25.3%</td>
<td>37.6%</td>
</tr>
<tr>
<td>Gross income</td>
<td>21.0%</td>
<td>29.4%</td>
</tr>
<tr>
<td>Annual gross rent:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preprogram</td>
<td>$3,983</td>
<td>$3,382</td>
</tr>
<tr>
<td>Preprogram with program</td>
<td>$4,291</td>
<td>$4,146</td>
</tr>
<tr>
<td>Percent change</td>
<td>7.7%</td>
<td>8.2%</td>
</tr>
<tr>
<td>Preprogram gross rent as percent of cost of standard housing</td>
<td>111.8%</td>
<td>115.1%</td>
</tr>
<tr>
<td>Tenant payment as percent of preprogram net income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preprogram</td>
<td>54.1%</td>
<td>69.7%</td>
</tr>
<tr>
<td>Preprogram with program</td>
<td>33.0%</td>
<td>37.8%</td>
</tr>
<tr>
<td>Increased rent payment as percent of subsidy</td>
<td>16.5%</td>
<td>15.2%</td>
</tr>
</tbody>
</table>

Sources: Author's calculations based on data from Lowry, 1983; and Kennedy and Finkel, 1987.
Similar analysis is not available from the Voucher Demonstration, but the magnitude of program-induced increases in housing expenditure suggests the need for caution. If the increased expenditures under vouchers go largely toward purchase of additional housing services as theory suggests, then an expanded Voucher Program would trigger larger and more immediate shifts in housing demand than suggested by the EHAP results. To the extent that vouchers result in substantial increases in the price of housing paid by recipients, then vouchers benefit property owners, rather than tenants. In either case, the presumption that vouchers will not trigger rent inflation is called into question, as is the presumption that vouchers represent a more cost-effective method for increasing the well-being of low-income recipients.

**Are production programs necessarily inferior?**

The recent increase in market rents challenges the proposition that demand subsidies are a cost-effective method of housing assistance. First, rent increases have raised the cost of subsidizing households through use of the existing stock and have made new construction programs relatively more attractive. In addition, by expanding the supply of rental housing, subsidized new construction programs may limit future rent increases, benefiting not only recipients, but others in the form of reduced rent payments. Although overlooked in recent housing policy literature, the price effects of housing supply programs may be important and certainly must be included in any complete assessment of alternative housing assistance approaches.

*Increasing rents and the costs of subsidized construction*

Comparing the relative cost of subsidizing new, as opposed to existing, housing involves several distinct components. First, subsidized production involves administrative costs not incurred in private construction, while subsidized construction often must adhere to higher construction standards that raise its cost relative to the cost of unsubsidized new construction. Next, the subsidy mechanism itself may reduce the incentive of the subsidized developer to produce housing in the least costly manner, at least as compared with the incentives operating for unsubsidized private development.

“Economic inefficiency” constitutes a final element of the cost differences. Under subsidized construction programs, units may be built
in depressed locations or at times during the business cycles when construction costs are high relative to market rents. In these situations, private market construction may be nonexistent, and subsidized units, even if built in the least costly manner, may have costs in excess of market value. Moreover, in weak market situations, market rents for units that just meet minimum program standards may be low relative to the market rents of better quality housing, further adding to the cost advantage of programs that focus on modest housing as opposed to new housing.

Each of these elements is not fixed but depends on program design and market conditions. Various experiments with “turnkey” construction represented efforts to improve the cost effectiveness of producing public housing. Moreover, it is important to reconsider the cost implications of rules that require publicly assisted construction to meet higher building code standards, rules that may raise construction costs relative to the cost of private construction. Finally, the relative cost of new construction as a subsidy tool depends in a critical manner on market conditions. In markets with a general excess supply of rental housing, the market rents for modest-quality units may fall well below the market rents for new units, while the market value of new units themselves may fall well below their construction cost.

Clearly, these relationships change over time and from one market area to the next. Since 1979, the date of the Section 8 Program data referenced in The Report of the President’s Commission on Housing, market rents have increased relative to the cost of new construction. As measured by the residential investment deflator component of the gross national product (GNP), construction costs increased by 47 percent from 1979 to 1988. By comparison, gross rents for a unit of constant quality increased by 59 percent over the same period. These trends have altered the relative cost of New Construction versus Existing Housing Programs. At the same time, the recent increase in real rents has increased budget outlays for units now under subsidy over the outlays projected when these commitments were first authorized (Pedone).

