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II HOUSING AND URBAN RENEWAL POLICIES

PUBLIC FINANCING OF HOUSING AND URBAN DEVELOPMENT IN WEST GERMANY

By Udo E. Simonis

"Rationality about a subsystem can be worse than subrationality about the whole system."
Kenneth E. Boulding

1. Recently, housing and urban development have become exposed to a peculiar configuration of conflicting trends and strained economic relations: the overall weak performance of the economy, the critical situation of public finance, a rapid increase in the cost of capital, a sharp rise in energy prices, and a relative shortage or excess of material and social infrastructure. The housing sector has responded to these trends basically in two ways: by a more-than-proportionate rise in product prices (i.e. housing costs and rents), and by a certain shift in the product structure (i.e. from tenements to owner-occupied housing). Although there is still an overall housing shortage in Germany - and even a growing housing shortage in certain urban areas and for certain social groups - we are experiencing a decrease in production and employment in the housing sector of the economy.

2. The economic background of housing and urban development, therefore, provides two important indications: first, housing costs should not grow too rapidly if a minimum additional supply is to be provided and a certain volume of housing production to be retained, and, second, effective demand should be strong enough and a certain balance in the

demand structure should be maintained to ensure that the necessary supply can be generated. It is in this interrelationship between the supply of and the demand for housing where public finance comes into the picture.

3. Since World War II, the housing sector of the economy in the Federal Republic of Germany, and especially in West Berlin, has never been left to respond to market forces alone. The housing stock as well as new housing investments have always been and still are (sometimes quite strongly) directly and indirectly influenced by government intervention. Over the years, there has been a remarkable shift in the extent, emphasis, and impact of government intervention in the housing sector.

4. There was an overall stock of about 24 million dwelling units in Germany in 198o. Approximately 37o ooo new units were added to the stock during that year. An estimated 2o ooo million Deutsche Mark (DM) of public finance (government expenditure and government revenue foregone) flowed into the housing and urban development sector. Assuming that this sum is apportioned solely to newly built dwelling units (and not existing ones), a new dwelling unit on an average is supported by 5o ooo DM.

However, these and the other data used in this paper must be regarded with some reservation. The amount and structure of public finance support for housing and urban development can be quantified only by rough estimation. Measures of promotion are numerous and overlap. The division of labour between the Central Government, the Länder and the Communities as well as the various institutions involved together create a very complicated transaction mechanism. It is justifiable to speak not of a system but of a conglomerate of government intervention measures in the housing sector.

5. In order to gain an impression of the importance of public financing in housing and urban development in Germany

it is not sufficient to look solely at the expenditure side of government budgets. On the contrary: the largest part of all public support is granted in the form of tax advantages. The amount of public revenue foregone however can only be "guesstimated", using the number of supported housing units and the average tax advantage per unit as a basis for calculation. In other words, in order to judge public financing of housing and urban development in Germany, public expenditure in the form of open subsidies for housing stock and new housing investment must be seen together with public revenue foregone in the form of tax concessions, tax exemptions and other hidden subsidies. The latter are now more important than the former.

6. As previously mentioned, for the year 1980 the overall sum of public financing for housing and urban development in Germany is estimated at approximately 20 000 million DM, of which 70-75 % flowed into single-family (owner-occupied) housing and the rest, i.e. only 25-30 % remained for tenement housing. (Of this total sum, some 7 400 million (or 37 %) was provided by the Central Government.) In comparing this sum of 20 000 million DM with the sum of total housing investment which in 1980 reached about 120 000 million DM, an indicator may be found for the economic impact of government activities on the housing sector.

T a b l e I gives statistical details of public finance support for housing and urban development in Germany for the year 1980.

7. In Germany, distinction is traditionally made among three subsectors of house financing representing distinctive government involvement: (a) privately financed housing ("freifinanzierter Wohnungsbau"); (b) tax-concessioned housing ("steuerbegünstigter Wohnungsbau"); (c) publicly subsidized housing ("Sozialer Wohnungsbau").

Freifinanzierter Wohnungsbau

In general, there are no direct government subsidies or special tax advantages and also no specific regulations regarding standards, prices (rent), etc. Financing on an average is composed of 7o-8o % privately borrowed capital (Ist and IInd mortgage loans, loans from building societies) and 1o-3o % equity capital.

Steuerbegünstigter Wohnungsbau

Tax concessions are granted if certain conditions regarding the amount of space per family size, rent and tenants' family income are met. Loans and *contributions à fonds perdu on* the yearly service of interests for and redemption of mortgages are granted (on a temporary basis).

Sozialer Wohnungsbau

Publicly subsidized housing, comprising rental and owner-occupied housing is principally aimed at low income groups. The eligibility for publicly subsidized housing is dependent upon definite criteria regarding family income and size of the family and the dwelling unit. In millions of cases over the years these criteria, however, have indirectly become obsolete. Increases in income and decreases in family size have led to a severe maldistribution of publicly subsidized housing (Fehlbelegung). The rent in the field of "Sozialer Wohnungsbau" is publicly controlled; this rent is, on an average, about 5 DM per square meter and month. It is fairly low compared to the total housing cost. The cost price for new houses on an average is now over 2o DM per square meter and month, and in Berlin, in some cases, nearer to 3o DM. The obvious discrepancy between controlled rent (Sozialmiete) and total housing cost (Kostenmiete) has grown rapidly in recent years, leading to an enormous burden on the public budget if standards are to be retained and costs not reduced, and if a certain volume of annual production is to be maintained.

