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The Economics of Housing Vouchers

JOSEPH FRIEDMAN
DANIEL H. WEINBERG

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Joseph Friedman

Department of Economics
and Center for Urban Studies
Tel Aviv University
Tel Aviv, Israel
and
Abt Associates Inc.
Cambridge, Massachusetts

Daniel H. Weinberg

Office of Income Security Policy
U.S. Department of Health and Human Services
Washington, D.C.

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Preface

This book presents an examination of the housing choices of low-income families in two metropolitan areas—Phoenix and Pittsburgh. Some of these households were offered a novel kind of housing subsidy—a housing allowance or housing voucher—in an experimental framework designed to test this approach to demand-side housing assistance. A housing allowance is a direct cash payment made to a needy family, typically based on its income and willingness to find decent housing in the marketplace. A voucher is sometimes suggested as the method to implement this housing assistance strategy.

Three types of housing allowance plans were tested in the Housing Allowance Demand Experiment. One, the "Housing Gap" housing allowance, covered the gap between the cost of modest but decent housing and the fraction of income a household is expected to devote to housing. Housing Gap allowances were conditional subsidies paid only to income-eligible households whose housing met certain health and safety requirements ("Minimum Standards"). As an experimental alternative, the requirement that recipient housing meet these Minimum Standards was replaced by a requirement that housing expenditure exceed a specified "Minimum Rent" level. The second housing allowance type, the "Percent of Rent" housing allowance, offerred participants a rebate of a percentage of their rent. Finally, to allow comparisons of housing allowance schemes with income maintenance programs, an "Unconstrained" housing allowance was tested. This type of allowance used the same payment formula as Housing Gap allowances without imposing any housing requirement on participants.

Chapter 1 presents an overview of U.S. housing programs and the dimensions of the U.S. housing problem. The experimental context of our analysis is then described. The rest of the book is divided into three major parts.

The first part investigates the "normal" housing market behavior of low-income households. This investigation of their housing demand uses the housing price reduction resulting from the Percent of Rent allowance to examine their demand for housing. Chapter 2 presents a simple microeconomic model that conceptualizes household behavior and then presents a summary of some of the extant evidence on housing demand. The remainder of the chapter estimates housing demand models for the low-income population in the Demand Experiment, using housing expenditures to measure housing. Chapter 3 then takes a different approach to measuring housing—a hedonic index of housing services that abstracts from particular characteristics of the household or landlord that may affect rent and attempts to measure housing in a more objective manner.

The second major part of the book examines the responses of Housing Gap and Unconstrained households—households receiving an income-based housing subsidy. Chapter 4 presents a model of household behavior that leads to the methodology for estimating experimental effects. The procedure adopted measures household response as a deviation from normal behavior. The models of normal behavior draw on the findings of Chapters 2 and 3. Two types of housing change are examined for Minimum Standards households in Chapter 4—physical housing standards and housing expenditures. Chapter 5 repeats the analysis for Minimum Rent households, and Chapter 6 examines the effect of both kinds of Housing Gap allowance payment on the consumption of housing services (the more objective measure of housing introduced in Chapter 3).

In the final part of the book, Chapter 7, we use our findings, and the findings of other analyses of additional aspects of housing allowances, to focus on the implications of the experimental findings for housing policy. We compare a housing allowance strategy with two other approaches, a pure income-transfer approach and a construction-oriented approach, concluding that none of the three strategies offer *the* one solution to the U.S. "housing problem." After discussing the role a housing allowance program may play in this housing policy triad, we offer some suggested approaches to implementing such a strategy.

The appendixes cover both basic and technical information. After providing more detail on the design and implementation of the Demand Experiment, we offer several technical appendixes that explicate our methodologies in detail and extend the analysis of the main text into additional areas. The final appendix offers some supplementary tables.

Housing vouchers are a particularly timely and important federal housing strategy. The final report of President Reagan's Commission on Housing (1982) has endorsed the concept of housing vouchers as a major element of U.S. housing policy. Similarly, the U.S. Department of Housing and Urban Development (HUD) has sent legislation to Congress in an attempt to create a workable national program of housing allowances (see Congressional Budget Office, 1982). We believe that our book can provide some valuable insights for housing policymakers in both the executive and legislative branches of government as they formulate and consider such an approach.