As these figures suggest, the relative costs of new construction and existing programs depend on the market context in which these programs operate. The special characteristic of housing conditions in the mid-1970s lowered the cost of leasing existing units relative to the cost of new construction. Summarizing detailed work on the topic that was completed as part of the Housing Allowance Experiment, Steven Mayo and his colleagues at Abt observed:
Thus what appears to be a “finding” in the comparative cost literature — that existing housing costs are less than new construction costs — may be more highly conditional on program features, administration, and economic conditions than some researchers have acknowledged.22

For a similar view see the comments of Anthony Downs in his 1973 work.23

The market effects of supply subsidies

Critics of subsidized housing construction programs often contend that these programs simply displace private nonsubsidized production and hence do not add to the aggregate supply of housing. If aggregate residential rental construction activity is limited by a scarce factor of production, subsidized production may simply bid these scarce resources away from nonsubsidized construction. Limitations on the aggregate flow of funds into the residential rental construction sector or on the supply of land zoned for multifamily development imply that — even in the short run — increases in the amount of subsidized new construction displace private, nonsubsidized production.

In a 1973 study, Craig Swan examined the housing subsidy programs of the 1960s and 1970s including Sections 221,235, and 236. Under the national housing finance system in place at the time, Swan found that subsidized housing construction had no net effect on total new construction because subsidized construction simply drew mortgage funds away from private nonsubsidized developers.24

Economic theory also suggests that the displacement of private, nonsubsidized production need not be the case. Subsidized housing production programs themselves may actually increase the aggregate supply of a factor of production available to the broadly defined construction sector. With direct government lending, or through creation of new financial intermediaries, subsidized housing programs can expand the aggregate flow of funds into the residential construction sector and thus expand aggregate construction. Similarly, subsidized development built on government-owned land or land that is otherwise not available to private production also does not displace nonsubsidized development.

Subsidized housing production may succeed in expanding aggregate supply and lowering market prices in the short run, but over time these effects may fade. The initial price decreases triggered by
subsidized construction may reduce incentives to build new units or keep current units in the housing stock. If subsidized new construction accelerates disinvestment or abandonment of existing units or reduces private new construction, the long-term effect on supply is reduced.

The extent of these market effects depends on the location of the subsidized development and on the nature of the housing produced under the program. Within any local housing market, there will be distinct housing submarkets defined both by the type of housing provided and by the characteristics of the households served. While housing submarkets are linked in the sense that households can move from one submarket to the next, they are not perfectly linked. Moreover, housing capital is fixed in location, durable, and difficult to modify. Thus it is quite possible at any one point in time to have an excess supply of dwelling units in one submarket (e.g., new efficiency apartments in large multifamily structures) and an excess demand for units of another type (e.g., lower quality, three-bedroom apartments in small wood frame structures). Depending on the proximity of the two areas, it may take many years for vacancies or price changes in one housing submarket to affect investment in another submarket.

Thus the displacement effect of subsidized production will depend on the type and location of units produced. Subsidized construction of new single-family homes in a moderate income suburban neighborhood may have a relatively immediate effect on unsubsidized construction of single-family homes. By contrast, the subsidized production of three- or four-bedroom rental apartments targeted for occupancy by low-income families with children may have little displacement effect. Because there is little private new construction of this type of unit, the subsidized construction program will most certainly expand supply in this submarket. Moreover, the additional supply may persist, especially if there is excess demand for low-cost three- or four-bedroom apartment units. In this situation, adding a new supply may limit price increases for the available supply of these units, without necessarily reducing maintenance and repair of existing units.

