

# EFFECT OF FISCAL POLICY ON HOUSING FINANCE IN INDIA

by

DEEPA KRISHAN

B.Sc. (Hons.), University of Delhi, India, 1974

M.Sc. Indian Agricultural Research Institute, New Delhi, India, 1976

M.Sc. University of Bath, UK. 1989

A THESIS SUBMITTED IN PARTIAL FULFILLMENT OF  
THE REQUIREMENTS FOR THE DEGREE OF  
MASTER OF SCIENCE  
in

THE FACULTY OF GRADUATE STUDIES

School of Community and Regional Planning

We accept this thesis as conforming

to the required standard

THE UNIVERSITY OF BRITISH COLUMBIA

APRIL 1994

©Deepa Krishan, 1994

In presenting this thesis in partial fulfilment of the requirements for an advanced degree at the University of British Columbia, I agree that the Library shall make it freely available for reference and study. I further agree that permission for extensive copying of this thesis for scholarly purposes may be granted by the head of my department or by his or her representatives. It is understood that copying or publication of this thesis for financial gain shall not be allowed without my written permission.

(Signature)

Department of School of Community & Regional Planning

The University of British Columbia  
Vancouver, Canada

Date April '94

## ABSTRACT

This thesis attempts to identify elements needed in a fiscal policy designed to encourage private investment towards urban housing in India. The need for such a policy arises due to the existing and projected urban housing shortage in India.

The Government of India attempts to address housing shortages through subsidies, tax incentives and regulation. However, the urban housing shortage continues to increase. One of the major constraints identified is the shortage of housing finance. An estimated investment of Rs. 572 billion is required to meet the existing urban housing shortage of about 10 million units. Fiscal policy instruments are useful in directing finance towards selected priority sectors. This thesis suggests that the fiscal policies of India be designed to encourage private investment in the urban housing sector.

Only a limited number of studies have been made to ascertain how fiscal policies influence housing and housing finance, even though tax incentives that affect housing are commonly used in many countries. These studies show that the effect of most housing tax expenditures is regressive. The incentives given by housing tax expenditures directly affect only the tax payers, and thus would be limited to the top two quintiles of Indian population. People in lower income groups would not benefit and would be discriminated against by these policies. For increasing urban housing in India, there is need to suggest policy measures that favourably impact all sections of the population.

A fiscal policy that helps the financial institutions to mobilize household savings towards investment in urban housing is necessary. These policies can be designed to encourage the rich to invest in institutions that provide low-cost housing finance credit to the poorer sections. This will

enable the urban dwellers, including the poorer sections amongst them, to have access to finance for housing at reasonable interest rates.

The fiscal policy must also give incentives to employers to provide housing or housing finance to their employees. They should also encourage businesses to invest in housing for low-income groups, and developers to provide subsidized housing to them. Such incentives would also help in reducing the role of the underground economy in the housing sector. Policies that actively discourage hoarding and speculation in land and property, such as a tax on vacant land, would increase the supply of housing.

In India, such fiscal policies would need to be complemented by changes in the regulatory framework to remove the deleterious effects of other policies, such as rent control laws, on the supply of housing. A tax system incorporating incentives to promote housing, formulated in coordination with housing and urban planners, and with a provision for regular evaluation of its effectiveness is likely to considerably help reduce the shortage of housing finance.

## TABLE OF CONTENTS

ABSTRACT.....	ii
TABLE OF CONTENTS.....	iv
LIST OF TABLES.....	vi
LIST OF ABBREVIATIONS.....	vii
DEFINITION OF AN URBAN AREA IN INDIA.....	ix
ACKNOWLEDGMENTS.....	x

### CHAPTER ONE

Introduction .....	1
1.1 Introduction.....	1
1.2 Background.....	3
1.3 Problem Statement.....	4
1.4 Objectives of the study.....	7
1.5 Scope of the study.....	7
1.6 Methodology.....	8
1.7 Thesis Organization.....	8

### CHAPTER TWO

Housing Situation in India.....	10
2.1 Housing in Developing Countries.....	10
2.2 Condition of Housing in India.....	11
2.3 National Housing Policy.....	14

### CHAPTER THREE

Housing Finance in India.....	19
3.1 Housing Finance- General System.....	19
3.2 Housing Finance in India.....	24
3.3 Constraints for Housing Finance.....	32

### CHAPTER FOUR

Fiscal Policies Relating to Housing.....	46
4.1 Introduction.....	46
4.2 Reasons for Government Intervention in Housing.....	48
4.3 Problems associated with Public Intervention.....	50
4.4 Definition of Tax Expenditures.....	52
4.5 How Housing Enters the Tax System.....	52
4.6 Significance of the Tax Expenditure Concept to Housing Policy.....	59
4.7 Tax Expenditures and Housing Finance Markets.....	60
4.8 Curtailing Tax Efficient Housing Investment.....	61
4.9 Other Forms of Government Intervention.....	61

4.10 Comparison Between Tax Expenditures and Direct Subsidies..	62
---	----

#### CHAPTER FIVE

Housing Tax Expenditures in India.....	68
5.1 Introduction.....	68
5.2 Taxation Policies Relating to Housing in India.....	69

#### CHAPTER SIX

Housing Tax Expenditures in Other Countries.....	80
6.1 OECD Countries.....	80
6.2 Britain.....	88
6.3 Canada.....	94
6.4 United States Of America.....	99
6.5 Developing Countries.....	102

#### CHAPTER SEVEN

Effects of Housing Tax Expenditures on Housing.....	106
7.1 Growth in Home-ownership.....	106
7.2 Urban Sprawl.....	108
7.3 Distributional Impacts and Tenure Choice.....	109
7.4 Tax incentives and Rental Property.....	112
7.5 Housing Credit Institutions.....	118
7.6 Tax Relief on Borrowing.....	119
7.7 Promotion of Home Ownership by Lower Income Groups.....	120
7.8 How Fiscal Preference Affects Different Income Groups.....	122

#### CHAPTER EIGHT

Conclusions and Recommendations.....	123
8.1 Limitations of the Study.....	123
8.2 Conclusions.....	124
8.3 Policy Implications and Suggestions for India.....	127
8.4 Recommendations for Further Study.....	136

BIBLIOGRAPHY.....	140
-------------------	-----

## LIST OF TABLES

2.1 Projections of Housing Requirements in India .....	12
2.2 Households Living in Rental Housing in India.....	12
3.1 Housing Investment in India.....	24
3.2 Rates of Gross Domestic Saving in India.....	39
3.3 Sources of Housing Finance in India.....	44
3.4 Share of Various Sources of Housing Finance in India.....	44
5.1 Taxation in India of Housing and Other Incomes.....	69
5.2 Home Loan Account Scheme in India.....	71
6.1 Taxation of Owner-occupied and Rental Housing in India and Selected OECD countries.....	87
6.2 Taxation in UK of Housing and Other Incomes.....	89
6.3 Tax Subsidies to Owner-occupiers in UK.....	90
6.4 Main Forms of Financial Subsidy by Tenure in UK.....	92
6.5 Housing Subsidies, Taxation and Benefits in UK.....	94
6.6 Major Federal Expenditures for Housing in Canada, 1979....	95
6.7 Federal Housing Tax Expenditures in Canada, 1979.....	97
6.8 Changes in Home-ownership Rates in Canada.....	98
6.9 Changes in Renter Households in Canada.....	98
6.10 Major Activities subsidized by Tax Expenditures in USA...	99
6.11 Housing Tax Expenditures for Individuals in USA.....	100
6.12 Distribution of Housing Tax Expenditures in USA, 1990...	101
7.1 Home Ownership in India and Selected OECD countries.....	106
7.2 Households by Tenure in UK and USA.....	110

## LIST OF ABBREVIATIONS

AHOP.....	Assisted Home Ownership Program (Canada)
ARP.....	Assisted Rental Program (Canada)
BES.....	Business Expansion Scheme (UK)
CMHC.....	Canada Mortgage and Housing Corporation
CPF.....	Central Provident Fund (Singapore)
EWS.....	Economically Weaker Sections
FI.....	Financial Institution
GDP.....	Gross Domestic Product
GIC.....	General Insurance Corporation (India)
GNP.....	Gross National Product
HDB.....	Housing Development Board (Singapore)
HDFC.....	Housing Development Finance Corporation (India)
HFI.....	Housing Financial Institution
HIG.....	High Income Group
HLA.....	Home Loan Account
HRA.....	Housing Rent Assistance (UK)
HTE.....	Housing Tax Expenditure
HUDCO.....	Housing and Urban Development Corporation (India)
IT.....	Income Tax
LIC.....	Life Insurance Corporation (India)
LIG.....	Low Income Group
MIG.....	Middle Income Group
MIRAS.....	Mortgage Interest Relief at Source (UK)
MITR.....	Mortgage Interest Tax Relief (UK)
MURB.....	Multiple Unit Residential Building (Canada)





## DEFINITION OF AN URBAN AREA IN INDIA<sup>1</sup>

An urban area in India is defined as follows:

(a) All places with a municipality, corporation, Cantonment board or notified town area committee, etc., and

(b) all other places which satisfy the following criteria:

(1) a minimum population of 5,000;

(2) at least 75% of male working population engaged in non-agricultural pursuits; and

(3) a density of population of at least 400 persons per sq. km. (1000 persons per sq. mile)

An URBAN AGGLOMERATION is by definition the continuous urban spread consisting of a core town and its adjoining outgrowths, which may be urban in their own rights or rural.

This thesis relates to urban areas having more than 100,000 persons.

---

<sup>1</sup>Source : Shukla, 1988.

#### ACKNOWLEDGMENTS

The author gratefully acknowledges the assistance of the Government of India, in granting leave of absence from her job and thereby providing the opportunity to conduct this study. The author also acknowledges the continuous support and guidance given by Dr. V. Setty Pendakur and Dr. Michael Leaf. Thanks are also expressed to her colleagues in both India and Canada who contributed significantly to this study. Special thanks are also given to her family for their constant support and patience.

