

Fundamental Housing Policy Reform

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Abstract

This paper argues that the two most serious shortcomings of the current system of low-income housing assistance are its excessive reliance on project-based assistance and its failure to provide housing assistance to all of the poorest families who ask for help. Evidence on the performance of housing programs indicates that project-based assistance has enormously excessive cost for the housing provided. It also needlessly restricts recipient choice. The non-entitlement nature of the system is inconsistent with plausible assumptions about taxpayer preferences. The paper describes concrete actions that will eliminate the excessive cost of the system and achieve an entitlement housing assistance program for the poorest households without spending additional money, and it shows that the major objections to these proposals are inconsistent with evidence on program performance.

Key Words: Housing policy, Low-income housing assistance, Housing vouchers

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1. Introduction

Low-income housing programs are an important part of the U.S. welfare system. The most widely cited figure for government expenditure on these programs refers to HUD's direct expenditure. This amounts to about \$25 billion a year. This figure ignores major USDA programs, the large and rapidly growing Low Income Housing Tax Credit, expenditures of state and local governments, and the many indirect subsidies that account for a large part of the cost of the system. In fact, governments in the United States spend directly or indirectly roughly \$50 billion a year on low-income housing programs. So they spend substantially more on housing subsidies to the poor than on other better-known parts of the welfare system such as Food Stamps and TANF.

The purpose of this paper is to describe the major shortcomings of the current system of low-income housing assistance and how these shortcomings can be remedied without spending more money. The major shortcomings of the system are its excessive reliance on project-based assistance and its failure to provide housing assistance to all of the poorest eligible families who ask for help. The consequences of the excessive reliance on project-based assistance are that many low-income households that could have been provided with adequate housing at an affordable rent within the current housing assistance budget continue to live in deplorable housing and taxpayers pay unnecessarily high taxes to achieve the current outcome. Disengaging from project-based assistance to existing apartments as soon as current contractual commitments permit,

terminating or phasing out current production programs, and avoiding new programs of project-based assistance would provide the resources to serve millions of additional households. These savings together with a gradual reduction in the large subsidies to current recipients would convert the current system to an entitlement housing assistance program for the poorest households without spending more money, thereby avoiding the inequity of providing assistance to some households and denying it to others with the same characteristics.

The paper is organized as follows. Section 2 provides an overview of the current system of low-income housing assistance. Section 3 summarizes the evidence on a wide range of effects of low-income housing programs. Section 4 presents in more detail the evidence on the cost-effectiveness of different housing programs. Based in part on the evidence concerning program effects, Section 5 argues for exclusive reliance on choice-based housing assistance. Section 6 shows that the usual objections to exclusive reliance on choice-based assistance are inconsistent with evidence on the performance of existing and past programs. Section 7 describes concrete proposals for eliminating project-based housing assistance. Section 8 argues that taxpayer preferences call for an entitlement housing assistance program for the poorest families. Section 9 shows how this can be achieved without spending more money. Section 10 summarizes the paper.

2. Overview of Current System of Low-Income Housing Assistance

The U.S. government provides assistance to live in rental and owner-occupied housing.¹ The most important distinction between rental housing programs is whether the subsidy is attached to the dwelling unit or the assisted household. If the subsidy is attached to a rental dwelling unit, each family must accept the particular unit offered in order to receive assistance and loses the subsidy when it moves. Each recipient offered tenant-based rental assistance has a choice among many units that meet the program's standards, and the family can retain its subsidy when it moves. The analogous distinction for homeownership programs is between programs that provide subsidies to selected sellers of housing and those that provide subsidies to buyers who are free to choose from many available houses.

There are two broad types of project-based rental assistance, namely, public housing and privately owned subsidized projects. Public housing projects are owned and operated by local public housing authorities established by local governments. The overwhelming majority were newly built for the program. Until 1969, with minor exceptions, federal taxpayers paid the initial development cost of public housing while tenants and local taxpayers paid the operating cost. However, the federal government now provides local housing authorities with substantial operating and modernization subsidies. In the public housing program, civil servants make all of the decisions made by private owners of unsubsidized housing as well as enforce the program's regulations.

¹ See Olsen (2003, pp. 370-394) for a more detailed description of the system of low-income housing programs. No low-income housing program routinely gives its recipients a choice concerning tenure. To accept assistance under a particular program almost always involves accepting a particular tenure.

The federal government also contracts with private parties to provide housing for low-income households. The majority of these private parties are for-profit firms, but non-profit organizations manage many projects. The largest programs of this type are the IRS's Low Income Housing Tax Credit, HUD's Section 8 New Construction / Substantial Rehabilitation and Section 236, and USDA's Section 515. Under most programs, these parties agreed to provide rental housing meeting certain standards at restricted rents to households with particular characteristics for a specified number of years. The overwhelming majority of the projects were newly built under a subsidized construction program. Almost all of the rest were substantially rehabilitated as a condition for participation in the program. It is important to realize that none of these programs provide subsidies to all suppliers who would like to participate. Since subsidies are provided to selected private suppliers, the market mechanism does not insure that subsidies are passed along to occupants of the subsidized units. If this is to be achieved at all, administrative mechanisms must be used.

The federal government has had two large homeownership programs for low-income households. It also funds a block grant to state and local governments that has been used to provide homeownership subsidies to these households. USDA's Section 502 Single Family Direct Loan Housing Program has subsidized almost 2 million families since 1949. This program provides subsidies directly to low-income homebuyers. HUD's Section 235 Homeownership Program for Low-Income Households was established in 1968, suspended in 1973, reactivated in 1975, severely limited in geographical scope in 1983, and terminated in 1987.² It subsidized about 500,000 units

² To say that it was terminated is to say that no new commitments were made after this date. The program still pays subsidies on behalf of some households who received earlier commitments.

over its history. Section 235 subsidized the occupancy of newly built and older houses. The larger component of this program allocated subsidies to selected builders rather than to the intended beneficiaries. The much smaller existing component provided assistance to buyers through a procedure that kept them poorly informed about their options. Local FHA Insuring Offices did not advertise the program to potential eligible buyers. Instead, they informed participants in the real estate industry of the terms of the program and waited for them to bring in applicants for 235 mortgages. The HOME Investment Partnerships Program allocates federal funds by formula to state and local governments. These funds could be spent on a variety of types of housing assistance subject to certain limits on the incomes of the households served, the cost to acquire and develop units, and the rents that may be charged for rental units. About half of this money is spent on homeownership subsidies.

Table 1 shows roughly how many households received each type of housing assistance in 2001.³ Although these numbers are sufficiently accurate for current purposes, they are inaccurate in several respects other than the obvious rounding. First, they ignore households served by some of the smallest programs. This results in an undercount. Second, some households are counted in more than one category. For example, some recipients of tenant-based assistance live in private subsidized projects. These households are counted in both categories. The total number of assisted households is overstated on this account. Furthermore, many private projects receive subsidies from several sources. For example, many Low Income Housing Tax Credit projects have received subsidies from the USDA's Section 515 Program. Since the number of households in private projects is obtained by adding the number of households

³ The primary source for these numbers is Millennial Housing Commission (2002, Appendix 3).

served by individual programs, this too leads to an overstatement of the number of assisted households. Third, it is reasonably argued that the number of assisted homeowners is understated. When the loan on a unit subsidized under a means-tested homeownership program is repaid that household is no longer counted as being assisted even though it continues to live in the house.

Project-based rental assistance is the dominant form of housing assistance to low-income families in the United States. The overwhelming majority of recipients receive rental assistance, and more than 70 percent of families served by low-income rental housing programs receive project-based assistance. HUD provides project-based rental assistance to more than three million families, the Low-Income Housing Tax Credit serves about a million families, and the USDA's Section 515 program houses almost a half million families. The Section 8 Housing Choice Voucher Program accounts for almost all tenant-based rental housing assistance, and even this program now allows housing agencies to devote up to 20 percent of their voucher budgets to project-based assistance.