Given the importance of the topic, the limited analysis of the market effects of new construction programs is surprising. Michael Murray’s macroeconomic analysis of subsidized housing production suggests that a well-designed and targeted production program need not displace, and often may augment, the supply of privately produced dwelling units. Based on an analysis of subsidized construction for the period 1961 to 1977, Murray argued that the
displacement effect of the privately financed units was nearly complete, but his macroeconomic analysis suggested that construction of 100 public housing units expanded aggregate housing supply by 75 units. Murray attributed the results in the public housing case to the fact that the program was financed by government borrowing and that it targeted production to low-income housing submarkets not closely linked to submarkets well served by nonsubsidized new construction and investment.25

Microeconomic simulation studies completed with the Urban Institute model also suggest that supply subsidies can expand aggregate supply and lower market rents, again with the extent of the price effects dependent on the nature of the program and the characteristics of the market area in which it operates. In *Housing Policies for the Urban Poor*, Struyk, Marshall, and Ozanne report on their use of the Urban Institute Housing Simulation Model to simulate the market effects of alternative housing assistance programs. Under the mortgage subsidy program, aggregate new construction increased and market prices for existing housing fell from 7 to 8 percent, depending on characteristics of the simulated metropolitan area.

Although available studies are limited and somewhat outdated, they underscore the importance of understanding better the market effects of housing supply programs. Just as the Voucher Program may impose costs on nonparticipants by raising prices, supply programs may confer benefits on nonparticipants by lowering or holding in check market price increases. Market price effects must be included in any complete assessment of the relative merits of alternative housing assistance programs.

**Housing market dynamics: the efficiency and equity of alternative transfer systems**

In discussing the merits of alternative housing assistance efforts, economists are quick to point to the substantial body of theoretical literature on the presumed efficiency of cash, as opposed to in-kind, assistance as a redistribution measure. Assuming that recipients know best how to maximize their well-being, cash transfers allow recipients to make the choices that are best for them. There are, however, noted exceptions to this general rule. When individual choice leads to the underconsumption of a good that society values or the consumption of a good that imposes costs on others, in-kind provision of assistance may be judged superior for efficiency.26
In addition to efficiency issues, alternative forms of subsidy have differing distributional consequences. If a housing assistance program raises or lowers market prices, it imposes costs or confers benefits on nonrecipients and generates gains or losses for property and land owners. Despite their obvious importance, these price effects, until recently, were largely ignored in the theoretical literature. This section briefly describes the economic literature on the efficiency and equity of alternative housing assistance programs and, using a simple example, illustrates that under a non-entitlement housing assistance program, the distributional effects of the market price changes may easily overwhelm the direct effects of the subsidy for participants.

**Housing programs and economic theory**

Standard economic theory holds that because housing allowances constrain consumer choice, they generally are inferior in efficiency terms to pure cash transfers. The effect of imposing housing standards is reduced, of course, in situations such as that of the Supply Experiment in which relatively large proportions of households live in “minimally acceptable” housing before the program. In such cases, the housing allowance approaches an unrestricted cash grant and is superior to in-kind assistance on efficiency grounds.27

In a recent paper, Stephen Johnson and Richard Zeckhauser observe that program-induced price effects, or pecuniary externalities, have been ignored by the literature on transfer efficiency. They argue that by lowering market prices, a supply-oriented program provides benefits to households by “sticking the stuck,” that is, a supply program implicitly taxes the economic rents that accrue to the owners of fixed (for example, land) or quasi-fixed (for example, long-lived durable capital) factors of production.28

Johnson and Zeckhauser also observe that it may be more efficient to tax implicitly the owners of these fixed or quasi-fixed factors of production than to pay directly for a larger program of cash transfers funded from general tax collections, taxes that introduce into the economy their own set of distortions. Johnson and Zeckhauser conclude that not only do the distributional effects of alternative subsidy programs depend on the extent to which these programs alter market prices, but the relative transfer efficiency of these programs also depends on these price effects.

A second assault on the presumed efficiency of cash transfers follows from the current housing policy debate. One common theme
Espoused by critics of demand-oriented programs is that production programs targeted to low-income recipients help advance other social goals. Advocates for supply-side programs argue that new construction programs not only directly benefit recipients, but also benefit all members of society by stabilizing the macroeconomy, promoting neighborhood revitalization, and expanding the range of housing choices available to racial or ethnic minorities.