Similarly, the book would be of interest to all those interested in housing policy, ranging from economists and regional and other social scientists in academia, to housing analysts and HUD, the Congress, and housing lobby groups, and to state and local government housing officials (particularly to those likely to be administering such a program). Others that may find useful information in this book are social scientists interested in the results of one of the largest social experiments ever conducted.

Acknowledgments

This book is the result of 3 years of work on the Housing Allowance Demand Experiment by the authors. It is the condensation of two reports to the Department of Housing and Urban Development (HUD) under a contract to Abt Associates Inc. (AAI) under HUD's Experimental Housing Allowance Program. Without the support and guidance of the members of HUD's Office of Policy Development and Research, the work would not have been possible. The study was carried out under the general and very capable direction of Jerry Fitts and Terry Connell, with the more specific attention of Garland Allen.

The success of the research effort owes a great deal to the careful development of the research design by Stephen Kennedy, Walter Stellwagen, James Wallace, and Helen Bakeman. All were intimately involved in the day-to-day operation of the experiment and the conduct of the research—Kennedy as the overall project director and principal investigator, Stellwagen as the overall quality control reviewer and general statistical advisor, Wallace as the director of research, and Bakeman as deputy project director. Special thanks go to Stephen Mayo, with whom we had numerous discussions on the housing economics involved and who paved the way for several of the analyses we undertook.

Several others contributed to the analyses presented here. Sally Merrill developed the hedonic indices used in Chapters 3 and 6, and Fred Luhmann performed many of the computer programming tasks involved in managing the data processing for the reports. Others too numerous to mention were involved in writing the questionnaires, developing the data base, and providing comments and suggestions along the way. We would also like to thank Clark Abt and Benjamin Chinitz for their support in the early stages of writing this manuscript. Cogent comments and suggestions were provided by Ernst Stromsdorfer and Raymond Struyk, who reviewed the first draft of this book. Of course, none of these individuals or institutions share our responsibility for the analyses reported here.

Even though the initial analysis work was supported by HUD at AAI and one of the authors is now at the U.S. Department of Health and Human Services (HHS), this book was written by the authors in their private capacity. No official support or endorsement by HUD, HHS, or AAI is intended or should be inferred.

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Chapter 1

Introduction

In the past 50 years, the federal government's role in the housing sector has grown from nearly nil to that of a major participant. This evolution was a response to the perception that the free market failed to respond adequately to the nation's housing needs. Government intervention was needed if the goal of the U.S. housing policy was to be fulfilled. This goal, as stated succinctly in the U.S. Housing Act of 1949, is to "provide a decent, safe, and sanitary living environment . . . for every American."

Although the mix and emphasis of housing policies has varied over time, most programs have been construction-oriented—geared toward increasing the supply of adequate housing. During the 1960s, economists, housing specialists, and the public at large criticized most housing programs as inequitable and wasteful. The programs were considered inequitable because they served only a small fraction of the population eligible for housing assistance and wasteful because the subsidized units were more expensive to build and maintain than similar units in the private housing market. Economists added an inefficiency argument, to wit, that the housing subsidy received was as an in-kind benefit and was therefore valued by the recipients as worth less than its cost to the government. These criticisms led to a revival of the idea of a demand-oriented alternative—a program of housing vouchers called *housing allowances*.

The idea of housing allowances is not new. It was considered but rejected in the formulation of the original Housing Act of 1937. However, in the early 1970s, when the disadvantages of conventional housing programs became increasingly apparent, housing allowances began to be considered a viable policy alternative.

Housing allowances are regular periodic payments made directly to eligible families (or individuals) unable to afford a decent home in a suitable living environment. The amount of the periodic allowance is usually related to a family's size and its income and often to the cost of a standard, existing house or apartment located in a modest neighborhood, as determined in each locality separately. Since the allowance is paid directly to families, they are given the purchasing power to enter the market for decent housing and considerable freedom to select the house or apartment they wish. Recipient families are freed from the direct stigma of welfare assistance or unwarranted restriction on individual choice. The only restriction on the family's choice is the imposition of some basic minimum of housing standards on the unit it occupies. These standards reflect the policymakers' views on what characterizes decent or adequate housing.

A properly designed housing allowance program can meet the policy goals of providing needy families with adequate housing at a price they can afford. Recipients would choose existing units rather than be constrained to specially built subsidized housing. Thus, with a given housing assistance budget, more eligible families could be served by an allowance program than by conventional, more expensive, construction-oriented programs.