3. Overview of Evidence on Program Effects

This section summarizes in very general terms the evidence on many important effects of low-income housing programs.⁴ The next section presents in more detail the evidence on the differences in the cost-effectiveness of different housing programs.

The available evidence indicates that recipients of any form of housing assistance typically occupy much better housing than they would occupy in the absence of

⁴ Olsen (2003) provides a more detailed account.

assistance.⁵ The improvement in housing is especially marked for new construction programs in their early years. However, well before they reach the midpoint of their service to assisted households, these projects have typically provided less desirable housing than the housing occupied by voucher recipients. Recipients of housing assistance not only typically live in better housing than in the absence of assistance but also occupy housing better than the housing that they would occupy if they were given cash grants in amounts equal to their housing subsidies. Participants in the tenant-based voucher program and many programs that provide project-based assistance typically pay significantly less for their housing and hence have more to spend on other goods.

Housing programs do not provide cash assistance with no strings attached. Due to the restrictions associated with receipt of housing assistance, the value of housing assistance to recipients is less than the housing subsidy, that is, the difference between the market rent of the subsidized unit and the tenant's contribution. The mean value of project-based housing assistance as judged by recipients is much less than 75 percent of the mean housing subsidy. The mean value of tenant-based housing assistance as judged by recipients is about 80 percent of the mean housing subsidy. Since the cost incurred by taxpayers to provide the subsidy exceeds the housing subsidy, the value of housing assistance as judged by recipients is an even smaller fraction of taxpayer cost. For tenant-based vouchers, the cost to taxpayers exceeds the subsidy by the administrative cost. For construction programs, the cost to taxpayers is much larger than the sum of the

⁵ The word "typically" is used throughout this paragraph because there are exceptions to all of the characterizations in it. For example, some assisted households live in worse housing than they would occupy in the absence of the program. They participate because the program lowers their housing expenditure and hence enables them to increase their consumption of other goods.

subsidy and administrative cost due to the excessive non-administrative costs of these programs.

The mean recipient benefit of each program varies inversely with income and directly with family size among families that are the same in other respects, but the variance in real benefits among similar households is large under most programs.

For the entire system of housing subsidies, the participation rate among eligible households is far below 50 percent for each combination of income and family size. For each family size, the participation rate first rises and then falls as income increases. The poorest households of each size have very low participation rates. Within each income class, participation rates are highest for one-person households, reflecting the strong preference received by the elderly in housing programs.

The evidence on the effect of housing programs on the characteristics of the neighborhoods in which recipients live suggests that that public housing tenants live in noticeably worse neighborhoods than in the absence of the program and that the program contributes to racial segregation in housing. Section 8 New Construction / Substantial Rehabilitation and Section 8 Certificates and Vouchers appear to have modest effects in the opposite direction.

Some individual housing projects have made the neighborhoods in which they are located much more attractive places to live. Other projects have had the opposite effect. These effects lead to changes in neighboring property values. The existing studies find small positive effects on neighboring property values on average for some programs and small negative effects for others. That is, federal housing programs differ little with respect to their effects on neighborhood revitalization.

Housing programs appear to have small work disincentive effects. They also have miniscule effects on the prices of unsubsidized units that are not located near subsidized units.

The most important finding of the empirical literature from the viewpoint of housing policy is that tenant-based vouchers and certificates provide equally good housing at a much lower cost than any type of project-based assistance. Since this is the major difference between different types of housing assistance, the next section considers the evidence on this matter in detail.

4. Evidence on Cost-Effectiveness of Different Housing Programs

When needlessly expensive methods of delivering housing assistance are used, many low-income households that could have been provided with adequate housing at an affordable rent within the current housing assistance budget continue to live in deplorable housing and taxpayers pay unnecessarily high taxes to achieve the current outcome. Therefore, it is important to consider the cost-effectiveness of alternative delivery mechanisms.

Almost all cost-effectiveness analyses of housing programs involve a comparison of the total cost of providing the housing with its market rent, an index of the overall desirability of the dwelling, its neighborhood, and its location. For tenant-based vouchers and certificates, the approach is straightforward because all of the costs associated with providing the housing during a period occur in that period and they are all in the records of the administering agency. To estimate the market rent of a unit occupied by a voucher

recipient, researchers first estimate a statistical relationship between the rent and characteristics of unsubsidized apartments and then substitute the characteristics of the subsidized unit into the estimated equation.

Analyzing construction or rehabilitation programs is more difficult because the time path of cost bears no particular relationship to the time path of the market rent of a unit and all of these programs involve indirect costs that are not in the records of the administering agency. The most widely accepted measure of cost-effectiveness for programs of this type is the ratio of (1) the present value of the market rents of the units over the period that the units are used to house subsidized families to (2) the present value of the rents paid by tenants and all direct and indirect costs incurred by federal, state, and local governments. If a government owns the project at the time that it stops being used to house subsidized families, the present value of the project's market value at that time should be subtracted from the present value of the costs.

This measure of cost-effectiveness focuses on effectiveness in providing housing to the recipient. It does not capture benefits or costs of a housing program to others. For example, it is possible that some housing projects make the neighborhoods in which they are located more attractive places to live. Other projects may have the opposite effect. The standard measure of cost-effectiveness captures neither positive nor negative effects of this sort.

Four major studies have estimated both the cost per unit and the mean market rent of apartments provided by housing certificates and vouchers and the largest older production programs, namely Public Housing, Section 236, and Section 8 New

Construction.⁶ These studies are based on data from a wide variety of housing markets and for projects built in many different years. Two were expensive studies conducted for HUD by a respected research firm during the Nixon, Ford, Carter, and Reagan administrations. They are unanimous in finding that housing certificates and vouchers provide equally desirable housing at a much lower total cost than any of these production programs, even though all of these studies are biased in favor of the production programs to some extent by the omission of certain indirect costs.

Table 2 summarizes the results of these studies. The studies with the most detailed information about the characteristics of the housing provided by the programs found the largest excess costs for the production programs. Specifically, Mayo et al. (1980) estimated the excessive cost of public housing compared to housing vouchers for providing equally desirable housing to be 64% and 91% in the two cities studied and the excessive cost of Section 236 to be 35% and 75% in these two cities. Another study with excellent data on housing characteristics estimated the excessive cost of Section 8 New Construction compared to tenant-based Section 8 Certificates to be between 44% and 78% [Wallace et al., 1981].⁷

The recently completed GAO studies produced similar results for the major active construction programs – LIHTC, HOPE VI, Section 202, Section 515, and Section 811.

⁶ The studies are Mayo et al. (1980), Olsen and Barton (1983), U.S. Department of Housing and Urban Development (1974), and Wallace et al. (1981). Olsen (2000) provides a description and critical appraisal of the data and methods used in these studies as well as a summary of their results.

⁷ This study made predictions of the market rents of subsidized units based on two different data sets containing information on the rent and characteristics of unsubsidized units. The study did not collect information on the indirect costs of the Section 8 New Construction Program. These indirect subsidies include GNMA Tandem Plan interest subsidies for FHA insured projects and the forgone tax revenue due to the tax-exempt status of interest on the bonds used to finance SHFA projects. Based on previous studies, the authors argue that these indirect costs would add 20 to 30 percent to the total cost of the Section 8 New Construction Program. The range of estimates reported in the text is based on the four combinations of the two predictions of market rent and the lower and upper limits on the indirect costs.

Table 3 reports results based on the conceptually preferable life cycle approach.⁸ The excess total cost estimates range from 12% for Section 811 to 27% for HOPE VI [GAO, 2001, p. 3]. These estimates are lower bounds on the excessive cost because some costs of the production programs were omitted. Most notably, the opportunity cost of the land and cost of preparing the site were omitted from the cost of HOPE VI projects. These are real costs to society of HOPE VI redevelopment. More generally, some costs of each production program were omitted. For example, some projects under each program receive local property tax abatements. The preceding results ignore this cost to local taxpayers.