A variant of this approach is the notion that housing is but one element in a broad array of income transfer programs that include provision of employment, training, health care, and other services directed at improving the well-being of the poor. This theory provides a rationale, for example, for producing low-income housing designed to house groups with special health or human service needs. In these instances, it can be misleading to judge the efficiency of a transfer program through too narrow a lens. Assessing the effect that alternative forms of housing assistance may have on the delivery of other services is an important aspect in evaluating the overall efficiency of the transfer.

Measuring the benefits and costs of alternative programs

Drawing on estimates obtained from the Voucher Demonstration, table 4 indicates that Voucher Program participants receive a direct monthly subsidy of $299. Including the cost of program administration and other indirect costs, total cost per voucher recipient totals $347 per unit per month (or $299 plus $48). This subsidy enabled voucher recipients, on average, to consume a unit with a market equivalent rent of $433 and to reduce their rental payments to $151 from a preprogram level of $278.

Assuming that the ratio of total cost to gross rent and the ratio of gross rent to market equivalent rent remain the same as in the 1979 Section 8 evaluation, it is possible to calculate tenant benefits and total program costs consistent with the 1986 Voucher Demonstration results. As indicated in table 4, these estimates imply that, with the Voucher Program, average monthly tenant benefit equals $282, where tenant benefit is again defined as the difference between the market equivalent rent and tenant payment.

Table 4 also presents estimates of program costs and tenant benefits for a representative new construction program. Absent current data on the cost of subsidized new construction, this table employs estimates of the change in construction costs as proxied by the residential investment deflator of the GNP and of the change in
rents as proxied by the Joint Center for Housing Studies residential rent index to update to 1986 dollars the 1979 estimates of new construction costs presented in table 1. Table 4 further assumes that administrative and other indirect costs have not changed relative to production costs over the period. In combination, these assumptions imply that it costs the government $549 per month to serve a tenant under the new construction program (HUD subsidy of $475 plus $74 of other/indirect costs), some 58 percent higher than the $347 government costs of the Voucher Program ($299 subsidy plus $48 indirect/other costs).

Table 4. Components of Costs and Benefits
Housing Vouchers and Representative New Construction Programs
(Average Monthly Costs, 1986)

<table>
<thead>
<tr>
<th></th>
<th>Housing Vouchers</th>
<th>Representative New Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Allocation of Cost</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tenant payment</td>
<td>$151</td>
<td>$151</td>
</tr>
<tr>
<td>HUD subsidy</td>
<td>299</td>
<td>475</td>
</tr>
<tr>
<td>= Gross rent</td>
<td>450</td>
<td>626</td>
</tr>
<tr>
<td>Gross rent</td>
<td>450</td>
<td>626</td>
</tr>
<tr>
<td>Other/indirect costs</td>
<td>48</td>
<td>74</td>
</tr>
<tr>
<td>= Total cost</td>
<td>$498</td>
<td>$700</td>
</tr>
<tr>
<td><strong>Allocation of Benefit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tenant payment</td>
<td>$151</td>
<td>$151</td>
</tr>
<tr>
<td>Tenant benefit</td>
<td>282</td>
<td>392</td>
</tr>
<tr>
<td>= Market value</td>
<td>433</td>
<td>543</td>
</tr>
<tr>
<td>Market value</td>
<td>433</td>
<td>543</td>
</tr>
<tr>
<td>Excess rent</td>
<td>17</td>
<td>83</td>
</tr>
<tr>
<td>= Gross rent</td>
<td>$450</td>
<td>$626</td>
</tr>
</tbody>
</table>

Source: Author's calculations based on preliminary results of freestanding voucher demonstration. Costs and market value of the representative new construction program assume some degree of production “inefficiency” present in the 1979 Section 8 evaluation.
Continuing the example, the data in table 4 are consistent with the general finding that more households can be served under a demand-oriented program than under a supply program. Table 5 indicates that, under a Voucher Program with parameters as shown in table 4, 719,000 households could participate for an annual cost of $3 billion, but the more expensive new construction program would serve only 455,000 households for the same total $3 billion expenditure. 29

As noted above, in addition to direct program costs and benefits to participants, program-induced price changes impose costs or confer benefits on households and property owners. While the exact size of these price effects is difficult to establish, it is relatively simple to show that the distributitional effects of even small market price changes in nonentitlement housing assistance programs may easily overwhelm the direct effects of the subsidy for participants.