## CHAPTER ONE

### INTRODUCTION

#### 1.1 Introduction

Access to adequate and affordable housing in urban areas is a major challenge in many countries including India. This thesis examines the ways in which fiscal policy has been used to attract investment to the housing sector in India and some other countries. It then suggests the features which a fiscal policy must have to attract sufficient finance for urban housing in India.

The tax system constitutes one of the most important instruments of development policy in any country<sup>2</sup>. If redistribution of income is considered a desirable social goal, then taxation is an important means to that end, one that every country utilizes, whether explicitly or otherwise. Economic growth, internal and external stability, and the attainment of an appropriate distribution of income and wealth are some of the goals that tax policy attempts to achieve, even though they are in the realm of public policy<sup>3</sup>. Taxation is only one of the means of achieving such national objectives. Though the potential efficacy of taxes in achieving many of these purposes has often been exaggerated, nevertheless, as taxes are one of the most pervasive instruments of government policy in any economy, it is both inevitable and appropriate that the effects of taxation on such general public policy objectives as growth, distribution, and stability need to be taken explicitly into account while designing the tax system.

Since 1950, fiscal policies of India, have been formulated not only to

---

<sup>2</sup>Bird (1992) p(ix).

<sup>3</sup>Bird (1992) p 8.

raise revenue, but also have been used for encouraging desired social and economic objectives. Though this dual role of tax laws has been criticized often as the tax laws become more complicated and the primary objective of tax laws to levy and collect taxes is compromised, fiscal policies have achieved a significant measure of success in India and other countries to achieve social and economic goals.

In India, there has been rapid growth of urban population during this century. The urban population increased nine-fold from 25.62 million in 1901 to 240 million in 1990<sup>4</sup> while the number of urban centres increased 80 per cent from 1834 to 3245<sup>5</sup>. However, in spite of this large aggregate urban population, India continues to be one of the least urbanized countries of the world, with only about 27 per cent of its population living in urban areas. The level of urbanization is expected to increase rapidly in the coming decades, and as per estimates of The Urban Institute (1989) 41 per cent of the population (projected to be approximately 460 million) will be living in urban areas by the year 2010.

As more people crowd into the cities, they will place increasingly heavy demands on government for housing and the provision of a host of necessary public services, such as transport, communication, water, sanitation, electricity, etc. Even at present, there is considerable shortage of urban housing and much of the housing stock available is of poor quality and often out of the reach of most of the urban poor. The 1991 Census of India estimates housing shortage in the country to be 29.8 million units, of which

---

<sup>4</sup>Definition of urban areas is given in Appendix 1.

<sup>5</sup>The Urban Institute, (1989).

9.6 million are in urban areas. The Government of India has been attempting to attract investment in housing through subsidies, benefits and tax concessions. How successful have these attempts been, in India and elsewhere, in solving the housing problem? Or, have these attempts become so tangled and unwieldy, that their original intent has been lost sight of? In this study, the role of fiscal policies in attracting investment to the housing sector in India and other countries is examined. The effectiveness of fiscal policies in increasing the amount of finance available for housing is examined.

## **1.2 Background**

In India, a large portion of tax revenues is generated through indirect taxes such as local excise (manufacturing) and sales tax. These taxes are regressive as they affect the poor more, who also pay them at the same rate as the rich. As the poor tend to spend a greater percentage of their income on basic goods, they pay a larger percentage of their income as taxes on goods consumed, as compared to the rich, who with their higher propensity to save, spend less and thus pay a smaller percentage of their income towards indirect taxes. In a more equitable taxation system, the emphasis should be on raising public revenues through progressive taxes, such as urban property taxes, income taxes and wealth taxes. The incidence of these taxes rarely falls on the urban poor as the basic exemption limits above which income and wealth are taxed, are fixed at a high level. Although the taxes designed to stimulate individual investment in the housing sector may directly affect only the better-off urban dwellers, such investment also has a spillover effect in improving the housing situation of the urban poor by raising their income through generation of employment. Tax policies designed to stimulate investments in low-cost housing, whether by the employer, or the state, or the

private sector indirectly benefit the urban poor.

The manner in which public revenues are spent is also of great significance in improving the equity and efficiency of the urban system. For a more equitable urban growth, urban investment, pricing and regulation policies need to be designed to assist those forms of housing, sanitation, transport and other related services that meet the needs of a majority of the urban population including the poor, and at costs they can afford.

### **1.3 Problem Statement**

The post second world war era has seen significant increases in per capita income, life expectancy and literacy rates in most parts of the world. This is particularly evident in the developing countries when contrasted with the earlier era of almost stagnant growth. The rapid economic development during the latter half of this century accompanied by political changes that led to a large number of countries gaining independence from their erstwhile colonial masters, has led to a tendency for greater involvement of the State in the welfare of its citizens. In India, which gained independence in 1947, government has not only directly invested in certain priority sectors, but has also used fiscal policies to try to attract private investment into these areas. Thus fiscal policy aim not only to raise revenue, but, for example, by giving tax breaks, encourage investment in specific industrial sectors or geographical areas.

Housing, conceived as a set of services, is an important aspect of the environment that has a profound impact on the socio-economic, physical and psychological development of human-beings. Yet a sizable fraction of the world's population does not have adequate shelter and lives in extremely insanitary and unhygienic conditions. Housing is a global problem, to which

even the developed countries have not been able to find an acceptable solution. The problem is more acute in developing countries, where a sizable population lives below the poverty line, and the low per capita income precludes larger provision of housing and shelter by the government.

The urban housing situation in India is cause for grave concern especially in view of trends predicting rapid urbanization. One of the major constraints identified for urban development is the lack of adequate finance for urban shelter<sup>6</sup>. Since 73 per cent of the population is rural and the economy is still predominantly agrarian, it is not surprising that the government has been more concerned about rural development, and has concentrated its resources and policies in that direction<sup>7</sup>. However, the importance of urban development has also been acknowledged in recognition of the fact that urban areas are the engines of development and the growing role of manufacturing and service sector in the economy. The twin constraints of low per capita income and large urban population make it imperative that the utility of scarce resources is maximized. For that, it is essential that comprehensive policies for mobilization and optimum utilization of both public and private finances are formulated and implemented. Due to inadequate investment in housing, the backlog of housing shortage has continued to grow in India. In 1991, it was estimated that a financial outlay of Rs. 571.8 billion<sup>8</sup> was required to address the housing shortage of an estimated 10

---

<sup>6</sup>The Planning Commission, (1992).

<sup>7</sup> For example, in 1991-92, Rs. 3571 millions were spent on rural development, against Rs. 41.8 millions spent on urban development. In addition, Rs. 876.9 millions were spent on housing (both urban and rural). (Source: Government of India, (1993) pp 4-5).

<sup>8</sup>Planning Commission, (1992).



million units in urban areas.

An efficient housing finance system based on the principle of competitiveness, should be able to raise the bulk of its resource requirements by mobilization of household savings in competition with other participants in the market. It is difficult for the housing sector in India, as in most other countries, to rely solely on the market determined system. Thus, government intervention becomes necessary to ensure that adequate resources are mobilized to meet housing needs.

Several tax incentives and concessions have been given to individuals and companies for housing, but they are of a peripheral nature and their real value has fallen due to inflation. Also, as the threshold above which incomes and property values are subject to taxation are fixed at a high level<sup>9</sup>, and many activities and sections of the population are exempt from income tax, less than one percent of the total population pays income tax. Therefore, it may be expected that, any direct tax policies will only affect the housing investment decisions of people who pay tax and that these measures will not have any effect on the housing availability of the poorer sections. However, the rich do not build only for their own housing needs, and apart from renting housing units they also provide a large proportion of housing for their employees. If the fiscal policies are designed to encourage investment in housing for rental purposes or for employees, they would go a long way in addressing the problem of housing shortage. Such policies can also be designed to attract investments in a government fund that is used for giving housing

---

<sup>9</sup>Individual incomes above Rs.35,000 are subject to income tax, as compared to average per capita income of Rs. 10,000. Also as various incomes are exempt, only 8 million persons are assessed to income tax out of a total population of 840 million - that is, less than 1 percent.

loans to the lower income groups. Housing activity encouraged by fiscal policy measures would also have significant spillover effects, especially in terms of employment generation, and would thus benefit the non-taxpayers indirectly.

The problem of urban housing shortage in India is very large and complex, and as direct taxes apply only to less than one per cent of the population, the impact of fiscal policy measures designed to increase investment in housing is likely to be limited. In such conditions, these measures are likely to have only a moderate potential in addressing the issue of shortage of housing finance.

#### **1.4 Objectives of the study**

The objective of the study is to determine the influence of fiscal policies and instruments on housing finance, by studying the situation in India and some other countries, and to attempt the formulation of a model for India that shows how fiscal policy instruments can be used to increase housing finance.

This is a theoretical and exploratory study, attempting to examine how the fiscal policies influence the amount of finance invested in housing. Fiscal policy measures that will increase the amount invested towards housing are suggested. The study may lead to the formulation of a hypothesis that through fiscal policies the amount of finance invested in housing can be influenced.

#### **1.5 Scope of the study**

This thesis is restricted to the study of influence of fiscal policy measures on availability of finance for urban housing. Only the direct tax policies of the federal or central government, that are related to the housing sector are studied.

## **1.6 Methodology**

Can investment in urban housing be influenced through fiscal measures? An attempt is made to answer this question by examining the fiscal policies of some countries, such as Canada, USA and UK, to the extent that they affect urban housing. These countries have been chosen, as they have made significant improvement in urban housing.