It is often argued that production programs work better than tenant-based vouchers in the tightest housing markets. The GAO study contains evidence concerning whether production programs are more cost-effective than tenant-based vouchers in housing markets with low vacancy rates. In addition to the national estimates, the GAO collected data for seven metropolitan areas. The data for the GAO study refer to projects built in 1999. In that year, the rental vacancy rates in the seven metropolitan areas ranged from 3.1% in Boston to 7.2% in Baltimore and Dallas, with a median of 5.6%. The overall rental vacancy rate in U.S. metropolitan areas was 7.8%. So all of the specific markets studied were tighter than average. Only five of the largest seventy-five metropolitan areas had vacancy rates lower than Boston's. In each market, tenant-based vouchers were more cost-effective than each production program studied. Table 4

⁸ The GAO study also reports first-year excess costs of the production programs. The first-year cost of a production program is the sum of the annualized development subsidies and the tenant rent and other government subsidies during the first year of operation. The GAO estimates of excess cost of production programs based on this method are much higher than estimates based on the life-cycle approach. Olsen (2000, pp. 18-21) explains the shortcomings of first-year-cost methodology and how this approach can bias the results in either direction.

reports the results for Tax Credit Program. The results for Section 202 and 811 are similar [GAO, 2002, pp.19-20].

Unlike the earlier cost-effectiveness studies, the GAO study did not compare the total cost of dwellings under the different programs that were the same with respect to many characteristics. Instead it simply compared the average cost of dwellings with the same number of bedrooms in the same metropolitan area or the same type of location (metropolitan or nonmetropolitan).

It has been argued that the GAO results overstate the excessive costs of the production programs for providing equally desirable housing because these programs provide better housing than the units occupied by voucher recipients. Although it is true that units in recently completed projects under construction programs have typically been better than units occupied by households with certificates and vouchers, the existing evidence suggests that this difference is not great. Furthermore, the relevant quality of the housing under a construction program is not its quality when it is new but rather the average quality of housing provided over the time that the project serves assisted households. This quality typically declines substantially over time. The existing evidence suggests that well before the units in subsidized projects reach the midpoint of their service to assisted households, they provide housing worse than the housing occupied by recipients of tenant-based vouchers and certificates.

Results from a number of previous studies illustrate these general points. Mayo et al. (1980) estimated the market rents of units under several housing programs in Pittsburgh and Phoenix in 1975 based on data on the market rent and numerous characteristics of unsubsidized units and their neighborhoods. Table 5 reports the results.

The public housing units involved were built between 1952 and 1974. So none of these units were more than 23 years old in 1975. Since public housing units typically remain in service for more than 50 years, none of these units had reached the midpoint of their useful lives. Table 5 indicates that these public housing units were no better than the units occupied by recipients of housing allowances. The Section 236 units were built between 1969 and 1975. So none of these units were more than a few years old at the time. Table 5 indicates that Section 236 units were not enormously better than the units occupied by recipients of housing allowances even when they were quite new.

Wallace et al. (1981) used similar methods and data to estimate the market rents of randomly selected Section 8 Existing and New Construction units in 16 randomly selected metropolitan areas in 1979. Although none of the units under the Section 8 New Construction Program were more than a few years old at that time, the difference in the mean market rents of units under the two programs was less than 10 percent, namely \$291 per month for Section 8 New and \$265 for Section 8 Existing.

David Vandembroucke's (U.S. Department of Housing and Urban Development, Office of Policy Development and Research) unpublished tabulations based on the 1991 American Housing Survey Metropolitan Sample paint a similar picture. He too estimated separate statistical relationships between market rent and numerous characteristics of unsubsidized units and their neighborhoods in a number of metropolitan areas and then used these relationships to predict the market rents of public housing units, units in privately owned HUD-subsidized projects, and units occupied by certificate and voucher holders. Table 6 reports the results. In eight of eleven metropolitan areas, the median market rents of the units occupied by recipients of certificates and vouchers was greater

than the median market rents of units in public and privately owned HUD-subsidized projects. Vandenbroucke did not report the median age of the units of each type in his sample. However, the median age of public housing units in the United States in 1991 was about 23 years and the median age of the units in privately owned subsidized projects was about 14 years. So it is plausible to believe the majority of public housing units in his sample had not reached the midpoint of their service to assisted households and the majority of privately owned projects were much younger.

In summary, the available evidence does not support the view that the GAO study understated the cost-effectiveness of the production programs because these programs provide better housing than tenant-based vouchers.

The GAO study will not be the last word on the cost-effectiveness of the programs studied. Improvements in its implementation of the life-cycle methodology are possible and desirable. Indeed, this should be the highest priority for research on housing policy. However, the GAO study provides the only independent cost-effectiveness analysis of these programs.

The bulk of the evidence on the cost-effectiveness of project-based assistance applies to units built or substantially rehabilitated under a subsidized construction program. The Experimental Housing Allowance Program provides evidence on the cost-effectiveness of project-based assistance to existing, previously unsubsidized housing. This is relevant for judging the likely outcome of recent legislation that gives housing agencies the authority to use the Housing Choice Voucher Program for this purpose.⁹

⁹ Housing authorities are allowed to provide additional project-based assistance to units that receive project-based assistance from other sources such as the LIHTC or HOME. The extent to which they have used their authority for this purpose is not known.

One type of housing allowance tested in the Experiment was essentially identical to the housing voucher program that operated between 1983 and 1998. It offered each eligible family a subsidy that depended on the family's characteristics, on the condition that the family occupies a unit meeting minimum housing standards. At the time of the Experiment, HUD operated the national Section 23 Existing Housing Program, the first program of tenant-based rental housing assistance in the United States. Under one variant of this program, housing authorities rented existing apartments and sublet them to eligible families. This is analogous to the project-based component of the Housing Choice Voucher Program.

The results for one of the metropolitan areas studied provide clear evidence on the cost-effectiveness of tenant-based versus project-based assistance for existing housing [Mayo et al., 1980, pp. 134-139]. All Section 23 units in Pittsburgh were leased by the housing authority and sublet to tenants. The ratio of total cost to market rent for these units was 1.67. For example, it cost \$835 to rent a unit with a market rent of \$500. The ratio for the tenant-based housing allowance program was 1.15.¹⁰ Therefore, it cost 45% more to provide equally good housing when the housing authority negotiated the rent than when tenants found their own units.

This illustrates the powerful role of incentives in determining housing program outcomes. Obviously, recipients of housing assistance have greater incentives than the civil servants who operate housing agencies to get the best housing possible for the

¹⁰ The administrative cost of the housing allowance program was about 15% of the total cost. This implies that landlords of housing allowance recipients received market rents for their units. Subsequent research has indicated that this is a common characteristic of all tenant-based rental assistance [Wallace et al., 1981; Weinberg, 1982; Leger and Kennedy, 1990].

money. This swamped other differences between program recipients and administrators in determining the cost-effectiveness of the alternative programs.

5. Evidence Argues for Exclusive Reliance on Choice-Based Housing Assistance

Tenant-based rental assistance has outperformed every program of project-based assistance, namely, it provides equally desirable housing at a much lower total cost, it produces significantly better outcomes in certain other respects, and it is not perceptibly worse in any respect. This makes a strong case for total reliance on tenant-based assistance.

If we compare programs of tenant-based and project-based assistance that serve recipients equally well (that is, provide them with equally good housing for the same rent), the project-based programs will serve many fewer families with a given budget. No credible evidence shows that any type of project-based assistance is as cost-effective as choice-based vouchers in any market conditions or for any special groups. Therefore, many eligible families and the taxpayers who want to help them will gain if tenant-based assistance replaces project-based assistance.