Table 5. Estimates of Total Benefits
Net of Rent Changes
for Housing Vouchers and Representative New Construction Program

(Billions of 1986 dollars unless otherwise specified)

<table>
<thead>
<tr>
<th></th>
<th>Housing Vouchers</th>
<th>Representative New Construction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participating households</td>
<td>0.719</td>
<td>0.455</td>
</tr>
<tr>
<td>(in millions)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total subsidy plus other indirect costs</td>
<td>$ 3.000</td>
<td>$ 3.000</td>
</tr>
<tr>
<td>Benefits to recipients</td>
<td>$ 2.434</td>
<td>$ 2.151</td>
</tr>
<tr>
<td>Eligible households not participating (in millions)</td>
<td>4.280</td>
<td>4.545</td>
</tr>
<tr>
<td>Nonparticipant rents:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preprogram</td>
<td>$ 14.302</td>
<td>$ 15.182</td>
</tr>
<tr>
<td>With program</td>
<td>$ 14.588</td>
<td>$ 14.884</td>
</tr>
<tr>
<td>Change</td>
<td>+ .286</td>
<td>-.298</td>
</tr>
<tr>
<td>Total benefits net of nonparticipant rent change</td>
<td>$ 2.148</td>
<td>$ 2.449</td>
</tr>
</tbody>
</table>

Source: Author’s calculations based on data in table 4 and assumptions specified in text.
For example, the data presented at the bottom of table 5 assumes that the participants in the Voucher and New Construction Programs were drawn from a pool of some 5 million eligible households. This scenario sets the eligible pool to be equal to the estimated number of poverty households not currently participating in housing assistance programs. As indicated in table 5, even an increase of $3 billion dollars would provide only enough vouchers to serve 719,000 of this pool of 5 million households. The remaining 4.28 million households would continue to go unserved.

Calculating the aggregate effect of the Voucher Program on the target population requires an estimate of program-induced market price change. Assuming that nonparticipants have an average preprogram rent equal to that of participants, then aggregate preprogram rent for nonparticipants is some $14.3 billion per year. In this context, the program-induced expenditure increases are large relative to preprogram rents; hence, it is reasonable to assume that nonparticipants will experience some rent inflation. As indicated in table 5, even a modest 2 percent increase in nonparticipant rents implies an aggregate rent increase of $286 million, an amount that lowers total benefits net of rent increases to $2.148 billion.

Applying the same logic, but in reverse, the New Construction Program depicted in table 5 directly serves only 455,000 households but potentially benefits nonparticipants by lowering market rents. In this case, nonparticipants number 4.545 million and pay a pre-program annual rent of $15.182 billion, which equals the pre-program monthly rent of $278 multiplied by 12 multiplied by the number of nonparticipants. For these nonparticipants, a small 2 percent reduction in market rents totals $298 million per year. Combined with the direct participant benefit figure of $2.151, this rent savings raises total benefits to $2.449 billion for eligible households.

This simple example illustrates that modest program-induced price increases can easily overwhelm differentials in direct participant benefits. Moreover, program-induced price increases almost certainly would not be confined to the pool of eligible households. Households already participating in subsidized housing programs will experience some rent increases, as will households with income just above income eligibility guidelines. These increases may be modest compared with the rent increases experienced by those in the eligible group, but with the national aggregate rent bill totaling some $150 billion, even a small percentage rent increase adds up to large aggregate dollar amounts.
Admittedly, table 5 does not constitute a formal cost/benefit analysis of the efficiency and distribution characteristics of alternative housing assistance efforts. Following Wallace and the President’s Commission on Housing, table 5 uses the simplifying assumption that the average recipient benefit is defined as market equivalent gross rent less tenant contribution. In theory, this approach may overstate program benefits for both production and existing housing programs to the extent that programs standards constrain a household to “over consume” housing, at least relative to an equivalent amount of cash transfer. Unfortunately, available estimates of program benefits that attempt to correct for these biases are based on limited data more than a decade old. Moreover, while focusing on the distortion in consumer well-being associated with program-related constraints, these studies ignore the equally significant constraints on consumer choice operating in the nonsubsidized market (presence of racial discrimination, for example), not to mention the potential for program-induced benefits accruing to nonrecipients as a result of production and consumption externalities.