This study utilizes secondary information. Qualitative and quantitative data from publications in the UBC library has been collected and studied so as to gain an understanding of the theoretical principles underlying the influence of fiscal policies on housing finance, and also to study the fiscal policies of various countries and analyze their effect on housing finance. Additional material was obtained through publications of the Government of India to study the situation in India<sup>10</sup>. On the basis of these, a model incorporating the fiscal policy measures that could result in boosting the amount of finance invested in housing finance in India has been formulated.

## **1.7 Thesis Organization**

This thesis consists of eight chapters. Chapter one introduces and defines the problem selected to be studied and details the methodology of the study. Chapter two describes the housing situation in India. Chapter three gives a descriptive analysis of the system of housing finance with special reference to India. In Chapter four, the concept of government intervention for encouraging investment in desired sectors is examined. Special attention is given to the theory regarding the use of tax expenditures in the housing

---

<sup>10</sup>The student has also drawn on personal experience gained as a bank officer in India, an officer in the taxation department of finance ministry of government of India, a student of fiscal studies, and as a resident of metropolitan cities of India.

sector. Chapter five details the housing tax expenditures in India, while those in certain other countries are described in Chapter six. In Chapter seven, the effects of housing tax expenditures are analyzed. Chapter eight concludes the study and gives policy recommendations regarding housing tax expenditures in India.

## CHAPTER TWO

### HOUSING SITUATION IN INDIA

This chapter starts with a discussion of the housing situation in developing countries. The next section discusses the housing situation in India. Highlights of the policies proposed in the National Housing Policy document of India are discussed in Section 2.3.

#### **2.1 Housing in Developing countries**

Housing shortages are a problem in almost every country, and the provision of adequate housing presents a challenge for government policy-making. However, the severity of urban housing shortage varies from place to place and it is generally observed that it is most severe in the big cities of developing countries.

The urbanization process in most developing countries represents a socio-economic reality, characterized by the mismatch between population and resources, enormous disparity in the distribution of income and wealth, and the concentration of population in cities. In most of the developing countries, the rate of urban population growth is high while the progress of economy is relatively slow. This leads to differences in the labour supply and labour demand which in turn results in underemployment and unemployment.

The disparity in the distribution of income and wealth is the underlying reason for the universal existence of the housing problem. Low levels of income in developing countries, and the disparity in distribution of income and wealth result in a much higher proportion of the population living in "absolute poverty"<sup>11</sup>. Under these circumstances, it is difficult for the

---

<sup>11</sup>Linn, (1983) p4.

developing countries to find sufficient resources to satisfy various needs of the population, including housing.

The housing problem in the cities of developing countries is deeply rooted in socio-economic circumstances. Therefore, the solution requires that the combined effect of mis-match between the population and mobilized resources, and the disparity in the social and the spatial pattern of distribution, be addressed and reduced. This needs to be done to such an extent that even the poorest urban households can earn enough to satisfy their basic needs including housing.

## **2.2 Condition of Housing in India**

The condition of a country's housing stock is a highly visible indicator of the quality of life enjoyed by its citizens. The majority of Indian population cannot afford even basic housing from their own financial resources, without external assistance by way of loans/grants, either from the public sector or from private sources. Public sector institutions in the area of housing, mostly depend on allocations from government budgets. Competition from other priority sectors such as agriculture, industry and defence, prevents sufficient allocations for housing in the national budget. Consequently a large part of the urban population is not adequately housed<sup>12</sup>, and it is estimated that 9.55 million units would be required to meet the urban housing shortage projected for the Eighth Five-Year Plan period (1992-1997)<sup>13</sup>. Table 2.1 gives the break-up of the housing requirements projected during this period.

---

<sup>12</sup>Sivashanmugam, (1987).

<sup>13</sup>The Economic Times, New Delhi. (11th February, 1994) p. 17.

Table 2.1-Projections of Housing Requirements in India (1992-1997)

Number of Housing Units Required (in millions)

	Rural	Metro	Other urban	Total Urban	Total
<b>Upgradation</b>	4.07	-	1.75	1.75	5.82
<b>New stock:</b>					
EWS	6.45	1.18	2.17	3.35	9.80
LIG	1.34	1.04	1.90	2.94	4.28
MIG	0.25	0.31	0.58	0.89	1.14
HIG	0.10	0.22	0.40	0.62	0.72
<b>Total new stock needed</b>	8.15	2.75	5.05	7.80	15.95
<b>Total housing requirement</b>	12.2	2.75	6.80	9.55	21.77

Source: The Economic Times; New Delhi. (11th February 1994).

Notes: EWS- Economically Weaker Sections

LIG- Low Income Group

MIG- Middle Income Group

HIG- High Income Group

Rental housing in India is predominantly an urban phenomenon, as the percentage of households living in rental housing in urban areas far exceeds that in rural areas. During the period 1961-1981, the percentage of urban households living in rented houses has shown a decline.

Table 2.2: Households living in rental housing in India

	1961	1971	1981*
Rural	6.39%	6.24%	6.97%
Urban	53.73%	52.88%	46.39%
Total	14.80%	15.43%	16.48%

Source: National Institute of Urban Affairs, (1989a); p. 1.

\*Does not include data for the states of Assam, Gujarat, Jammu and Kashmir and Nagaland; and the Union Territory of Delhi.

The advantages to the tenant of rental housing are zero investment; greater flexibility and mobility. However, all the money spent on rental housing is a consumption expense, whereas expenditure on ownership housing is also an investment. Ownership of housing in all societies including India, enjoys a superior status. In India, the expected high rate of inflation of house prices, uncertainty relating to future levels of rent and to frequency

of movement, the prevalence of practices such as "pugree" or key money<sup>14</sup> make ownership housing even more attractive.

It is estimated that to house everybody, 3 million units are needed to be produced every year, against the annual production of about 310,000 units during the eighties<sup>15</sup>. The sheer magnitude of the housing problem makes it necessary to have a phased program to eradicate this shortage. In 1987- The International Year of Shelter for The Homeless- the Government of India resolved to provide a dwelling to each household in the country by the year 2000. In this endeavour, the thrust in the housing sector was proposed to come primarily from the private sector. The role of the public sector was to be a limited one, concentrating primarily on providing subsidized housing to the poor, including the economically weaker sections (EWS), slum dwellers, and dock and plantation workers. The public sector would also provide financial support to housing boards, development authorities to undertake land acquisition, and development and housing construction, primarily for low- and middle-income groups. The private sector would have to play the major role in augmenting the housing stock.

National income accounts indicate that housing investment as a proportion of gross capital formation in the country has declined from about 30 percent in 1950 to only about 12 percent in 1975<sup>16</sup>. Housing contributed 16.72 per cent

---

<sup>14</sup>This is the deposit tenants pay the landlord when renting premises. The amount may vary from 3 months' rent to 3 years' rent.

<sup>15</sup>The Urban Institute, (1989).

<sup>16</sup>Mohan, (1982) p1. This is primarily due to the diversification of the economy, with large investments in the industrial sector.



to gross domestic capital formation in 1984-85 and 3.22 per cent to GNP<sup>17</sup>. The growth of gross capital stock in housing in terms of real value has only been about 1.5-1.6 per cent per year, compared to the annual population growth of over 2 per cent. Census data indicate that the quality of shelter per capita has declined over the last 30 years, as measured by indices of crowding. For example, between 1961 and 1971, the average number of persons per room increased from about 2.6 to 2.8<sup>18</sup>. About 51.2 million people live in slums and squatter settlements and about 50 per cent of urban households live in crowded one-room tenements. There has been a 30-50 per cent rise in the property prices in every major city of the country in the last two years<sup>19</sup>. The trend of urban property appreciating faster than other investments is likely to continue, as while the overall population is growing at the rate of 2.1% per annum, the population growth of urban areas is over 4% annually<sup>20</sup>.

### **2.3 National Housing Policy**

The Government of India adopted its National Housing Policy (NHP) in 1992<sup>21</sup>, wherein it recognized that housing forms an important part of the strategy of the government for the alleviation of poverty and employment generation, and is viewed as an integral part of overall improvement of economic development. The rapid growth of urban population and its concentration in 300 cities with a population exceeding 100,000 has led to

---

<sup>17</sup>Urban India, (July-December 1990) p 101.

<sup>18</sup>Mohan (1982) p1.

<sup>19</sup>India Today, (August 1993); p. 114.

<sup>20</sup>Sivasankaram, (1991).

<sup>21</sup>Government of India (1992a)

congestion and overcrowding in small houses, steady growth of slums and informal settlements and severe pressure on civic services. This has been aggravated by institutional deficiencies of housing agencies and local bodies, and insufficient attention to the shelter needs of the poor.

Chief among the goals proposed to be achieved in the NHP are, reduction of homelessness, and provision of a larger supply of developed land and finance to different income groups. For supply and management of land, the central and state government would, among other things, use fiscal and municipal taxation policy, including tax on vacant urban land, in order to curb speculative activities, and to increase the supply of serviced land. For conservation of housing stock and rental housing, the NHP envisages steps to be taken by the central and state governments and financial institutions, for providing fiscal and property tax incentives and financial assistance for expansion and upgradation of dwelling units and for proper maintenance of buildings.

The NHP recognizes that the bulk of the housing in the country is constructed by the people themselves with their own resources. The crucial role of government at different levels is not to seek to build houses itself, but to make appropriate investments and create conditions where all may gain and secure adequate housing, and to remove impediments to housing activity. It is envisaged that 20 per cent of the requirement of investment in housing would be met by specialized housing finance institutions (HFIs), insurance and banking sector, provident fund, mutual funds etc. and through additional mobilization of household savings. The objective of the NHP is to promote easy access to finance for different housing activities and to evolve an elastic and widespread resource mobilization strategy to tap household savings in the

formal and informal sector. Steps would also be taken for the removal of constraints to the flow of finance into the housing sector.