The magnitude of the gain from shifting from project-based to tenant-based rental assistance would be substantial. Even the smallest estimates of the excess costs of project-based assistance imply that shifting ten families from project-based to tenant-based assistance would enable us to serve two additional families. Since HUD provides project-based assistance to more than three million families, the Low-Income Housing Tax Credit serves more than a million families, and the USDA's Section 515 program

houses almost a half million families, a total shift from project-based to tenant-based assistance would enable us to serve at least 900,000 additional families with no additional budget. The most reliable estimates in the literature imply much larger increases in the number of families served. For example, the Abt study of the Section 8 New Construction Program implies that tenant-based vouchers could have provided all of the families who participated in this program with equally good housing for the same rent and served at least 72 percent more families with similar characteristics equally well without any additional budget.

Although there is little direct evidence on the effects of the analogous types of homeownership assistance, the reasons for the excessive cost of project-based rental assistance strongly suggest that providing assistance directly to low-income buyers rather than to builders will produce better housing for the money.

Some reasons relate to tying assistance to new construction. In the absence of distortions that lead to too little housing construction, subsidies that result in the construction of additional housing will inevitably produce houses whose construction costs exceed their market values. In unsubsidized markets, construction of housing occurs whenever the market value of a house is at least as great as its construction cost. The additional houses that could have been built had market values less than their construction costs. So a government program that results in more construction provides housing with a real resource cost greater than the market value of equally desirable existing units. Another reason to expect excessive cost for subsidies to builders of new houses is that they provide subsidies for the inputs used to build the house but not for the

inputs used to maintain it. This distorts input choice towards construction inputs and away from maintenance inputs in the production of housing services.

The other reason to believe that providing subsidies to selected builders will lead to excessive total cost for the housing built stems from the monopolistic position of the builder who is given the power to allocate the subsidy. The selected builders who are allocated subsidies have monopoly power because few subsidized units are available relative to the number of eligible households that would like to buy them if the builder charges the market price for the house. This enables these builders to sell their houses even if they charge above-market prices. This inevitably leads to excess profits for these builders. If a subsidy were provided to selected builders without any strings attached, these builders would charge a price that exceeds the market price by an amount that eliminates the benefit to the intended beneficiary. As a result, they would make excessive profits. Program restrictions on the builders reduce their excessive profits. If the restrictions were too severe, the selected builders could not earn a competitive rate of return and hence would not participate in the program. If the program's entire budget is used, the restrictions are clearly not that severe. If many more firms want to participate than can be accommodated with the program's budget, we can be fairly certain that profits are excessive.

Choice-based assistance has two major advantages over unit-based assistance in addition to providing equally desirable housing at a lower cost. First, it allows each recipient to occupy a dwelling unit with a combination of characteristics preferred to the specific unit offered under a program of unit-based assistance without affecting adversely taxpayer interests. With choice-based assistance, a recipient can occupy any unit meeting

the program's minimum housing standards.¹¹ The program's standards reflect the interests of taxpayers who want to help low-income families with their housing. Units that meet the program's standards and are affordable to assisted families differ greatly with respect to their characteristics, neighborhood, and location. Assisted families whose options are the same under a program of choice-based assistance are not indifferent among the units available to them. Each family will choose the best available option for their tastes and circumstances. Since all of these units are adequate as judged by the program's minimum housing standards, restricting their choice further serves no public purpose. Unit-based assistance forces families to live in particular units in order to receive a subsidy. So it greatly restricts recipient choice among units meeting minimum housing standards without serving any public purpose. If the subsidy is the same, it is reasonable to expect recipients of choice-based assistance to be significantly better off than they would be with unit-based assistance.

Second, the variance in the subsidy among families with the same characteristics is much greater under all existing and past programs of unit-based assistance than under the Section 8 Housing Choice Voucher Program. Under the Voucher Program, families with the same characteristics are offered the same subsidy under the same conditions. The largest components of all existing and past programs of project-based assistance involve the construction of new units. Over time, the condition of these units typically declines. In a mature construction program such as public housing, the difference between the best and the worst unit is substantial. Households with identical

¹¹ Choice-based housing programs often have other standards such as upper limits on the gross rent of the unit occupied. However, this does not change the essence of the argument. Families offered choice-based assistance have a much wider range of choice among units that are adequate as judged by the program's minimum housing standards.

characteristics pay the same rent independent of the desirability of their unit. So the households that are offered the best units receive much larger subsidies than the households that occupy the worst units.

6. Objections to Exclusive Reliance on Choice-Based Assistance

Two main objections have been raised to exclusive reliance on tenant-based assistance. Specifically, it has been argued that tenant-based assistance will not work in markets with the lowest vacancy rates and construction programs have an advantage compared with tenant-based assistance that offsets their cost-ineffectiveness, namely they promote neighborhood revitalization to a much greater extent.

Taken literally, the first argument is clearly incorrect in that Section 8 Certificates and Vouchers have been used continuously in all housing markets for almost three decades. A more precise version of this argument is that tenant-based assistance will not work well in some markets because these markets do not have enough affordable vacant apartments that meet minimum housing standards to house all families offered vouchers. The conceptual defects of this argument are easy to understand, and it is inconsistent with the empirical evidence.

All vouchers authorized in a locality can be used even if the number of vacant apartments that meet minimum housing standards and are affordable to voucher recipients is less than the number of new and recycled vouchers available. Many families offered vouchers already occupy apartments meeting the program's standards. We do not need vacant apartments for these families. They can participate without moving. In the

absence of assistance, these recipients typically devote a high fraction of their income to housing and skimp on other necessities. The housing voucher reduces their rent burden. Other families who are offered vouchers live in housing that does not meet Section 8 standards. However, these apartments can be repaired to meet the standards. Similarly, vacant apartments that do not initially meet the program's standards can be upgraded to meet them. In short, we do not need new construction to increase the supply of apartments meeting minimum housing standards.

The evidence shows that these are not theoretical curiosities. The tenant-based Section 8 Certificate and Voucher Programs have substantially increased the supply of affordable housing meeting minimum housing standards. One detailed analysis is based on data from a national random sample of 33 public housing authorities in 1993 [Kennedy and Finkel, 1994]. Thirty percent of all recipients outside of New York City continued to live in the apartments that they occupied prior to participating in the program [Kennedy and Finkel, p.15].¹² Forty one percent of these apartments already met the program's standards and 59% were repaired to meet the standards [Kennedy and Finkel, p.83]. About 70% of all recipients outside of New York City moved to a new unit. About 48% of these apartments were repaired to meet the program's standards [Kennedy and Finkel, p.84]. The rest moved to vacant apartments that already met the standards. Therefore, the apartments occupied by about half of the families that received certificates and vouchers outside NYC during this period were repaired to meet the program's standards. The previously mentioned sources contain similar results for NYC. In this city, only 31 percent of the apartments occupied by recipients had to be repaired to meet the program's standards.

¹² The authors analyzed New York City separately from the other housing authorities.

The Housing Assistance Supply Experiment of the Experimental Housing Allowance Program provides additional evidence on the ability of tenant-based vouchers to increase the supply of apartments meeting minimum housing standards even in tight housing markets. The Supply Experiment involved operating an entitlement housing allowance program for ten years in St. Joseph County, Indiana (which contains South Bend) and Brown County, Wisconsin (which contains Green Bay). These were smaller than average metropolitan areas with populations of about 235,000 and 175,000 people, respectively. The general structure of the housing allowance program in the Supply Experiment was the same as the Section 8 Voucher Program that HUD operated from 1983 until its merger with the new Housing Choice Voucher Program, except that homeowners were eligible to participate in the Supply Experiment. About 20 percent of the families in the two counties were eligible to receive assistance [Lowry, 1983, pp. 92-93]. By the end of the third year when participation rates leveled off, about 41 percent of eligible renters and 27 percent of eligible homeowners were receiving housing assistance [Lowry, 1983, pp.24-25].

