

Housing the World's Poor

The Four Essential Roles of Government

by David A. Smith

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Though free markets unleash productivity and innovation, they are still bound by economic laws. The most important law is that market price reflects market demand. Because half of every population is below median income, market-quality housing commands market prices. As a result, markets alone will never satisfactorily house a nation's poorest citizens. Thus, whether people buy or rent, housing is typically affordable to only half of the population. Those citizens who flood the world's growing metropolitan areas, however, are overwhelmingly poor: they arrive in cities that were built for smaller populations, and whose formal-sector housing producers can only build housing that these urban immigrants cannot afford.

The result is a spontaneous community of self-built or informally built homes—the shanty towns, settlements, and ever-expanding slums that sprout like mushrooms on the outskirts of cities in the developing world. People who move to the city act by impeccable economic logic: they follow the money. Seeking to maximize income, these citizens willingly consume the least expensive space they can, which is often just a room in a larger informal structure. Left alone in the marketplace, the impoverished create and inhabit slums because that is their only available and economically sensible option. It has been this way for over two centuries: London in 1795, Boston in 1855, New York City in 1905, and Mexico City in 1995, to name but a few, all experienced a rapid growth of overcrowded informal housing.



Rapid migration to cities in many developing countries has led to the formation of informally built slums like Kibera, pictured above. Kibera, located just outside Nairobi in Kenya, is filled with poor workers and their families, who have been receiving no government support. Photo courtesy khym54.

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Slums are a reflection not of market failure but of societal failure. Economists since John Stuart Mill have realized that, if production operates by inexorable economic principles—only profitable ventures are undertaken and only economically sustainable ventures survive—the distribution of wealth is a societal, and hence governmental, choice. If the international public wants healthy cities, the poor must have access to housing in homes they can afford. Since market forces will never provide housing they can afford—and they never will have the ability until they cease being poor—it is up to government to stimulate the creation of sustainable affordable housing.

As nations advance, government plays several roles, summarized by the mnemonic acronym LEaPS: Law, especially as it pertains to property; Enabling environment for capital formation and capital flow; public-private Partnership as the cost-effective vehicle for delivery; and Subsidy at the margin to go where pure market forces will not. Each level builds on the one before; each is more complex than its forebear; and each can be no better than its predecessors' cumulative success. While paces may differ and boundaries between stages may blur, a nation's quest for affordability follows a predictable four-stage evolution.



In London, England, converted Victorian-era slums still exist as government-subsidized "council housing." The government, under the Labour Party leadership, has been trying to find more methods of providing affordable housing to millions of lower-class British citizens. Photo courtesy khaosworks.

Initially, there is the rule of law. Affordable housing is real property, and if property is not protected by the full weight of law and government, it will not be built, renovated, invested in, or maintained. Without laws that bind the governed and their governor, renter and owner, investor and builder, it is impossible to construct any economically sustainable model of affordable housing creation.

This process starts with land and the strength of private enforceable title to land. In Kenya, for example, the now-discredited previous government crowded the poor into enormous slums while expropriating vast swaths of developable land that the former president's cronies and extended family still hold. In Kibera, Nairobi's largest slum, home to one in five Nairobians, citizens live in a community only a few miles from downtown, where there is no formal title to land and no contractual right to

any structure, only rent payments to local headmen based on verbal claims and midnight enforcement for a family's right to squat in a ten by ten foot room. Law in Kibera is tribal and local. So absent is the Kenyan government from any aspect of Kiberan life that one might as well erect border gates at its entrances and deem it a foreign country that has internally seceded from its parent nation. It is a distillation of disinvestment and exploitation, the ultimate poverty

warehouse, and a place where inhabitants' main goal is something as basic as clean water or proper sanitation.

Governments must lead by protecting private property from those who might seek to prey upon property owners such as future governments or their own corrupt officialdoms. When governments effectively protect private property, citizens invest in housing with their cash, their enterprise, and their sweat. When governments do not, as in [Zimbabwe in 2005](#), capital and citizens flee, causing a country to sink into poverty, violence, and eventual anarchy. Unfortunately for Kenya, recent land reform initiatives have stalled with the defeat of the proposed new constitution.

The second role of government is in fostering an environment conducive to capital. The rule of law assures that one who owns a home may keep it. To sell it—and more directly to build a new home or improve an existing one—its owner needs more capital than the typical individual possesses. Capital flows into enterprises as long as it sees prospective economic return. Housing is particularly challenging for capital to assess because housing has the longest return cycle of any asset class, ranging into decades; and, unlike other assets, it is not portable, so the lender cannot readily repossess it. Non-portability causes the lender to have to evaluate collateral and reclaim possession on site, adding cost and risk to the credit decision and lending process.

To develop capital, governments need sound macroeconomic policy, a currency not prone to massive deflation, reliable capital markets, means of aggregating financial instruments and selling financial investments, a robust banking and investment banking system, and a diversity of real estate capital forms—such as mortgages, loans, and bonds. Governments can stimulate these markets through state-established housing finance entities such as [Mexico's Sociedad Hipotecaria Federal \(Federal Mortgage Company\)](#) and [Thailand's Government Housing Bank](#) or smaller secondary market makers like [Malaysia's Cagamas](#).