In the interest of long-term development of the mortgage market and to provide assured resources for the housing finance system, increasing proportion of the resources of public financial institutions will be channelled into housing with lending rates reflecting the average yields of these resources. Apart from diverting increasing proportion of annual provident fund accumulations for housing finance, housing-linked savings schemes for the workers in the organized sectors and public sector employees will be introduced.

It is envisaged that, The National Housing Bank (NHB-the apex agency charged with linking the housing finance system with the financial sector as a whole) will facilitate the promotion and regulation of HFIs in the public and private sector, refinance their operations, and expand the spread of housing finance to different income groups all over the country. The Housing and Urban Development Corporation (HUDCO) will be strengthened and its resources increased for meeting requirements of providing shelter for lower income groups in rural and urban areas, and for expanding infrastructure facilities in the urban areas. The complementary roles of different agencies and institutions in public and private sector concerned with land development, house construction and finance will be supported.

Innovative savings and lending institutions in public and private sector will be introduced to integrate the housing finance system with the capital market by enabling HFIs access to the funds on a competitive basis with other financial institutions and by permitting NHB and HUDCO to set up mutual funds for housing, apart from their access to external aid. Steps will be taken to

introduce a secondary mortgage system in order to attract funds from a wide range of investors, including insurance and provident funds, and to integrate housing finance with the overall financial system. The long-term goal of The National Housing Policy is that the housing finance system as a whole becomes self-financing. It should be able to meet the needs of different income groups and purposes, with longer repayment periods, graduated payments and simplified procedures; so as to ensure affordable installments and larger coverage across different urban and rural areas.

The need to carefully target capital and interest subsidies for urban and rural poor; and to make improvements in the housing finance procedures and shelter delivery system in order to bring down the cost of shelter for the poor to affordable levels; is recognized in the NHP. The housing finance system will be devised to respond on flexible terms to a variety of shelter needs of the rural and urban poor.

The need to make a detailed assessment of the role of informal credit network and community based savings systems for housing, and to devise ways of establishing its links with the formal credit institutions, so as to enhance access of the urban and rural poor to housing finance, is acknowledged. The cooperative housing movement, especially for the lower and middle income groups, will be given assured access to institutional finance to supplement internal resources.

The NHP proposes to provide fiscal incentives to promote investment in housing activity by the private sector and individuals, and to channel additional savings for housing activity from households and enterprises. To induce employers in the organized sector to provide housing for their workers, tax incentives will be given for investment in rental or ownership housing,

especially for low income employees. Similar incentives will be given to promote the building of new building materials and components produced out of industrial and agricultural wastes, and those which substitute the use of scarce resources like wood, and energy intensive materials like cement and steel. The levy of stamp duty and registration fees will be rationalized, especially to reduce the financial burden for lower income groups. Government will encourage housing schemes in the major cities to channel foreign investments in residential property, and would extend appropriate incentives like speedy clearance by Central, State and Local governments to stimulate a sustained and large in-flow of such investment.

Investment in rental housing, especially for the lower and middle income groups will be stimulated by encouraging individuals and groups to construct houses for full or partial letting by providing access to land, institutional finance, enabling regulations and incentives in central, state and municipal taxation of property and incomes.

The chief constraints in provision of adequate housing for all urban dwellers are shortage of land, and shortage of finance. Though land is fixed in supply, more land can be developed if finance is available. So, to address the question of housing shortage, it is essential to examine the issue of housing finance. This issue is examined in the next chapter.

## CHAPTER THREE

### HOUSING FINANCE IN INDIA

In this chapter, the basic features of housing finance are examined first. Section 3.2 describes the housing finance system in India. This is followed by a discussion of the constraints to housing finance in India in section 3.3.

#### **3.1 Housing Finance - General system**

The basic proposition of the housing finance process is that a loan is required by most people to purchase a house <sup>22</sup>. This is primarily because, buying a house is probably the largest single expenditure incurred by most households, and also because people buy houses when they are relatively young, when they have little savings of their own. Hence they need to borrow.

There are four separate ways in which housing loans can be provided:

1. The simplest way is the direct system, through which loans for house purchase are provided directly by the holders of financial assets, without the intermediation of a financial institution. As the financial requirements of borrower and lender can never be identical, the direct system can never be fully efficient.
2. In the contract system, potential house purchasers commit themselves to a period of saving, after which they are eligible to a loan. This system encourages thrift, and enables people to acquire loans at relatively cheap rates. This system is used extensively in three OECD countries: France, Austria and West Germany.
3. The deposit taking system is the most common system. Institutions, such as

---

<sup>22</sup>Boleat, (1986), pp 83-98.

commercial banks, savings banks, cooperative and mutual banks, that in the course of their business raise deposits from the public, use these deposits to make housing loans. In a number of countries there are specialist deposit taking institutions; e.g. building societies in Great Britain, Australia, and New Zealand, and savings association and federal savings banks in the USA.

4. The mortgage bank system has the attraction of matching long term housing loans with long term bond issues. Generally, rates of interest on both loans and bonds are fixed. The institutions operating the mortgage bank system do not need a branch network, and thus their overhead expenses are much lower than deposit taking institutions. This system is used extensively in the Continental European countries, especially Italy, Sweden and Denmark. The mortgage bank system worked well when interest rates were relatively stable, but it has proved more problematic when interest rates have been variable<sup>23</sup>. Variable interest rates cause unseen fluctuations in the monthly mortgage to be paid, but they are much fairer between consumers. If interest rates rise people would prefer to continue with low interest rate loans, but when interest rates fall people do not want to be committed to long term loans at high fixed rates. It is difficult for consumers to forecast the future trend of interest rates, and time their purchases accordingly. With a fixed rate of interest there may be people living alongside, paying significantly different mortgage rates. Fixed rates of interest are damaging to housing markets, as people may defer or prepone their decision to buy in accordance with their expectation of interest rates, thus amplifying the normal cyclical fluctuations in the housing market. Variable rates are also beneficial to

---

<sup>23</sup> Boleat, (1986).

HFIs.

Institutional funds for housing are provided in the following ways:

1. By direct lending to house buyers- the method used predominantly by banks, and some insurance companies. It is unattractive for institutions, other than deposit taking institutions, to service and hold house purchase loans because it is fairly labour-intensive and requires a branch network, if economies of scale are to be captured.
2. By direct loans to HFIs.
3. The institutional investors purchase marketable unsecured securities issued by HFIs. These give liquidity to the institutional investor while providing the lender a steady source of funds for house purchase.
4. Secondary mortgage market, which is huge in USA, enables the HFI that originates and services a mortgage asset, to sell it to another institution who holds the mortgage in its loan portfolio.

The relationship between housing finance and the broader macroeconomic situation of a country has been extensively debated. Burns and Grebler (1977)<sup>24</sup> conclude that new housing investment as a proportion of gross national product at first increases with the wealth of the country, and then decreases after a point. Buckley and Madhusudan (1984)<sup>25</sup> find that there is a significant positive correlation between financial deepening and the level of housing investment across their sample of more than 30 countries. Malpezzi (1990)<sup>26</sup> also stresses the critical role of housing finance in the development

---

<sup>24</sup>As quoted in Hoffman et al, (1991); p. 33.

<sup>25</sup>Hoffman et al, (1991) p 34.

<sup>26</sup>Ibid, p34.



strategy. By treating housing more as a consumption good than as an investment, planners fail to recognize its potential for encouraging savings and enhancing other sectors of the economy.

House prices are strongly influenced by the components of the cost of capital, such as the marginal tax rate of the market clearing buyer, property tax rate, before-tax nominal discount rate, mortgage interest rate, and the expected rate of house price appreciation. Increases in financing rate and property tax rates and reductions in marginal tax rates and expected appreciation all lead to reductions in house prices. These elasticities rise with the income tax bracket of the homeowner. The value of housing-related deductions and exclusions rises with the income tax bracket of the homeowner, which holding other factors constant, lowers the cost of capital<sup>27</sup>.

Boleat (1986) has reported a significant positive correlation between a country's level of development and its use of financial intermediation. He also stresses the importance of informal housing finance and savings, the source of more than 80 per cent of housing investment in developing countries.

Provision of housing finance is an important element of housing policies pursued by the governments of developed and developing countries of the world in the post world-war era<sup>28</sup>. Investment in housing is viewed as a necessary component of the package of investments for promoting socio-economic development, as it does not merely create a shelter, but also provides other benefits. Increasing emphasis on more investment in housing is a direct offshoot of the welfare state goals of the modern governments.

---

<sup>27</sup>Lea and Johnson, (1984), p 260.

<sup>28</sup>Wood, (1986).

Housing in both developed and developing countries is under-invested. The financial markets in housing in developed countries are comparatively better developed than in developing countries, where they are still in their infancy. Investment in modern housing stock and housing services in the developing countries is inadequate due to low per capita income, high land prices and rising construction costs on one hand, and due to inadequate financial assistance from their underdeveloped financial systems on the other.

In developing countries, access to housing finance has traditionally been limited to persons with higher incomes. The reasons for this may include prohibitive income and down payment requirements for housing to meet loan underwriting standards, a perception by lenders that lending to lower income households is difficult and risky, or the fact that lending institutions with limited funds lend only to the least risky borrowers. Struyk and Turner (1986)<sup>29</sup> argue that expanding the population of borrowers is an integral part of improving the living standards in the developing world. Quasi-formal and informal credit programs are vital in providing credit to the poorest and least privileged citizens of developing countries, who are excluded from the formal-sector lending process. Struyk and Turner (1986)<sup>30</sup> have reported that access to formal housing finance leads to improved housing quality and infrastructure services in Philippines and Korea.

A central theme of much of the more recent housing finance research concerns "Enabling Strategies"<sup>31</sup>. Enabling requires that national governments,

---

<sup>29</sup>As quoted in Hoffman (1990) p 51.

<sup>30</sup>Ibid, p 54.