The Supply Experiment sites were chosen to differ greatly in their vacancy rates in order to determine whether the outcomes of an entitlement housing allowance program depend importantly on this factor. At the outset of the Supply Experiment, the vacancy rates in Brown and St. Joseph County were 5.1% and 10.6% [Lowry, 1983, p. 53]. So the average vacancy rate in the two sites was almost exactly the average vacancy rate in 2000 for U.S. metropolitan areas (7.7%). In 2000, only 26% of the 75 largest metropolitan areas had vacancy rates less than the vacancy rate in Brown County at the outset of the experiment and 20% had vacancy rates greater than the vacancy rate in St. Joseph

County. The participation rate differed little between the two sites. Indeed, it was higher in the locality with the lower vacancy rate [Lowry, 1983, p.122].

Data for analysis was collected during the first five years of the experiment in each site. During that period, about 11,000 dwellings were repaired or improved to meet program standards entirely in response to tenant-based assistance and about 5,000 families improved their housing by moving into apartments already meeting these standards [Lowry, 1983, p. 24]. The former represented more than a nine percent increase in the supply of apartments meeting minimum housing standards. Tenant-based assistance alone produced a greater percentage increase in the supply of adequate housing in these localities in five years than all of the federal government's production programs for low-income families have produced in the past 65 years [Cutts and Olsen, 2002, p. 232]. The annual cost per household was less than \$3000 in today's prices.

We do not need production programs to increase the supply of apartments meeting minimum housing standards. The Experimental Housing Allowance Program demonstrated beyond any doubt that the supply of apartments meeting minimum housing standards can be increased rapidly by upgrading the existing stock of housing even in tight markets. This happened without any rehabilitation grants to suppliers. It happened entirely in response to tenant-based assistance that required families to live in apartments meeting the program's standards in order to receive the subsidy.

Some argue that the low success rates in the Section 8 Housing Voucher Program in areas with low vacancy rates implies that the available vouchers cannot be used in these areas and hence new construction must be subsidized in order to serve additional low-income households.

In discussing this matter, it is important to distinguish between a housing authority's so-called success rate and its ability to use Section 8 Vouchers. An authority's success rate is the percentage of the families authorized to search for a unit that occupy a unit meeting the program's standards within the housing authority's time limit. Its utilization rate is the fraction of all vouchers in use.

An authority's success rate depends on many factors including the local vacancy rate. One careful study of success rates [Kennedy and Finkel, 1994] indicates that among localities that are the same with respect to other factors those with the lowest vacancy rates have the lowest success rates. Obviously, it is more difficult to locate a suitable unit when the vacancy rate is low.

An authority's success rate bears no necessary relationship to the fraction of the authority's vouchers in use at any point in time. No matter what an authority's success rate, the authority can fully use the vouchers allocated to it by authorizing more families to search for apartments than the number of vouchers available. For example, if an authority has a success rate of 50 percent, authorizing twice as many families to search as the number of vouchers available will result in full utilization of the vouchers on average. If each housing authority adjusted its issuance of vouchers to its success rate in this manner, some authorities would exceed their budget and others would fall short in a given year. However, the national average success rate would be very close to 100 percent.

For many years, public housing authorities have over-issued vouchers and thereby achieved high usage rates despite low success rates. They have a reserve fund for this purpose, and current regulations call for penalties on authorities with usage rates below

97 percent. According to HUD's Fiscal Year 2002 Performance and Accounting Report, the voucher utilization rate was 94 percent in that year. HUD's Budget Justifications submitted to Congress in February 2003 indicate that they expect the utilization rate to be even higher in 2003 and 2004.

The overwhelming majority of tenant-based certificates and vouchers are in use at each point in time. Even more would be in use if housing authorities were more aggressive in over-issuing vouchers. Although it is true that some families who are offered vouchers do not find housing that suits them and meets the program's standards within their housing authority's time limits, other eligible families in the same locality use these vouchers. This indicates clearly that the problem is not that there are no vacant apartments that meet program standards and are affordable to voucher recipients or apartments whose landlords are willing to upgrade them to meet program standards. In the tightest housing markets, these apartments are more difficult to locate. Unsubsidized families also have trouble locating apartments in tight housing markets.

The real issue is not whether tenant-based vouchers can be used in all market conditions but whether it would be better to use new construction or substantial rehabilitation programs in tight housing markets. Evidence from the GAO study mentioned earlier indicates that tenant-based vouchers are more cost-effective than production programs even in markets with low vacancy rates. Another key question is which type of assistance gets eligible families into satisfactory housing faster. If the choice is between authorizing additional vouchers or additional units under any construction program, the answer is clear. Tenant-based vouchers get families into satisfactory housing much faster than any construction program even in the tightest

housing markets. By over-issuing vouchers, housing agencies can put all of their vouchers to use in less than a year in any market conditions. No production program can hope to match this speed.

How long does it take from the time that money is allocated for construction programs to the time that the first units are available for occupancy? Evidence is available for older production programs. Based on data on a national random sample of 800 projects built between 1975 and 1979, Schnare, Pedone, Moss, and Heintz (1982) found the mean time from application for project approval to completion of the project ranged from 23 months for Section 236 to 53 months for conventional public housing. Mean times ranged from 26 to 31 months for the variants of the Section 8 New Construction and Substantial Rehabilitation Program. Occupancy of the completed apartments required additional time. Although the authors did not report results separately for different markets, it seems reasonable to believe that these times were greater in the tightest housing markets because the demand for unsubsidized construction would be greatest in these locations.

It might be argued that project-based assistance for existing housing gets families into housing more rapidly than tenant-based vouchers whether the project-based units were built under subsidized construction programs or rented by a housing authority in a previously unsubsidized building. When a unit with project-based assistance is vacated, it can be offered immediately to the next family on the waiting list. If that family declines the offer, the unit can be offered to the next family on the list. This process will probably result in occupancy of the unit in less time than it usually takes to get a voucher into use.

However, the reason for the speed of this type of housing assistance in getting families into housing negates its advantage in this regard. Project-based assistance for existing housing gets families into housing faster by severely restricting their choice. It essentially offers them an all-or-nothing choice.¹³ If a housing authority offered each family the choice between a particular unit and a voucher involving the same subsidy, it is reasonable to believe that the majority would choose the voucher even though they would spend more time searching for housing because they would expect to find a unit that better suits their tastes and circumstances.

The second major objection to the exclusive reliance on tenant-based assistance is that new construction promotes neighborhood revitalization to a much greater extent than tenant-based assistance. The evidence suggests that there is little difference between housing programs in this regard.

The evidence from the Experimental Housing Allowance Program is that even an entitlement housing voucher program will have modest effects on neighborhoods and the small literature on the Section 8 Voucher Program confirms these findings for a similar non-entitlement program [Lowry, 1983, pp. 205-217; Galster, Tatian, Smith, 1999B]. These programs result in the upgrading of many existing dwellings, but this is almost surely concentrated on their interiors.

It is plausible to believe that a new subsidized project built at low-density in a neighborhood with the worst housing and poorest families would make that neighborhood a more attractive place to live for some years after its construction. The issue is not, however, whether some construction projects lead to neighborhood

¹³ Many, perhaps most, housing authorities allow a family on the waiting list to reject a few units before deleting them from the list. However, the family's choices under project-based assistance are still very restricted.

upgrading. The issues are the magnitude of neighborhood upgrading across all projects under a program over the life of these projects, the identity of the beneficiaries of this upgrading, and the extent to which upgrading of one neighborhood leads to the deterioration of other neighborhoods.