Even allowing for the fact that new construction programs may have transfer inefficiencies greater than those suggested in table 5, the central argument of this paper still holds. Assuming, as a worst case, that households living in subsidized new construction receive no additional benefits over and above those of tenants living in existing units and subsidized by vouchers. Total direct benefits would fall to $1.540 billion (455,000 recipients multiplied by monthly benefit of $282 multiplied by 12), substantially below the direct benefit measures of $2.434 billion produced with vouchers. In this instance, it would take a 3 percent market-price effect (or some unspecified combination of market-price effects and positive externalities) to offset the presumed differential efficiency of the production versus voucher program illustrated in table 5. In short, transfer efficiency is just one criterion for judging the merits of alternative programs. Externality effects, be they pecuniary or real, must be accounted for in any complete assessment of alternative subsidy approaches.

Which policy is best and who decides?

In his book *Housing Policies for the Urban Poor*, Raymond Struyk asks the question, “Which Housing Policy Is Best?” His candid answer is as follows:
It depends. It depends on which objectives are weighted most heavily; on conditions in the housing market at the time the program is introduced, and on income trends, growth in the number of households, and the cost of producing housing. There is no single answer; indeed, there may not even be a single answer for each metropolitan area. (Chap. 6)

This quotation echoes the central theme of this paper, for indeed, both the relative efficiency and the distributional consequences of alternative housing assistance programs depend on a variety of factors. Vouchers may be good in some contexts, but economic theory and recent empirical analysis suggest that they are “not best at all times and under all situations,” especially when the concept of best is expanded to include both subsidized and nonsubsidized poor.

The “best policy” depends in a critical fashion on the nature and the extent of program-induced price increases and externality effects. Because a growing number of poverty households compete with the near poor for the dwindling supply of low-cost housing, housing policy must involve a blend of supply and demand subsidies. Because funding limitations currently block the creation of an entitlement housing assistance program, housing policy must balance the often competing goals of expanding the ability of participating low-income households to pay for decent housing while at the same time working to limit the adverse effects that rent increases and the loss of low-cost nonsubsidized stock have on households falling outside of the housing assistance “safety net.”

Programmatic discretion is essential if scarce housing resources are to be used in a manner that best serves the interest of all the poor. The recent scandals at HUD and the visible failure of some locally operated housing programs are reminders that discretion can be misused and abused. Decisions regarding the appropriate blend of housing supply and demand subsidies cannot be made at the federal level, nor will they always be made wisely at the state or local level. Rather than continue the futile debate as to whether future housing assistance efforts should involve mostly vouchers or mostly production subsidies, the nation would do well to undertake the business of developing flexible programs that offer appropriate choices to state and local decision makers. Perhaps more importantly, rather than continue to pay homage to the virtues of the private marketplace, the nation would be wise to create the institutional capacity needed to operate a national housing policy sensitive to local market conditions and dedicated to serving the best interest of all the poor.
Author

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Endnotes


8. For discussion see Struyk and Bendick 1981.


27. For general summary see Francis J. Cronin, “The Efficiency of Demand-Oriented Housing Programs: Generalizing from the Experimental Findings,” *The Journal of Human Resources* 18: 100-25. See also Cronin 1981 and 1982; and Reeder 1985.


29. Widely cited studies include Mayo et al. 1980; Wallace 1981, and more recently Sa-Aadu 1984. Since these studies are based on data for the 1970s, they tend to overstate the current cost advantages associated with the voucher approach. Notice that while the data from 1979 presented in table 1 suggest that 77 percent more households could be served under the less costly existing housing programs, simply adjusting the data for changes in rents and construction costs lowers this figure to 58 percent. Though widely cited as a reference in support of the cost effectiveness of voucher programs, Mayo recognized this point and presented evidence that suggested in Phoenix, in 1960, market conditions might have been such as to eliminate totally the cost advantage of new production programs over existing housing programs. See Mayo 1980.