<sup>31</sup> Hoffman, (1991) p55.

rather than provide housing or subsidies directly, facilitate the provision of housing by liberalizing the market, building up support systems for housing, and integrating housing markets with broader capital markets and macro-economic policy.

### 3.2 Housing Finance in India

TABLE 3.1: Housing Investment in India

Plan Period	Total investment in the Economy (Billion Rs.)			Investment in housing (Billion Rs.)			% of housing investment to total investment in economy
	Public	private	total	public	private	total	
1st-1951-56	15.6	18.00	33.60	2.5	9.0	11.5	34
2nd-1956-61	36.5	31.00	67.50	3.00	10.00	13.00	10
3rd-1961-66	61.00	43.00	104.0	4.25	11.25	15.5	15
4th-1969-74	136.55	69.8	226.4	6.25	21.75	28.00	12
5th-1974-79	314.0	161.61	475.6	10.44	36.36	46.80	10
6th-1980-85	975.0	747.10	1722.1	14.91	115.0	129.9	7.5
7th-1985-90	1681.5	1800.00	3491.48	24.58	290.0	314.5	9
8th-1992-97 (proposed)				77.50	697.46	774.96	

Source: Urban India: (July- Dec. 1990). p 125.

Note: In general all plans are for five years. However, there were 3 annual plans from 1966-1969, and 2 annual plans in 1990 and 1991.

There has been a steady increase in the quantum of housing investment in India, since 1950 (Table 3.1). However, in percentage terms, the share of housing investment to the total investment in the economy has been declining, from 34 per cent in the first Five-Year plan (1951-56) to 7.5 per cent in the

sixth plan period (1980-85). While the private sector investment in housing has declined from 50% in 1950 to 16% in 1990, the share for public sector investment has gone down from 16% to 1.4%. This decline is due to reduction in the share of investment in housing relative to investment in other sectors.

The Indian housing finance sector has two distinct sectors- formal and informal. The **formal** sector includes specialized housing finance institutions like the Housing and Urban Development Corporation (HUDCO), Housing Development and Finance Corporation (HDFC), the cooperative housing finance societies and the state housing boards/development authorities, and also general investment institutions like the Life Insurance Corporation (LIC), the General Insurance Corporation (GIC), the Unit Trust of India (UTI) and the commercial banks. The primary function of the general financial institutions is to protect the interests of their main beneficiaries, whose savings they command, and housing finance is a supplementary effort, triggered by their search for alternative investment opportunities. They also invest in housing to fulfill national commitments to social-oriented sectors<sup>32</sup>.

The **informal housing finance** market is quite unique to the developing countries. In India, it is also the more important component. It includes the indigenous money lenders and bankers, friends, relatives and employers, who supplement the personal resource mobilization efforts of the individual home owner- who may also utilize his cash savings in addition to what he can raise through liquidation of self-acquired or inherited assets.

Over three-fourths of the annual financial investment in the housing sector in India is from the informal sector, while only 22.6 per cent comes

---

<sup>32</sup>Lall, (1985).

from the formal financing institutions. The central and state governments provide a substantial proportion of the finance through budgetary allocations. The contribution of specialized financial institutions has been gradually increasing, with the spread of activities of HUDCO, HDFC and the cooperative societies. There has also been some increase in the investment flows through the provident fund organizations, but the relative contributions in terms of total financing have not improved in the case of the commercial banks, GIC and LIC to any noticeable extent. The overall role of specialized financial institutions is not substantial enough to make a discernible impact on the role of the informal housing finance market<sup>33</sup>.

The housing finance market has relatively little interaction with the national capital market. This is due to several factors, such as the non-availability of a mass level institutional framework to mobilize savings at competitive rates of interest, the need of housing sector for long-term credit whereas the capital market may supply mainly short-term funds, the non-availability of attractive salable financial assets from the housing sector and the general disinclination of commercial banks to finance housing activity as a normal business operation. Another important characteristic of the formal housing finance market is the dependence of specialized institutions on the public sector, either the central or state government and LIC and GIC. These institutions have had little success in tapping household savings.

In the informal housing finance market, the most important supplier of finance is the extended family of the home owner. The home owner mobilizes his own resources from his savings, as well as liquidation of assets. Relatives

---

<sup>33</sup>Lall, (1985).

and friends also provide substantial support. The indigenous bankers and money lenders play a very crucial role in the case of people in low income groups, residents of smaller cities and persons with casual or seasonal incomes. In the informal housing sector (including slums and squatter settlements), the role of indigenous money lenders is significant.

Housing finance for the middle- and high-income-groups is provided mostly by the private sector and also by HUDCO and HDFC at the national level, and by housing boards and development authorities at the state level. These groups also have access to finance provided by their employers, commercial banks and insurance companies. In larger cities, the members of these income groups have been forming group housing cooperative societies, which collectively bargain for allotment of serviced land and finance. The bulk of finance is generally obtained from the HFIs and allocated to individual house builders. There is combined preparation of plans for the layout and houses. Benefits of economies of scale are availed in the purchase of building materials. Even after completion of construction, the society is not dissolved, but takes over the functions of repair and maintenance of the housing stock and public areas of the colony. These cooperative group housing societies have been very successful in the metropolitan towns and are encouraged by the Government as they bring about augmentation of housing stock in a planned and legal manner. In India there were 60,000 housing cooperatives by 1991, with over 4 million members<sup>34</sup>. The Cooperative Housing Movement has to its credit over 1 million constructed houses. The cooperative sector has invested Rs. 40 billion in the housing sector and every year Rs. 6 billion

---

<sup>34</sup>Government of India, (1992)11

more are added. About 60 per cent of housing finance disbursed by apex cooperatives has gone to economically weaker sections and lower income groups. As part of the land allotment policy, government gives preference to cooperatives in the allotment of land.

Even for the middle- and high-income groups, a significant portion of housing finance comes through informal channels. Apart from personal savings and borrowings from family, friends and relatives, an indigenous system of raising large amounts of interest free loans has been developed. This is the chit fund system<sup>35</sup>. The operation of chit funds is not confined only to the purpose of raising finance for shelter. The chit fund system of raising finances, is used extensively, but not exclusively, by the poorer sections, who vary it in terms of frequency and amounts, to suit their needs.

The prevalence of chit fund and other informal means of raising housing finance, even among the better-off people, who have access to formal avenues of finance, illustrates two points. First, the formal financial system is still undeveloped and rudimentary, so even the more affluent sections of the society have to resort to informal methods. This deficiency of the finance sector perpetuates the extralegal sector- which in turn results in a large

---

<sup>35</sup>A number of persons- friends, relatives, colleagues and even neighbours pool the same amount of money. The total amount so collected is given to a member of the group, whose name is picked up by draw of lots. This procedure is repeated every month, for as many months as there are members, and each month another member is allotted the total amount in the fund- which is known as chit fund, after the chits on which each member's name is written. In this manner the members of a fund have access to interest free loans. They are also able to save a target sum without going to a bank or institution, where apart from feeling intimidated by the procedures and forms, they will also be required to produce collateral or security and will have to sign a number of statements and pledges. The chit fund system operates in an informal manner and all transactions are verbal and without any tedious book-keeping. The system operates on the basis of trust and friendship where an occasional default is covered up by friends. More persistent defaults are addressed through peer pressure- from relatives, friends and seniors in workplace and neighbourhood. A chit fund may operate with installments of any amount.

parallel economy. The second point illustrated is that, the volume of investment required for shelter is so large that all avenues of finance are explored and exhausted and a large portion of future earnings is also committed. The relative quantum of investment required for a three-room house in a middle class locality of Delhi is worked out at a total of a person's average salary for eight years<sup>36</sup>. Considering that an average household has only one salary-earner and can save upto a maximum of 25 per cent, it means that all the savings of the household for 32 years (almost the entire working tenure) are required to provide for a house of its own. This large outlay for a house leaves little for other major expenses, such as illness or education and marriage of the children. It stands to reason that when the better-off find it so difficult to have housing of their own, the situation for the poorer sections, who can afford to spend only about 5-10 percent of their earnings towards provision of housing is even more grim.

The very high cost of housing units and the difficulty in obtaining adequate financing for expanding the supply of low-priced housing places additional burden on low-income-groups. The poor are generally excluded from conventional financing schemes due to high interest rates and restrictive loan terms. Moreover, the efforts of the government to provide housing for low-income-groups have rarely reached the targeted population. Instead, the benefits of conventional solutions are absorbed by the upper- and middle-income groups because of high housing and infrastructure standards that the poor cannot afford.

A sizable proportion of the urban poor in India are employed in the

---

<sup>36</sup> Pugh, (1990).



informal sector. This informal sector provides cheap labour and products for the formal sector, for whose promotion and expansion most of the government policies are geared. As the informal sector is kept impoverished in the developmental system, conventional construction and housing financial institutions are unable to address the needs of this sector. Therefore alternative non-conventional strategies are needed to help supply the housing requirements of this segment. Explicit policies and mechanisms are required to be created for the lower-income groups employed in the informal sector, as the policies for the rest of the population cannot meet their different needs.

These policies have to recognize the strengths and abilities of the poorer sections whom they are meant to benefit. Generally it is assumed that the poor are so poor that they are unable to save anything. But it is reported by UN (1978) that despite very low incomes, they can achieve an unexpectedly high rate of saving when a strongly desired item is seen to be accessible and can be purchased in small and easy installments. This observation is supported by Sivashanmugam (1987) who has reported that in the lowest income group (earning Rs. 700 or less p.m.), 43 per cent of the households save regularly; while in the next income group (earning Rs. 701-1500 p.m.), 85 percent of the households save regularly.