The primary beneficiaries of neighborhood upgrading will be the owners of nearby properties. Since the majority of the poorest families are renters, it is plausible to believe that most of the housing surrounding housing projects located in the poorest neighborhoods is rental. Therefore, if a newly built subsidized project makes the neighborhood a more attractive place to live, the owners of this rental housing will charge higher rents and the value of their property will be greater. Since the occupants of this rental housing could have lived in a nicer neighborhood prior to the project by paying a higher rent, they are hurt by its construction. The poor in the project's neighborhood will benefit from the neighborhood upgrading only to the extent that they own the property surrounding the project.

With the passage of time, the initial residents will leave the improved neighborhood and others who value a better neighborhood more highly will replace them. In short, housing programs involving new construction will shift the location of the worst neighborhoods to some extent. The aforementioned possibilities are rarely recognized in discussions of housing policy, let alone studied.

What has been studied is the extent to which projects under various housing programs affect the desirability of the neighborhood. If a housing project makes its neighborhood a better place to live, it will increase neighborhood property values. The existing studies find small positive effects on neighborhood property values on average

for some programs and small negative effects for others [Lee, Culhane, and Wachter, 1999; Galster, Smith, Tatian, and Santiago, 1999A, Chapter 4]. No study finds substantial positive effects on average for any program.

In short, the usual objections to exclusive reliance on tenant-based vouchers have little merit. Tenant-based vouchers can get recipients into adequate housing faster than production programs even in the tightest housing markets, and they are more cost-effective than production programs in all market conditions. We do not need production programs to increase the supply of adequate housing. Production programs have not had a perceptibly greater effect on neighborhood revitalization than tenant-based vouchers.

7. Proposals to Shift Budget from Project-Based to Choice-Based Assistance

The available evidence on program performance has clear implications for housing policy reform. To serve the interests of taxpayers who want to help low-income families with their housing and the poorest families who have not been offered housing assistance, Congress should shift the budget for low-income housing assistance from project-based to tenant-based housing assistance as soon as current contractual commitments permit and should not authorize any new programs involving project-based assistance. The following concrete steps will achieve these results.

First, the money currently spent on operating and modernization subsidies for public housing projects should be used to provide tenant-based vouchers to public housing tenants, as proposed by the Clinton Administration and by Senator Dole during his presidential campaign. HUD provides housing authorities with between \$6 and \$7

billion each year in operating and modernization subsidies. This is about a fourth of the total HUD budget for low-income housing assistance. The evidence indicates that we can get more for this money by giving it to public housing tenants in the form of housing vouchers.

The Quality Housing and Work Responsibility Act of 1998 mandates the conversion of public housing projects to tenant-based assistance under certain circumstances and allows it under other circumstances. HUD has recently produced final rules governing some parts of this process and proposed rules for other parts [68 FR 54600, 68 FR 54612, 68 FR 54624]. This conversion should be required in all cases.

To enable housing authorities to provide decent housing despite this loss in revenue, they should be allowed to rent their apartments to any household eligible for housing assistance for whatever rent this market will bear. Families with tenant-based vouchers would occupy many of these apartments. Other families eligible for housing assistance would occupy the rest. Housing authorities could raise additional money by taking advantage of the current regulation that allows them to sell projects. At present, they have little incentive to do it. Without guaranteed federal operating and modernization subsidies, many authorities may well decide to sell their worst projects. These are the projects that will be abandoned to the greatest extent by their tenants with vouchers, and they are the most expensive to operate. If housing authorities are unable to compete with private owners for their tenants, they should not be in the business of providing housing.

Second, contracts with the owners of private subsidized projects should not be renewed. The initial agreements that led to the building or substantial rehabilitation of

these projects called for their owners to provide housing meeting certain standards to households with particular characteristics at certain rents for a specified number of years. At the end of the use agreement, the government must decide whether to change the terms of the agreement and the private parties must decide whether to participate on these terms. A substantial number of projects have come to the end of their use agreement in recent years and many more will come to the end of their use agreements over the next decade. When use agreements are not renewed, current occupants are provided with other housing assistance, usually tenant-based vouchers. Up to this point, housing policy has leaned heavily in the direction of providing owners with a sufficient subsidy to induce them to continue to serve the low-income households in their projects. Instead we should give their tenants portable vouchers and force the owners to compete for their business.¹⁴

It is important to realize that for-profit sponsors will not agree to extend the use agreement unless this provides at least as much profit as operating in the unsubsidized market. Since these subsidies are provided to selected private suppliers, the market mechanism does not insure that profits under the new use agreement will be driven down to market levels. If this is to be achieved at all, administrative mechanisms must be used. Administrative mechanisms can err in only one direction, namely, providing excess profits. If the owner is offered a lower profit than in the unsubsidized market, the owner will leave the program. We should leave the job of getting value for the money spent to the people who have the greatest incentive to do it, namely, the recipients of housing assistance.

¹⁴ See Weicher (1997) for a detailed analysis of vouchering out project-based assistance.

Third, the construction of additional public or private projects should not be subsidized. This involves terminating or phasing out current production programs and avoiding new production programs.

The Low-Income Housing Tax Credit is the largest active production program. It subsidizes more units than all of the other active production programs combined. The Tax Credit Program is already the nation's second largest low-income housing program, and it is the fastest growing program. The tax credits themselves involved a tax expenditure of about \$3.5 billion in 2000. However, these projects received additional development subsidies from state and local governments (usually funded through federal intergovernmental grants) accounting for a third of total development subsidies. Therefore, the total development subsidies were over \$5 billion a year. Furthermore, owners of forty percent of tax credit dwelling units received additional subsidies in the form of project-based or tenant-based Section 8 assistance. These add about \$1.5 billion a year to the cost of the program. So the cost of the program to taxpayers was about \$7 billion in 2000. Finally, Congress recently increased new commitments of tax credits under the program by 40 percent and tied future tax expenditures to the consumer price index.

The GAO results on the cost-effectiveness of the Tax Credit Program, combined with the results of studies of similar earlier programs, argue for the termination of Low-Income Housing Tax Credit. The money spent on this program is better spent on expanding the Housing Choice Voucher Program.

It might be argued that the GAO results are not sufficiently compelling to justify immediate termination of this program and the Tax Credit Program is sufficiently

different from older production programs to make evidence of their effects of little relevance for this decision. However, this evidence is surely more than adequate to justify rescinding the recent indexing of the tax credit for inflation and immediately launching a careful, independent analysis of the cost-effectiveness of the Tax Credit Program. If this research shows that the Tax Credit Program is as cost-effective as tenant-based vouchers, indexing for inflation can be reinstated.

Similar remarks apply to other active production programs. For example, no additional money should be allocated to HOPE VI. This program is an improvement over traditional public housing in that it avoids concentrating the poorest families at high densities in projects. However, the GAO study reveals that it is highly cost-ineffective compared with tenant-based vouchers that also avoid these concentrations.

Finally, there should be no new production programs. Congress should reject the Administration's proposal for a tax credit to selected builders of housing for low-income homeowners modeled after the Low Income Housing Tax Credit.¹⁵ It should also reject the Millennial Housing Commission's proposals to create new programs of project-based assistance such as tax incentives to preserve and expand the stock of existing units providing project-based assistance, a new rental production program with a 100 percent capital subsidy, and elimination of limits on the amounts of Mortgage Revenue Bonds that states can issue to finance low-income housing projects. Any additional money for housing assistance should be used to expand the Housing Choice Voucher Program.

¹⁵ The Administration's American Dream Program to provide a part of the downpayment on a house for low-income families is not subject to the same criticisms. Since the argument for subsidizing homeownership is strongest for low-income families and this program is well designed to benefit these families and increase their homeownership rate without creating other distortions, a good case can be made for it.

Fourth, Congress should declare a moratorium on further project-based assistance under the Housing Choice Voucher Program until it can consider the results of a study that compares the cost-effectiveness of the already committed project-based vouchers with tenant-based vouchers. Sufficient money should be budgeted for this study to insure that credible results are produced.