In Egypt, for example, the Egyptian government and the [US Agency for International Development](#) are struggling to reform an anachronistic deeds-owned system that compels a buyer to maneuver through a 77-step registration system before emerging with a secure title to an urban property. Typical Egyptian home financing is seven years or less, provided by the builder or seller rather than a bank. As a result, homes transfer infrequently, which leads to huge mismatches between Cairo households' current housing needs and their housing consumption. Governments must cut through red tape to create capital and financial markets that enable speedy and low-cost exchanges of future promises for present capital. When appropriate markets are in place, people finance housing and are willing to borrow large sums for long periods in order to own homes.

Another component of government's role is fostering public-private partnerships. Law and capital-enabling environments create marketplaces where market-wealthy participants develop, own, buy, and sell homes. These classic economic marketplaces alone will never produce sustainable affordable housing, because slums are economically rational, albeit societally undesirable. Achieving affordability means pushing down the affordability frontier, delivering a market-quality home to a slightly-below-market participant.

Decades of experience and billions of dollars of expenditures throughout the developed world have demonstrated that government is a very poor direct provider of social housing. Examples include "council housing" in the United Kingdom, public housing in the United States, and the *cités HLM* in France. Government does better to steer, not row, by providing programmatic tools and inviting the private sector to use them to both make its own profit and reach government objectives. Today, virtually no responsible government advocates new public ownership; indeed the trend is toward privatization. Thus, US public housing—created as a result of the 1937 Housing Act—gave way to private-public housing following the 1968 National Housing Act and was privatized via HOPE VI, a program to eradicate severely distressed public housing. UK council housing privatizes via stock transfer to non-profit housing associations registered as social landlords.

In a public-private partnership, the private sector expects clean boundary rules, prompt and consistent administrative guidance, even-handed selection and judicious enforcement of law, acknowledgment of its profit motive, efficient decision-making, and protection against political or journalistic vilification. Conversely, the public sector expects program participants to do what they say they will do; be financially accountable; have real equity at risk; take their financial lumps when things go badly, whether through incompetence or misadventure; and not seek unwarranted bailouts just because things went wrong. This public-private partnership is a complex intervention that requires considerable skill and sophistication to establish and then equal parts cleverness and wisdom to implement to fruition. In South Africa, for example, the 2003 financial sector charter is a landmark effort to define the appropriate relationship between capital providers and government. Government sets targets and provides capital encouragement, and the capital providers then innovate toward specified societal outcomes such as increased black homeownership and redevelopment in formerly black townships.

Government must take the initiative by creating programs and agencies to administer those programs that make sovereign resources, such as borrowing capacity and credit enhancement, available to the private sector if—and only if—the private sector undertakes delivering a particular kind of home, at an agreed affordable price, for the benefit of a target customer group. When the relationship between the public and private sectors is balanced, there emerge developers, builders, lenders, and originators, who actively create homes and recruit affordable customers to buy or rent them.

The final listed responsibility of government is in subsidies and financial contributions. Public-private partnership will extend affordability only so far because the contributions of efficiency, scale, risk tolerance, and risk transfer materialize into only a few percentage points increase in affordability. For the bottom quartile of society, housing is unaffordable, unacceptable, and impossibly distant.

Government may wish it could secure affordability at no cost, but the laws of economics are unforgiving; true affordability for the population's lowest-income quartile requires financial contributions by the government. The science lies in designing the right concoction and adding appropriate subsidies and incentives to an existing ecosystem predicated on public-private partnership. Government can provide its resources in numerous ways: donated or cheaply sold land; increasing supply of higher-density inclusionary zoning in exchange for a portion of the

created value; appropriated grants, such as down payment assistance or loans; ongoing subsidies like Housing Benefit; or fiscal incentives such as tax deductions and tax credits.

In the United Kingdom, for example, beyond the resources of land allocated by English Partnerships, housing grants allocated by the Housing Corporation, and Housing Benefit, the Labour government continues to explore approaches to expand its supply of affordable housing beyond the existing Housing Association stock. The UK's capacity to develop affordable housing is constrained entirely by appropriations of Housing Grant. Much attention is being given to intermediate or key worker housing that will enable first responders like police, firefighters, doctors, nurses, and teachers to live in the communities they protect and serve. Similar challenges confront Ireland, where the booming Celtic Tiger economy is reversing the Irish diaspora and stimulating a metropolitan Dublin population growth intensity not seen in two centuries. Ireland is pioneering ways to create additional appropriated or fiscal incentives that will stimulate affordable intermediate housing as a permanent addition to supply, a waystation for families moving from council housing to homeownership.

Government must lead by establishing large sources of subsidy—whether direct appropriations or taxes foregone—compatible with existing public-private delivery mechanisms and programs to deliver additional affordability beyond what can be reached through the means of an advantaged market. The same housing specialists populating the public-private partnership sector will create even greater affordability by deploying subsidies.

Government's Final Obligation

Beyond its four roles, government must have the essential quality of far-sighted patience because it takes time to create effective financial systems, and they in turn take time to create sustainable, affordable housing. Individual housing properties are long-lived, composed of a long gestation period, a long development, and a long maturity. Add to that the complexity inherent in a successful interdependent housing financial ecosystem, and it takes decades to reach policy makers' ultimate goal of developing functioning delivery at all levels of affordability based on the interplay of law, capital, partnership, and subsidy.

These ecosystems grow slowly and die quickly. Elected officials who create policy have to look beyond next week's headlines, beyond next year's election, and even beyond the next incumbent's administration. For that reason, affordable housing delivery is most effective when the commitment to housing affordability is a long-term policy bedrock so solid its support is bipartisan and non-partisan.

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