To encourage savings among the poor for housing, it has been suggested<sup>37</sup> that there should be deposit insurance and indexation of savings for housing of the poor from inflation. Preferential tax rates for such savings have been tried successfully in Korea and Indonesia. The involvement of commercial banks, trust funds and insurance companies not currently engaged in direct

---

<sup>37</sup>United Nations, (1978).

lending for mortgages is likely to increase competition among the housing finance institutions and could lead to better terms for their clients. The poor show exceptional ability to mobilize indigenous resources. They salvage waste, old and non-conventional building materials from demolition sites and garbage dumps. They are able to construct dwellings at costs much lower than any system of public sector construction, yet their investments are substantial both in aggregate as well as for each household. A survey of Poona slums<sup>38</sup> indicates that the best shanty dwellings (constructed by the poor) are comparable to, or are better than any public sector provided EWS housing, and cost just over Rs. 2000 on average in contrast to Rs. 8000-10,000 cost that is the minimum rate that the public sector can provide at.

An important role is played by HUDCO for meeting the housing needs of the poor. It has financed over 2.6 million dwelling units in the urban areas since 1960, and of these 90 per cent have gone to poorer and vulnerable groups.

For meeting the needs of housing finance in India, the **National Housing Bank (NHB)** was established in 1988. It is providing assistance through a number of schemes, such as, Home Loan Account Scheme, liberalized lending by commercial banks and refinance facilities. Refinance for land development and shelter programs of public/private agencies and cooperatives in order to increase the supply of serviced land has been undertaken. By the end of 1991, the NHB had advanced refinance amounting to over Rs. 7 billion to various commercial banks and other housing finance institutions and cooperatives. Over half-a-million accounts have been opened under the Home Loan Account scheme,

---

<sup>38</sup>Mohan, (1982).

mobilizing household savings to the tune of almost one billion rupees (Govt. of India, 1992).

Apart from the creation of the NHB, the **banking sector** in India has been involved substantially in housing finance. Revised interest rates have been fixed for the housing loans advanced by the commercial banks and housing finance institutions.

Another source of formal housing finance is housing loans from employers. These are provided by all the public sector employers; and by large private sector firms. However, the incidence of this type of formal finance is quite low, as it is restricted only to the small section of the population that is employed in the formal sector- thereby excluding not only the persons employed in the informal sector and by small private firms, but also the self-employed and the unemployed. Even the persons who are eligible for these loans have to wait a considerable period before they are eligible for the loan and also due to the limited amount of funds available for such loans. It would be useful to examine policies that would encourage more firms to give housing loans to their employees.

### **3.3 Constraints for Housing Finance**

By developing country standards, the Indian financial system is both sophisticated and large relative to the GDP. Furthermore, the rate of saving is high, averaging 22 per cent in the 1980s. The depth and breadth of the Indian financial system exceeds that of most developing countries, even those that are more developed than India<sup>39</sup>. But, the Indian financial system is also monolithic. Only a few financial institutions have access to most of the

---

<sup>39</sup>Buckley et al, (1989) p19.

country's financial resources, and most of these are government controlled. These institutions are highly regulated and tend not to compete with each other. They act as instruments of government investment policy as they allocate resources according to government directives, rather than in response to market incentives.

The key constraint in housing investment has been the lack of an organized system of housing finance on a large scale as only a few agencies provide finance for housing. Only employees in the organized sector have access to such finance, not the self-employed and others outside the organized sector. Considering that persons not employed in the formal sector form a sizable portion of the urban population, it is imperative that a widespread system of housing finance is established. The aim should be to provide institutions at the local level where an individual can go to obtain mortgage financing at reasonable rates for a long term. To fulfill this aim despite the problem of availability of long term finance, Mohan (1982) has suggested that there should be simultaneous formation of Apex Housing Refinancing Institutions, Mortgage Insurance system and local level housing finance institutions. The local level housing finance institutions such as housing banks are required to mobilize savings for housing by offering attractive schemes, and then ploughing these savings back into the community in the form of housing loans and mortgages. The Apex Housing Refinancing Institutions are needed to refinance the mortgages for which the funds can be raised from long term sources of finance, such as LIC, GIC, provident fund etc. There is need to provide mortgage insurance systems to make the mortgages safe and marketable. There has been some progress in India in establishing local level housing finance institutions through the formation of National Housing Bank,

but without the other two institutions it has a limited impact on the overall housing finance situation in the country.

The small amount of housing investments made by formal FIs can be explained by the fact that very few assets are involved. The more developed an economy is, the greater is the extent of financial intermediation. In the case of housing investment in developing countries, relatively large numbers of small loans are involved, raising transaction costs. Severe problems arise if short-term deposits are transformed into long-term loans. Recurring high inflation makes lending for housing production unattractive, and there often exists a lack of confidence in young FIs. These factors explain the very low institutional participation in housing investment in India. The contribution of the commercial banks amounts to hardly 10% of the institutional housing investment, i.e. less than 1% of the total market.

Apart from addressing resource constraint, contemporary policies might also have to be adopted to improve the scope for an increase in housing production. Guarantee of tenure, would not only stimulate low-income families to improve their dwellings but would also increase their chances of obtaining access to the existing financial and mortgage systems<sup>40</sup>. The formation of voluntary associations and building societies, in which the participant low-income families could unite, with the aim of increasing their credibility with existing financial systems and a transfer of land rights, would also be beneficial. A further relaxation of building codes and a more efficient supply of building materials (cement, steel and timber) would deflate housing costs.

---

<sup>40</sup> Such loans are cheaper than loans raised through the informal sector, mainly indigenous bankers who charge usurious rates of interest. Also, their savings would earn interest, unlike cash savings.

A better environmental infrastructure (roads, drainage, levelling and water and sewage connections); and further development and application of low-cost building technology for housing construction; would go a long way in stimulating housing construction.

Housing finance and land policy are the two major areas in need of the attention of policy makers in the economics of housing reform<sup>41</sup>. Reforms and progress in housing finance can lead to increased supplies of housing, with possibilities of extending housing wealth and welfare to moderate and low-income groups. However, housing finance can also lead to housing and land price inflation. One key consequence of this is that low-income access to housing is impeded, and housing resources are diverted to the upper and richer end of the housing market.

Housing systems in developing countries are inequitable, reflecting the prior inequality in the ownership of capital and earnings from work in the production-consumption economy. Competition for housing and good street space is intense because supply falls short of demand. This results in insanitary slums or living on the pavements. From the reformist perspective the housing policy has three clear purposes in such a context<sup>42</sup>. First, the income generating potential for the total economy, especially in the informal sector, has key significance. Second, it becomes a priority to increase the supply of housing across a wide range of distribution of income. If supplies to the higher percentile ranges are not increased, then some housing provisions for low-income households will be bought from them by the more affluent. Third,

---

<sup>41</sup>Pugh, (1990).

<sup>42</sup> Pugh, (1990).

specific policies to improve the housing welfare of low-income households are needed.

Urban development creates assets which in total represent enormous economic and social value. There is potential to add to urban investment, and to use housing policy as a means of extending property rights in assets. The further down the profile of income distribution that asset value in land and housing is extended, the more will policy be redistributive in favour of moderate and low-income households.

To spread the extent of owner-occupied housing and land, housing and land policies have to be coordinated to ensure that land price escalation is curbed. If ineffective land policies, speculation in land, and restricted availability of housing capital occur, resources in housing will mainly concentrate with upper income groups. In these circumstances supplies of new housing and land will be trickled out at low levels. Strong competition favouring the wealthy will push up land and building costs. Housing markets operate efficiently when there are high rates of employment, low rates of inflation, low interest rates, and competition among builders and financiers<sup>43</sup>.

Housing production has its economic costs but it also has economic benefits that spread into the general economy. It adds to income and employment, it upgrades skills, it reduces social costs such as the value of time lost from sickness, it motivates savings and it contributes to the general economic and social development of the society. It is estimated that an investment of Rupees ten millions in housing would yield employment for 670

---

<sup>43</sup> Pugh, (1990).

man years<sup>44</sup>.

On the demand side of the housing market, such things as the willingness to pay and the choice of priorities among food, housing, and other things are readily expressed. But in many crucial parts of markets and production, supply is not adequately forthcoming. In India, the bottlenecks to supply include, insufficiency of building materials, blocked access to land, inadequate mortgage and credit markets, and continuously low additions to the housing stock. Land price inflation is also evident and problematic. Further problems arise, because rents are controlled and government regulations on prices influence many building materials. Rent controls and regulations lead to the development of black markets and black economy. Rent controls undermine the long term supply of private rental housing. The rate of development in public rental housing does not fulfill the demand and need for rental housing.

Savings towards housing investment can be induced with tax incentives and the development of housing credit institutions. By enlarging housing credit, the potential demand is brought within affordable loan and mortgage instruments, leading to expanded production and competition among housing firms. Housing markets and housing sector become better organized.

In the context of low income housing, the question of affordability in the provision of adequate housing becomes a key issue for both the private and public sectors. In the past, as a rule of thumb affordability was taken at 20% of the income; either for rent or for repaying installments on loans<sup>45</sup>. Affordability varies greatly, especially with regard to the amount of saving

---

<sup>44</sup>Urban India, (July-December 1990) p102.

<sup>45</sup> Pugh, (1990) p77.



in the household and in how their housing expenditure varies when their income increases.

As housing is a basic need, economists would expect low degrees of responsiveness when income increases. Malpezzi (1985)<sup>46</sup> has reported that evidence from developing countries shows that housing has low income elasticity of demand. However, housing does absorb some share of increase in income over the medium and longer terms, providing there is some perception of improvement in housing conditions. If a household can have access to affordable loans, it can upgrade its housing standard and pay for the continuation of these standards over the duration of the loan and beyond.

With useful and effective initiatives in public policy, some savings and investments can be used to enlarge the volume of resources that go into housing. Housing finance is the key link in the potential for transforming the housing and social urban investments into property and benefits for the masses. This is not inevitable as it would not materialize if flows of saving coming from the general community are channelled into higher-income housing. The process to assist a wider range of income groups, depends upon the terms and conditions built into the design of housing credit.