Fifth, if Congress decides to adopt the Bush Administration's proposal to convert the Housing Choice Voucher Program to a housing block grant to the states, it should require that the entire budget of the program be used for choice-based assistance. Evidence indicates clearly that states would devote the bulk of an unrestricted housing block grant to project-based assistance. The HOME Investment Partnerships Program is a block grant to states and localities that permits either project-based or choice-based assistance. Contrary to the implications of the systematic evidence on the effects of different types of housing programs, states and localities have chosen to spend the bulk of their funds on project-based assistance. In 1995, states allocated 94% of their rental assistance to specific projects [Urban Institute, 1999, p. 86]. Left to their own devices, it is reasonable to expect that they will do the same with the proposed block grant. Being close to the people does not provide any insight into the design of efficient housing programs. Therefore, the legislation converting the Voucher Program to a block grant should contain an explicit prohibition on the use of block grant funds for project-based assistance.

8. Housing Assistance Should Be an Entitlement for the Poorest Eligible Families

Unlike other major means-tested transfer programs, housing assistance is not an entitlement despite its stated goal of “a decent home and suitable living environment for every American family” [Housing Act of 1949]. Millions of the poorest families are not offered any housing assistance, while a smaller number of equally poor families receive large subsidies. For example, an assisted family with one child and an adjusted annual income of \$8000 living in an area with the average Payment Standard would have received an annual housing subsidy of \$6000 from the Housing Choice Voucher Program in 2002 if it occupied an apartment renting for the Payment Standard. The majority of families with the same characteristics living in that locality would receive no subsidy from any low-income housing program. Furthermore, the majority of the poorest eligible families are offered no assistance while many families with considerably greater income are assisted. About 34 percent of the families who receive tenant-based vouchers and certificates are above the poverty line, while 70 percent of families below the poverty line do not receive housing assistance from any HUD program.

The non-entitlement nature of housing assistance is a historical accident. Because the first significant housing program for low-income households involved the construction of housing, it was not possible to make it an entitlement for any significant number of families. Building millions of public housing units over a short period of time was infeasible. The income limits for eligibility were not designed to be consistent with the amount of money that the Congress wanted to devote to housing assistance.

Now that vouchers are used to provide housing assistance, the impossibility of building enough units to serve an enormous number of families provides no justification for maintaining a non-entitlement program. Almost all families eligible for housing assistance already live in housing. The majority of these units already meet housing standards. Other vacant units meeting housing standards are available. Many units can be inexpensively upgraded to meet housing standards. New construction is not needed to provide adequate housing for all of the poorest families who would want to participate in the entitlement housing program that could be funded with the current budget for housing assistance.

No one has attempted to explain why we should offer assistance to some, but not other, families with the same characteristics, and no one has provided a persuasive argument for denying assistance to the poorest families while providing it to otherwise identical families in the same locality whose income is many times as large.¹⁶ It is difficult to reconcile these features of the Housing Choice Voucher Program and all other low-income housing programs with plausible taxpayer preferences.

In thinking about whether housing assistance should be an entitlement, it is helpful to think about how a taxpayer who wants to help low-income families with their housing feels about dividing a fixed amount of assistance between two families that are identical in his or her eyes. At one extreme, we could give one of the families the entire amount available for housing assistance. At the other extreme, we could divide it equally between them. The former is inconsistent, and the latter consistent, with the usual

¹⁶ It is often argued that we should not limit assistance to the poorest families because it is desirable to have a mix of incomes in subsidized housing projects. Obviously, this argument is not applicable to tenant-based assistance. Furthermore, the conflict between the desire to serve the poorest families and to avoid concentrating them in projects in programs of project-based assistance can be avoided by vouchering out these programs.

assumptions about preferences, namely, that the amount that a person is willing to sacrifice for an additional unit of anything of value decreases as its quantity increases. To say that two potential recipients are the same in the eyes of a taxpayer is to say that the taxpayer is willing to sacrifice the same amount for the same change in the consumption pattern of either family. If all housing assistance goes to one potential recipient, the value to the taxpayer of the change in the consumption bundle resulting from the last dollar of housing assistance received by this recipient will be less than that resulting from the first dollar of housing assistance to the other recipient. The taxpayer's well-being can be increased by reallocating housing assistance until both potential recipients receive the same assistance.

It is also reasonable to conclude that taxpayers place the highest value on helping the poorest families. Why else would almost all means-tested housing programs provide the largest subsidy to families with the smallest income?

Another strong argument for an entitlement housing assistance program for the poorest individuals and families is its effect on homelessness. The homeless are the poorest of the poor. Research indicates that an entitlement program of housing assistance for the poorest individuals and families would eliminate homelessness except for the chronic homeless who suffer from serious mental illness and substance abuse [Early and Olsen, 2002, p. 19].¹⁷

¹⁷ The chronic homeless require a more comprehensive approach. Existing supportive housing facilities will certainly be a part of the solution to dealing with these people. Due to the time necessary to determine eligibility, an entitlement housing assistance program for the poorest households will not eliminate the desirability of short-term facilities to house people who would otherwise live on the streets. Although we might want to fund them in a different manner, existing shelters would surely be among the short-term facilities used.

To say that housing assistance should be an entitlement for the poorest families is not to say that they have a natural right to it. Although some people hold this view, many others who think that housing assistance should be an entitlement reject it. They believe that the poorest families are entitled to whatever assistance their fellow citizens are willing to provide. To say that housing assistance should be an entitlement means that any eligible person who asks for housing assistance will get it. To favor an entitlement program of housing assistance is to reject the notion that we should provide assistance to one family and deny it to another family with the same characteristics. Time limits, work requirements, and subsidy formulas that provide greater subsidies to families with some labor earnings rather than no labor earnings are completely consistent with an entitlement housing assistance program. They simply specify what a family is entitled to.

9. Proposal to Create an Entitlement Program of Housing Assistance

The preceding argues strongly that a program of housing assistance should be an entitlement for the poorest families. The usual argument against making housing assistance an entitlement is that it would be too expensive. Those who make this argument seem to have in mind delivering housing assistance to all currently eligible families using the current mix of housing programs and the current rules for the tenant's contribution to rent. This would indeed increase the amount spent on housing assistance greatly, though this magnitude has not been estimated. However, we do not have to make more than 40 percent of the population eligible for low-income housing assistance, we can reduce the fraction of housing assistance delivered through programs that are cost-

ineffective, and we can reduce subsidies at every income level.¹⁸ If we reduce the fraction of the population eligible for housing assistance, increase the fraction of families served by choice-based assistance, and reduce the subsidy at each income level under each housing program, the cost of an entitlement housing assistance program would be less than commonly assumed.

Indeed, it is easy to develop an entitlement housing assistance program with any level of cost desired. For example, we could have an entitlement housing assistance program without spending any additional money by a simple change in the Housing Choice Voucher Program, namely, reducing the subsidy available to each eligible family by the same amount. At current subsidy levels, there are many more families willing and able to use vouchers than can be funded with the current budget. As we reduce the subsidy at each income by the same amount, the number of families who want to participate will decline and waiting lists will shrink. If we reduce subsidies sufficiently and adjust the number of families served so as to spend the same amount on the program, all families who want to participate on the terms offered will receive assistance. We will then have an entitlement housing assistance program for the poorest eligible families, thereby eliminating the horizontal inequities of the current program.

In discussions of housing policy, a common objection to this proposal is that no one would be able to find housing meeting the program's standards with the lower subsidies. This objection is logically flawed. We start from a position where many more people want to participate than can be served with the existing budget. If we reduce subsidy levels slightly, it will still be the case that more people want to participate than

¹⁸ See U.S. Department of Housing and Urban Development (2000, Table A-1) for the fraction of households eligible for housing assistance.

can be served. If we decrease the subsidy levels so much that no one wants to participate, we have decreased them more than the proposed amounts.