Seen historically, public financing in the housing sector has used three different methods of d i r e c t financing: capital subsidies, interest and redemption subsidies, and mixed subsidies for the housing project. All are handled either in the form of loans at reduced interest rates or in the form of a contribution à fonds perdu. The relative importance of these three methods has changed greatly over the years (from capital subsidies to interest and redemption subsidies). It also differs from one federal state to the other.

There has also been a certain shift in priority in public financing from new housing investment (Neubau) to existing stock (Altbau) which means that relatively speaking, project modernization and urban renewal are gaining in social and economic significance. The economic incentives for project rehabilitation and modernization and for urban renewal, in fact, seem to be stronger now than those for new housing construction and development. Large portions of total housing investment now go into certain parts of the city housing stock and in many cases lead to over-modernization (Luxusmodernisierung) and/or to the transfer of property - from the status of rental housing to owner-occupied condominiums.

In addition to the d i r e c t subsidies already mentioned which are all related to the housing project itself (Objektsubventionierung), person-oriented, individual subsidies (housing allowances or "Wohngeld") have been introduced and are gaining increasing significance. "Wohngeld" as a direct subsidy to the monthly rent of an individual tenant or to the housing cost of an individual owner is now an important part of German housing policies although having only an indirect effect on financing new housing investment. It will have even greater social significance if the ratio between the rent or cost of housing and the family income increases further - and this is what will probably happen in the future.

9. There are various indirect subsidies regarding i n d i - r e c t public financing in the housing sector: tax exemptions, tax concessions, public assurance of privat credit solvency, etc. Their main positive effects are considered to be (a) mobilization of private capital by promoting capital formation and influencing capital yield; (b) promotion of self-financing through granting of depreciation privileges - especially tax concessions under Art. 7b of the Income Tax Act; (c) facilitation of capital formation for special tasks, e.g. in the form of depreciation allowances for project rehabilitation and modernization and energy saving measures; (d) reduction of the management, land and construction cost of housing - especially real estate tax.

However, because of their suspected and/or real regressive effects on the distribution of income and wealth, most of these provisions of indirect financing of housing have come under strong pressure from academic and political critics. Various schools of thought have developed and flourish, and the message they preach varies from the theme of "back to the market" to that of "stronger, goal-oriented government intervention" in the housing sector. It is here, that by favouring or not favouring indirect or direct government influence a remedy is thought to be found for the relatively weak performance of the housing sector in Germany in recent years.

1o. Those who will win this intellectual debate as to whether, where, how, and for whom government should intervene in the housing sector (and those who will implement the related political strategy) must take into account that the market itself is ailing. Recently, the demand for housing has been badly affected by the high interest rates for mortgages, which are now above 1o % p.a.. By German postwar standards, capital costs are now extremely high and they are being kept artificially so because of international economic considerations. Furthermore, rapidly rising building land prices have been observed in cities (above 5 % p.a.); they will

continue to grow as long as it pays to keep land and not to sell it. Additionally, construction costs are rising annually at an average rate of about 1o %; these costs will continue to rise as there is a premium for high cost and a disincentive for low cost housing construction. It is due to these developments that several research institutes expect the real volume of building output in Germany to decrease in the current year by about 4 % compared with last year.

Table I:

Public Finance Support for Housing and Urban Development, 1980 - Estimates in million Deutsche Mark (DM)

Field of Activity/Measures	Central Government	Länder and Communities	Total
1. Publicly Subsidized Housing			
- Interest and redemption subsidies (Object-oriented subsidies)	750	1,950	2,700
- Interest reductions, connected with the actual stock of loan	-	-	2,500
note: loan payments	800	1,900	2,700
loan repayments	700	-	700
2. Other Interest Reductions			
- Civil servant housing	-	-	550
- "Social burden sharing"	-	-	150
3. Person-oriented, Individual Subsidies (Wohngeld)	950	1,100	2,050
4. Indirect Public Financing			
- Tax concessions (§§ 7b & 54 Income Tax Act)	1,750	2,350	4,100
- Tax concessions (§ 7,5 Income Tax Act)	200	200	400
- Tax concessions (Real Estate Tax Act)	-	1,300	1,300
5. Non-Profit Building Societies			
- Tax exemptions	250	250	500
6. Project Modernization, Energy Saving Measures			
- Financial subsidies (Federal and Länder Programs)	400	400	800
- Tax concessions (§ 82 a Income Tax Regulation)	200	250	450
7. Promotion of Savings for Building Purposes			
- Premiums	950	950	1,900
- Tax concessions	300	400	700
8. Financial Subsidies for Urban Development, according to:			
- Urban Development Planning Act	250	450	700
- Short and long-term programs	250	500	750
- Additional Länder-programs	-	500	500
Sum: Total Public Finance Support for Housing and Urban Development	7,400	12,650	20,050

Source: DIW, Wochenbericht 50, 1980.