Typically formal HFIs provide less than 20% of the annual investment in housing. Most of that investment is channelled to higher income groups and upper ranges of middle income groups. As an economy modernizes, its capital markets grow and become more specialized, with some development in housing finance. But, housing and non-housing capital have distinctly different needs and economic forces. Generally, housing requires longer term finance than

---

<sup>46</sup>As Quoted in Pugh (1990) p. 77.

industry. It also functions best when placed on a revolving basis so that flows of borrowing and lending are continuous, providing the capacity to grow. The efficiency of saving institutions is important, because it keeps the cost of borrowing down. But in a developing country the costs of reaching households and tapping their saving potential can be considerable. It may be necessary to establish a network of localized branches and to deploy outreach programs in order to induce the savings habit. Innovative and flexible savings schemes are required among low-income households, so as to adapt to the irregular and intermittent nature of their income.

**TABLE 3.2 Rates of Gross Domestic Saving in India**

Plan period	Public sector*	Private, corporate and co-operative sectors*	Household sector*	Total*
1950-51	1.8	0.9	7.5	10.2
First Plan 1951-56	1.7	1.0	7.7	10.4
Second Plan 1956-61	2.1	1.3	9.0	12.4
Third Plan 1961-66	3.4	1.8	9.1	14.3
Annual Plans 1966-69	2.4	1.3	11.0	14.7
Fourth Plan 1969-74	2.9	1.7	12.8	17.4
Fifth Plan 1974-79	4.7	1.6	15.6	21.9
Sixth Plan 1980-85	4.0	1.8	16.7	22.5
Seventh Plan 1985-90 (target at 1984-85 prices)	4.5	2.2	17.0	23.7

Source: Sivashanmugam (1987) p 74.

\* As a percentage of GDP at current values.

As Table 3.2 depicts, there is a great savings potential in the general community. Households as a whole are net savers in the economy. The development of capital markets can be hastened by using housing as a means and as a motivator.

Mulkhraj in 1980's<sup>47</sup> reported that when home ownership and mortgage obligations were taken up by moderate-income families; there were changes in the patterns of income and consumption. Income tended to increase, mainly from supplementary or overtime work. In the first years of repayment, consumption is pressed down, but it becomes more efficient and productive. Waste is avoided, expenditure on children's education, clothing of women and children increases; as the family feels a status and situational change.

The development of housing credit has a number of dimensions and some problems to overcome. The FIs will be exposed to competition in the capital market, where they lend for the long term but borrow within the confines of intensely competitive short-term conditions. The realities of competition, changes in the rates of interest, and the general performance in the national economic management, with its impacts on inflation and employment, can affect the flow of funds. The institutions have operating risks, such as, borrower's defaults, collapse of market in a recession, and intensive competition for the deployment of savings. Risks can be moderated, borrowers can be constrained to pay higher proportion of their own savings in deposits for home purchase, higher standards of collateral can be imposed, and income eligibilities can be made more restrictive. All these reduce access to moderate and low income groups. It is these very conditions, along with limited flow of funds, which create a situation where formal housing credit serves only the borrowing needs of the higher income groups in the developing countries. This can become a problem for all income groups because housing credit expansion that is tied to the upper end of the housing market can inflate housing and land prices for

---

<sup>47</sup> Pugh, (1990).

all groups. Competitive pressures drive up prices and steer resources to the upper end of the market.

Developers often find that capital is not always readily available to finance the building and marketing process. In developing countries this often means that projects will be commissioned only when the ultimate consumers, the household, have made their arrangements to obtain credit and to so organize this, that it finances the building process. In this way private developers can finance their production and reduce the risk of failing to sell their product. But, the process is restrictive and cumbersome. Housing would flow more rapidly if developers learnt how to interpret market preferences and lead the market. It would mean that they took more of the risk, and would be possible if finance were available from the capital market to resource the development and construction of housing. It should be possible to serve a wider range of opportunities in the housing market, including sites and services schemes, which need not be provided by the government only but can be privately organized or be planned and executed under joint venture schemes.

Housing credit and mortgages connect the supply of housing to the demand of households. Accessibility to credit and installment purchase becomes all important. This accessibility depends upon the duration of the loan, the level of rate of interest, and the amount of deposit that is required as a down payment. Banks and building societies<sup>48</sup> establish their loans on the basis of their supply of funds, the income level of applicants, and the secured value of the property or a collateral asset value in the borrower's standing in

---

<sup>48</sup>The building society movement is non-existent or undeveloped in most of the developing countries. The building society movement began in Britain. In the earlier years of the industrial revolution, some skilled workers created small scale savings funds so that members could borrow in times of need. From these funds came some housing allocations for home ownership.

owning wealth. In the developing countries, the banking sector often has some mutual savings funds and there are money lenders who charge high rates of interest.

Formal sector housing finance serves mainly the high- and middle-income groups. Loans are available from cooperative societies and a few specialized HFIs. Typically the loan meets only about 47 per cent of the price of the dwelling. The price of a typical dwelling is about 8 times the value of annual household income of the borrower. The average income among borrowers is about Rs 33,000 per annum, and this compares with low-income families who have about 8,400 at the top of their range, and about Rs 4,000 near the bottom<sup>49</sup>. Such finance is not affordable to the masses, and even for the more affluent it does not flow in significant volumes to meet all the demands.

Existing HFIs overlook the household sector that contributes about 74 per cent of total domestic savings<sup>50</sup>. These formal agencies depend on either budget allocations or borrowings from other financial institutions (LIC, GIC, UTI and commercial banks) which in turn mobilize the household savings, resulting in multifinancial transfers in the housing finance intermediation. This results in increased cost of finance to the ultimate beneficiaries; irregular supply of funds to the housing agencies and over dependence on other financial agencies. The savings instruments used by the HFIs are not compatible with household characteristics. Sivashanmugam has put forward the hypothesis that creation of appropriate institutions and instruments will bring the household savings into housing finance intermediation.

---

<sup>49</sup> Pugh, (1990).

<sup>50</sup> Sivashanmugam, (1987).

As per the National Building Organization<sup>51</sup> the total backlog of housing is estimated at 31 million in 1991- of which 10.4 million is in urban areas. Rs. 571.8 billion are required to meet this shortfall of urban housing. More than 80 per cent of housing finance comes from private savings and non formal sources of credit. Housing finance institutions would be required to mobilize household savings through operations of innovative saving programs including those linked to credit for housing and the capital market in order to raise high volume resources through a combination of cost effective debt and equity instruments.

The role of formal finance in terms of the volume of housing finance, is larger than the general perception, but its role in terms of the number of borrowers it assists is small<sup>52</sup>. Existing lending procedures are too rigid to allow small borrowers to take advantage of the liberal terms and conditions at which the formal institutional sources extend housing finance. Loan to housing cost ratios are extremely low, and these result in poor quality of construction.

Public investments in housing are extremely low in India, accounting for only 1.5% of total development assistance. Public, institutional sector provides only 20-25% of the total housing investments, while the rest is provided by the household sector- household and other non-institutional sources<sup>53</sup>. The informal sources of finance, which are mostly used by the poor are generally more expensive. There exists a dualistic housing finance market,

---

<sup>51</sup>As quoted in The Planning Commission (1992).

<sup>52</sup>National Institute of Urban Affairs, (1992) p (ii)

<sup>53</sup>Ibid, p (xi).

wherein there is a very high degree of dependence by the poor and low income households on own savings and informal, non-institutional sources, and on own savings and formal and institutional sources by relatively high and middle income group of households.

**Table 3.3: Sources of Housing Finance in India**

Source of finance	% of households	Magnitude of investment by source (million Rs.)
Savings only	14.8	Savings 10.25
Formal credit & Savings	24.2	a. Savings 22.09 b. Formal credit 25.06
Informal credit & Savings	40.5	a. Savings 14.61 b. Informal credit 6.13
Formal credit, Informal credit & Savings	20.5	a. Savings 25.64 b. Formal credit 18.93 c. Informal credit 9.40
ALL	100.0	a. Savings 72.58 (54.9%) b. Formal 44.00 (33.3%) c. Informal 15.53 (11.8%) d. TOTAL 132.11 (100.0%)

Source : National Institute of Urban Affairs (1992) p 9.

**Table 3.4: Share of Various Sources of Housing Finance in India**

Source of finance	Percentage share
FORMAL SOURCES	33.3
a. Provident fund and employer	10.9
b. Banks and others	10.3
c. Specialized HF agencies	12.1
INFORMAL SOURCES	66.7
a. Savings	54.9
i. Cash savings	33.8
ii. liquidation of assets	21.1
b. Loans from friends & relatives	9.9
c. Loans from indigenous bankers	1.9
TOTAL INVESTMENT IN HOUSING FINANCE	100.0

Source: National Institute of Urban Affairs (1992) p 11.

Tables 3.3 and 3.4 give the details of various sources of housing finance as reported in a survey conducted by the National Institute of Urban Affairs(1992) in certain cities of India. This survey shows that the sampled households generally used more than one source of finance for housing. Formal

sources of finance were used more by households belonging to upper income groups. However, they also used informal sources.

Housing finance is one of the key determinants of housing. Given the huge shortfall of both urban and rural housing in India, it is imperative to increase the available amount of housing finance. As formal housing finance constitutes only about one-third of the total, and that also benefits a small fraction of higher- and middle-income sections of the population, the poorer sections are left to finance their housing needs through informal finance, which is more expensive. In the next chapter the issue of how fiscal policies can increase the amount of formal housing finance, is examined.