A more sophisticated argument against the proposal is that the poorest households will be unable to participate in the proposed program. The simple proposal above calls for reducing the guarantee under the Voucher Program (called the Payment Standard). This is the subsidy received by a household with no income. If the Payment Standard is less than the rent required to occupy a unit meeting the Program's minimum housing standards, then a household whose income and assistance from other sources is just sufficient to buy subsistence quantities of other goods would be unable to participate in the proposed Voucher Program.

Previous studies have shown that a considerable reduction in the payment standard could occur without precluding participation by the poorest of the poor. Olsen and Reeder (1983) and Cutts and Olsen (2002) find that the Payment Standard exceeds the market rent of units just meeting the Program's minimum housing standards in all of the many metropolitan areas and bedroom sizes studied. The median excess varied between 33 to 80 percent between 1975 and 1993. Although refined estimates have not been made with more recent data, a rough estimate is that the median excess over all combinations of metropolitan area and number of bedrooms was 68 percent in 2001 [Cutts and Olsen, 2002, pp. 224-225].

The preceding proposal might lead to a particularly low participation rate by the poorest households. This could be counteracted by a smaller reduction in the payment standard combined with an increase in the fraction of adjusted income that tenants are expected to contribute to their rent. This would result in a smaller decrease in the

subsidies offered to the poorest households and a larger decrease for the richest eligible households. For a given program budget, this would yield a higher participation rate by the poorest of the poor and a lower participation rate by other eligible households.

To say that housing assistance should be an entitlement is not to say that it should be designed to insure that all eligible families participate. It is inevitable that the participation rate will be less than 100 percent in a well-designed entitlement housing assistance program. An entitlement housing assistance program should provide no subsidy to families with incomes at the upper limit for eligibility to avoid the inequity that results from offering families with incomes just below the upper income limit a higher standard of living than families with incomes just above it. This implies that families with incomes just above the income limit for eligibility will be eligible for small subsidies. In order to get this subsidy, they will have to occupy a unit meeting particular housing standards, spend time filling out paperwork and dealing with program administrators, and reveal personal information. These are all inherent in operating a means-tested housing program. Furthermore, few enjoy accepting public or private charity. For all of these reasons, many families will choose not to participate in an entitlement housing assistance program.

A popular view is that many families offered vouchers do not participate because there are no vacant units meeting the program's standards in the area. Although market conditions play some role in program participation, the factors mentioned in the preceding paragraph are more important. The participation rate in the food stamp program has been about 60 % in recent years [Castner and Shirm, 2004]. This is not

because eligible families could not find a grocery store or because there was no food on the shelves of grocery stores.

What would be the participation rate in an entitlement housing program? The participation rate was less than 50 percent in the entitlement housing assistance programs operated in the 1970s in Green Bay and South Bend as a part of the Experimental Housing Allowance Program. However, this is not to say that the participation rate in any entitlement housing assistance program would be less than 50 percent. The evidence from the Experiment indicates clearly that participation depends on the generosity of the subsidy and the program's minimum housing standards. The average annual subsidy in the sites where the entitlement programs were operated was about \$3000 in today's prices. The average annual subsidy in the Housing Choice Voucher Program exceeds \$6000. These numbers are not entirely comparable because the experiment was conducted in smaller than average metropolitan areas where housing prices were lower than average. Nevertheless, we should expect a higher participation rate with the current subsidy schedule of the Housing Choice Voucher Program.

Since reducing current subsidies at each income level in the Housing Choice Voucher Program enough to implement immediately an entitlement housing assistance program for the poorest families would excessively disrupt the lives of current recipients, it is surely desirable to phase in this program. Specifically, we could freeze subsidies at their current levels allowing inflation to erode real subsidy levels and simultaneously increase the number of vouchers authorized so that the budget of the Housing Choice Voucher Program continues to grow at the desired rate. At the current rate of inflation, this will lead to a slow rate of convergence to an equitable system of housing assistance,

but it is surely better than maintaining the current system that offers assistance to a minority of families of each type.

10. Conclusion

Given the current economic slowdown and the added expense of fighting international terrorism, it is clear that little additional money will be available for housing assistance over the next few years. The question is: How can we continue to serve current recipients equally well and serve some of the poorest families who have not yet been offered assistance without spending more money? The answer is that we must use the money available more wisely.

Research on the effects of housing programs provides clear guidance on this matter. It shows that we can serve current recipients equally well (that is, provide them with equally good housing for the same rent) and serve many additional families without any increase in the budget by shifting resources from project-based to tenant-based assistance. We should learn from our past mistakes and not heed the call for new production programs. Indeed, we should go further and terminate current production programs and disengage from project-based assistance to existing apartments as soon as current contractual commitments permit.

The stated goal of the Housing Act of 1949 is “a decent home and suitable living environment for every American family.” It is time that we delivered on that commitment. Contrary to popular opinion, this does not require spending more money on housing assistance. It can be achieved without additional funds by transferring funds

from less cost-effective methods for delivering housing assistance to the most cost-effective approach and reducing gradually the large subsidies received by current recipients.

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Table 1. Overview of Current System of Low-Income Housing Assistance

Rental	6,600,000	
Project-Based	4,700,000	
Public Housing		1,300,000
Private Projects		3,400,000
Tenant-Based	1,900,000	
Homeownership	800,000	
Seller	170,000	
Buyer	630,000	

Table 2. Excess Cost of Older Production Programs

Program/Study	Localities	Projects Built	Excess Cost
Public Housing			
Olsen and Barton	NYC	1937-1965	14%
Olsen and Barton	NYC	1937-1968	10%
HUD	Baltimore, Boston, L.A., St. Louis, S.F., D.C.	1953-1970	17%
Mayo et al.	Phoenix	1952-1974	64%
Mayo et al.	Pittsburgh	1952-1974	91%
Section 236			
Mayo et al.	Phoenix	1969-1975	35%
Mayo et al.	Pittsburgh	1969-1975	75%
Section 8 NC/SR			
Wallace et al.	National	1979	44%-78%

**Table 3. Excess Cost of Active Production Programs
(GAO, 2001, Life Cycle Approach)**

Program	Excess Cost
Low-Income Housing Tax Credit	16%
Hope VI	27%
Section 202	19%
Section 811	12%
Section 515	25%

**Table 4. Excess Cost of Tax Credits in Markets With Different Vacancy Rates
(GAO, 2002, Life Cycle Approach)**

Metropolitan Area	Vacancy Rate	One Bedroom	Two Bedroom
Baltimore	7.2%	24%	24%
Boston	3.1%	6%	19%
Chicago	6.5%	34%	25%
Dallas/Fort Worth	7.2%	21%	21%
Denver	5.6%	40%	21%
Los Angeles	5.1%	11%	21%
New York	4.7%	21%	17%
All Metro Areas	7.8%	19%	14%

Table 5. Market Rents of Units under Production Programs in Their Early Years Compared with Voucher Units

City	Program		
	Section 236	Public Housing	Housing Allowance
Pittsburgh	\$1826	\$1748	\$1626
Phoenix	\$2417	\$1918	\$2084

Table 6. Median Monthly Market Rents of Subsidized Units (1991)

City	Program		
	Voucher and Certificate	Privately Owned Projects	Public Housing
Atlanta	\$505	\$400	\$328
Baltimore	\$460	\$458	\$373
Chicago	\$475	\$550	\$440
Columbus	\$375	\$395	\$340
Hartford	\$593	\$570	\$543
Houston	\$365	\$325	NA
New York	\$605	\$578	\$520
Newark	\$568	\$570	\$500
San Diego	\$480	\$410	NA
Seattle	\$475	\$455	\$445
St. Louis	\$403	\$378	\$380