Support for housing allowances was far from unanimous. Critics charged that demand subsidies, which do not directly add housing units to the stock of adequate housing, would cause housing price inflation. In addition, doubts were raised about the ability of low-income households to use their allowances effectively in competition for adequate housing units in the marketplace.

In order to determine the effectiveness of a housing allowance-based housing assistance strategy, the U.S. Department of Housing and Urban Development (HUD) established a research program on housing allowances—the Experimental Housing Allowance Program (EHAP). HUD sponsored three experiments, each designed to address a particular cluster of issues:

1. How do households use their allowances? (Demand Experiment)
2. How does the housing market respond to the allowances? (Supply Experiment)
3. Can existing public agencies adequately administer a program of housing allowances? (Administrative Agency Experiment)

This book is based on our analysis of household behavior in the Demand Experiment. It describes how families changed their housing in response to housing allowance offers.

THE EVOLUTION OF HOUSING PROGRAMS

Before World War I, public intervention in the housing sector was limited to regulatory measures such as building and occupancy codes to assure minimum standards of safety and health. Large-scale intervention, particularly direct assistance designed to improve housing conditions, is therefore a relatively modern phenomenon.

In the nineteenth century, public concern was concentrated on sanitation, rather than directly on housing. As cities became increasingly populated by poor immigrants, public officials became aware of the severe health problems in densely settled neighborhoods. They proceeded to install or improve water supply and sewage systems. This trend was reinforced in the late nineteenth century as the germ theory of disease gained prominence (Burns and Grebler, 1977, p. 75). Government intervention in housing was extended to include such requirements as sanitary and running water systems and improved ventilation in newly constructed buildings.

Housing conditions that may facilitate the spread of disease have largely been eliminated in the United States. Nevertheless, the continuing public intervention in the housing sector demonstrates that there are additional reasons for public involvement. The two major contemporary rationales for government intervention in the housing sector are housing market imperfections and "merit good" considerations.[1] Imperfections in the housing market arise from "such factors as the fixed supply of land in urban settings, zoning and discrimination which reduce tenant mobility, linkages between location and job availability, lumpiness of housing outlays, credit risks, and so forth" (Musgrave, 1976, p. 215). Furthermore, the existence of externalities in neighborhoods whereby the attributes and living conditions of one dwelling unit can affect the value and living conditions of another also argues for the government to attempt structural remedies for these imperfections.

The basic argument for providing cash assistance to households to be used specifically for housing instead of general cash transfers is based on the belief that housing is a "merit good—a form of consumption which society views more important than allowed for by individual choices" (Musgrave, 1976, p. 215), coupled with the feeling that "the poorest people among us should live in better housing than they are able to afford,

[1] The rationales for government intervention in housing have been discussed at length in U.S. Department of Housing and Urban Development, *Housing in the Seventies Working Papers* (1976). See particularly the papers by Weicher, Muth, Musgrave, and DeSalvo.

and that they should be assisted to do so" (Weicher, 1976b, p. 182). In particular, the imposition of building codes to improve the quality of housing increases its cost and places a floor on the rents of such housing. This rent is typically higher than the share of income that families at the lower end of the income scale would freely choose to allocate for housing. Housing subsidies could then be viewed as a way to compensate poor families for the government's actions in limiting their housing choices.

Many approaches have been used to provide housing assistance to low-income households.[2] Subsidies for low-income families began in 1937 when the public housing program was established. Under this program, local housing authorities were empowered to replace slum housing with newly constructed rental housing. The federal subsidy reduced the capital cost of the project by reducing the effective rate of interest paid by the developer. In 1968, the federal subsidy was extended to cover part of the operating costs of public housing projects as well. A second major program was the urban renewal program, established in 1949. This program reduced the costs of building by partially subsidizing land acquisition costs.

To enable the government to work through capital markets, the Federal National Mortgage Association (FNMA) was established in 1938. In their "below market interest rate" program (Section 221.d.2), FNMA lent money at below-market interest rates to private developers agreeing to build moderate-income housing. In 1961, Congress created the "market rate" program (Section 221.d.3). This program allowed loans for apartment projects. It was complemented by the 1965 "rent supplement" program, which allowed the federal government to make rental payments on behalf of tenants to the sponsors of "market rate" housing, thus permitting low-income families to live in conventionally financed (at the market interest rate) housing. Rent supplements covered the difference between 25% of the tenant family's income and the rent. These interest rate programs were succeeded by the Section 236 interest subsidy program.

Since 1961, home ownership has also been subsidized by the federal government. The subsidy program extended loans to buyers who were perceived to have high default probabilities. In 1968, the Section 235 program introduced subsidies for home purchase using the same formula as did the Section 236 program.

Practically all federal housing programs came under criticism by the late 1960s and the early 1970s as being too costly, not working as desired, or not serving enough eligible families. At that time, a major shift in policy

[2] This description of U.S. housing programs is based on Weicher (1976*b*).

was undertaken to focus on the demand side of the housing market, by giving subsidies directly to families. This approach was in sharp contrast to the supply-oriented programs in which subsidies were in effect tied to specific units. The Housing and Urban Development Act of 1965 added two programs—the rent supplement program and the Section 23 leased-housing program—which moved in the direction of the housing allowance by giving beneficiaries more flexibility in choosing the places they could live and by making the value of the subsidy depend on a family's income. The Section 23 housing program allowed Public Housing Authorities to lease existing private dwelling units and subsidize low-income households to live in them. One potential expansion of this program was to provide housing allowances—to directly enable eligible households to purchase adequate housing in the private market. The households themselves would then be responsible for finding apartments and negotiating with landlords.

One step toward such an unrestricted system of housing subsidies was the 1974 revision of the Section 23 program—retitled Section 8. The Existing Housing portion of the Section 8 program focused on households as objects of the subsidy and permitted them to locate suitable units by themselves, but the government retained some control over location and assisted in lease negotiation, with payment going directly to the landlords. (The two other parts of the Section 8 program are known as "New Construction" and "Substantial Rehabilitation" and retain a supply-side orientation.)

Housing allowances, though not a new idea, having been examined by Congress in some way for more than 40 years (see Hamilton, 1979, pp. 3–4), may be viewed as representing a further step in the direction of demand-side housing subsidies. As mentioned earlier, housing vouchers were considered but rejected in formulating the Housing Act of 1937. They were reconsidered in the Taft Subcommittee hearings on postwar housing policy in 1944, in designing the Housing Act of 1949, and in the 1953 report by the President's Advisory Committee on Government Housing Policies and Programs.

In 1968, the President's Committee on Urban Housing (the Kaiser Committee) argued in favor of a housing allowance and recommended that the government undertake an experiment to determine whether a housing allowance program would be feasible and worthwhile. Housing allowances were thought to have several potential advantages. Housing allowances could be less expensive than some other kinds of housing programs because they permit utilization of existing sound housing and they are not tied to new construction. Housing allowances could also be more equitable. Because no new units have to be built, more eligible households can be served by a housing voucher program than by a new construction program of the same dollar size.

In addition, the amount of the allowance can be adjusted to changes in income without forcing the household to change its residence. To obtain better housing than is required to qualify for the allowance, households may also, if they desire, use their own resources, either by paying higher rent or by searching for housing more extensively. As long as program requirements are met, housing allowances offer households considerable choice in selecting the housing most appropriate to their needs. In contrast to traditional housing assistance programs that provide a specific type of housing in a given location, housing allowance recipients are free to choose where they live. They may choose to locate near schools, near friends or relatives, or to break out of racial or socioeconomic segregation. They may also choose the type of building they live in—single or multifamily. Finally, housing allowances may be less costly to administer. Because program administration need not involve supervision of every detail of participant housing, the burden of obtaining housing that meets essential requirements is shifted from program adminstrators to participants.

The recommendations of the committee inspired preliminary analytic efforts, and small-scale demonstrations were conducted by the Model Cities agencies in Kansas City, Missouri, and Wilmington, Delaware. The Housing and Urban Development Act of 1970 called for HUD to carry out a major investigation of housing allowances; under this mandate HUD initiated the Experimental Housing Allowance Program (EHAP). Of the three experiments initiated, only the Demand Experiment was designed to examine the effects of alternative formulations of the housing allowance on the behavior of households offered an opportunity to participate. The Demand Experiment was also the only one to follow the model of prior social experimentation, by including control groups and drawing heavily on the design of the income maintenance (negative income tax) experiments.[3] Neither the Supply nor the Administrative Agency experiments included a control group and should, therefore, more correctly be called demonstration projects.

THE U.S. HOUSING PROBLEM

There is a widespread perception by the American public that there is a housing problem. Furthermore, it is believed that the problem can and

[3] See, for example, Rossi and Lyall (1976).