## CHAPTER FOUR

### FISCAL POLICIES RELATING TO HOUSING

This chapter contains a discussion of fiscal policies relating to housing. The introduction in section 4.1 details as to how governments use taxation and fiscal policy measures to achieve public policy objectives. Section 4.2 examines the reasons as to why governments intervene in housing, while section 4.3 gives the problems associated with such intervention. Section 4.4 defines the term "tax expenditures". The ways in which housing enters the tax system are discussed in section 4.5. The significance of the tax expenditure concept to housing is described in section 4.6, while tax expenditures and housing finance are discussed in section 4.7. Ways to curtail tax efficient housing investment are mentioned in section 4.8. Other forms of government intervention are listed in section 4.9. The last section, section 4.10 compares tax expenditures with direct subsidies.

#### 4.1 Introduction

The relation between taxation and economic growth has long been a matter of concern to policy makers and students of public policy<sup>54</sup>. The classical economist analyzed the effects of taxation on growth and the related question of distribution of incomes, while in Keynesian economics, the effects of taxation on the stability of economics became an important subject of analysis. Subsequently, the effects of taxation, on the distribution and the rate of growth of national income, on employment and on other policy objectives, were also studied. Gillis et al<sup>55</sup>, list the objectives of fiscal

---

<sup>54</sup>Bird and Oldman, (1990) p 1.

<sup>55</sup> Quoted in Bird and Oldman, 1990.

policy as the promotion of economic growth, the reduction of income disparities between households and regions, the promotion of economic stability and economic efficiency, and the increasing of returns from natural resource endowments. In a mixed economy that is pursuing planned economic development, such as India, fiscal policy plays a central and multi-dimensional role. To quote the Seventh Five Year Plan (1985-90) document of India,

"Through it (fiscal policy) the government creates and sustains the public economy consisting of the provision of public services and public investment; at the same time it is an instrument for reallocation of resources according to national priorities, redistribution, promotion of private savings and investments, and the maintenance of stability<sup>56</sup>."

The principal way in which fiscal policy influences growth is through the efficacy, or otherwise of mobilizing resources for development. Fiscal policy also affects growth by influencing the efficiency of resource allocation, both within the public economy and without. In India, fiscal policy has been used extensively for giving special inducements for savings<sup>57</sup>.

The current phase of economic development in India has led to a large increase in its urban population; and consequently a huge housing shortage. To provide affordable and adequate shelter for all, the availability of adequate finance and an efficient delivery system is essential. An efficient housing finance system based on the principle of competitiveness should be able to raise the bulk of its resource requirements by mobilization of household savings in competition with other participants in the market. It is difficult

---

<sup>56</sup>Acharya, (1988) p. 287.

<sup>57</sup>Acharya, (1988) p 290.

for the housing sector, at its present stage of development to rely solely on the market determined system where resources are likely to be driven to sectors that offer the highest return. Thus, there is need for the government to intervene to ensure that adequate resources are mobilized to meet housing needs. Taxation policies are one form of such interventions through which government attempts to attract resources to the housing sector.

Taxation policies form an important part of fiscal policies of a country. The term "fiscal policy" applies to the use of public finance instruments to influence the working of the economic system to maximize economic welfare<sup>58</sup>. Fiscal policy makers concentrate on specific objectives, such as reduction of the rate of inflation, acceleration of the rate of growth, and redistribution of income. The instruments of fiscal policy are both revenue and expenditure. Among the revenue instruments the most important role is played by taxes; however governments also rely on fees, on the prices of public utilities and on sales of assets. In addition to providing revenue, each tax can also be used to achieve particular goals.

In many countries there appears to be a propensity to introduce tax incentives in response to almost any new or promising investment idea. Help for a backward region, stimulus to a new/existing industry, provision of desired services like housing for the poor and not-so-poor; all of these have been and are the objectives of investment tax incentives in many countries<sup>59</sup>.

#### **4.2 Reasons for Government Intervention in Housing**

While there is a divergence of opinion as to whether housing should be

---

<sup>58</sup>Tanzi (1990).

<sup>59</sup>Boskin and McClure (1988).

treated as a free market or as a social need, it is widely accepted that even though the market can be used to allocate much of the housing stock, there are particular problems that require public intervention for the reasons<sup>60</sup> listed below:-

- 1) Housing policies favouring the poor can be used as a means of redistribution of income towards the poor, who would otherwise suffer from bad housing condition as a consequence of poverty. Housing is considered to be a "merit good" whose consumption is politically acceptable to promote. Poor housing exacerbates other personal problems and can yield to growth of social evils.
- 2) Governments intervene to attain vertical equity through redistribution of income; and to attain horizontal equity, by tax benefits that aim towards tenure neutrality.
- 3) Government interventions ensure that the true effect of externalities, and spillover effects of improving one's house on the neighbourhood are accounted for.
- 4) High cost and long life of housing means it requires long term finance, against uncertain future income. By public intervention, it is possible to encourage investments in housing in keeping with its true value to the society.
- 5) Intervention may be done to promote interests of a particular group. Mobility of labour can be promoted by giving access to subsidized housing to job movers. Rent control, subsidy policy, and policies to provide stability to mortgage interest rates; can be and have been used to counter inflation.

---

<sup>60</sup> Hills, (1991).

6) Intervention for wider political or social aims may be resorted to. This may be to promote a social mix of people in neighbourhoods and to prevent formation of ghettos. This can be in the form of provision of subsidy or tax concessions to certain groups who are to be moved to a particular region. Interventionary policies that encourage owner-occupiers may be used in an effort to create a "property-owning democracy"<sup>61</sup>, based on the assumption that property owners are more conservative and less inclined towards revolution.

7) The market mechanism is unlikely, on its own, to produce an efficient allocation of property. As the ownership of land and housing property is generally unevenly distributed, so the market is not likely to allocate the income from these in the way the community would wish.

For these reasons all governments intervene in urban land and housing markets, although to widely differing degrees. Intervention takes many forms, including a regulatory framework, taxation, subsidies to particular activities, and direct ownership and participation in urban investment and the provision of services.

#### **4.3 Problems Associated with Public Intervention**

---

Several practical issues have proved problematic when designing suitable means of intervention. These affect the choice of techniques and the distributional consequences of such intervention.

1. Multiple objectives: Many interventionary techniques are introduced with the hope of meeting often incompatible, multiple objectives. Theoretically, any tax should not distort the working of the market, except positively to modify allocation in line with defined objectives; it should be equitable,

---

<sup>61</sup>Hills (1991) p 21.

treating those in similar circumstances similarly, but capable of being used to redistribute from rich to poor; and it should be a good revenue source, easy to collect and difficult to evade. The problems of devising a tax that meets these requirements in principle alone are very great; even without considering the practical difficulties of implementation<sup>62</sup>.

2. Undesirable side effects: Many policies operate in unpredictable ways. Even if the government has been able to specify objectives and design policies consistent with their achievement, unwanted side effects may significantly reduce their value.

3. Technical problems of definition and operation: These arise because it is extremely difficult to turn theoretically straightforward interventionary approaches into operational policy instruments.

4. Perversion of instruments to meet other ends: A tax incentive may be used by interest groups to promote a particular activity, which may no longer be useful in the government's perspective. If the interest group is very powerful, then it would be politically difficult to alter the provision. Advantage may also be taken of the intervention to create tax shelters; and thus evade taxes.

5. Legal and administrative problems: In an attempt to fine-tune the intervention, the legal provisions are generally made complex. It may be administratively difficult to determine the eligibility for concessions. Also each intervention is discriminatory against some people not benefitted and they may challenge the policy legally.

---

<sup>62</sup>Hills, (1991).

#### **4.4 Definition of Tax Expenditures**

A tax expenditure is usually defined as a departure from the generally accepted tax structure that produces a favourable treatment of particular types of activities or groups of taxpayers. Tax expenditures can take the form of: 1) tax exemptions, where income from particular sources is excluded from the tax base; 2) tax allowances, where sums are deducted from assessable income in order to arrive at the taxable income; 3) tax credits, amounts are deducted directly from tax liabilities, and may or may not be allowed to exceed tax liabilities; and 4) rate reliefs, where specific activities or taxpayers are subject to reduced rates of tax. The term tax expenditure emphasizes the proposition that, in principle, all tax expenditures can be structured as a direct expenditure program and thus evaluated in direct expenditure terms.

Though the notion of tax expenditure appears to be an oxymoron, there is a basic logic to the concept<sup>63</sup>. The way in which people and business are treated for tax purposes gives the government enormous power over the amount of money income that people finally get and keep. Tax expenditures are based on the fact that the tax system is not neutral, people in like circumstances are not treated equally in the way they are taxed. They concern the extent to which the tax system is used as a deliberate instrument to change the distribution of money income that would prevail if taxes were truly neutral. Tax expenditures are more subtle and far-reaching than transfer spending.

#### **4.5 How Housing Enters the Tax System**

Taxes can be divided into those on income, consumption, wealth and

---

<sup>63</sup> Peterson, (1991) p 57.

transactions. Housing could enter each of these tax bases. A landlord's income from rent, owner occupier's income (the imputed rent), capital gains (income from sale of housing property) can all be subject to taxation. The consumption of housing services by all households, whether paid for through rent or received in kind, can be taxed. Residential buildings are one of the single largest component of net personal wealth and their property value is subject to wealth tax. Transactions involving transfer of property are registered on payment of stamp duty.

Taxation of housing is difficult because its true economic costs are poorly measured by cash flow payments. Cash flow costs of housing may combine the purchase of both current consumption and of an investment asset. Housing costs may also be hidden, in the form of opportunity cost of an owners' equity stake in a house, or depreciation that only becomes apparent over a long period of time. Returns from housing often come in kind (as imputed rents) or accrue over long periods (as capital gains) with only infrequent transactions. The effects of tax concessions or subsidies may be capitalized in house prices, meaning that current recipients are not the true beneficiaries from them.

Housing tax expenditures (HTEs) are an important source of housing subsidies. They have frequently evolved along with taxation systems, rather than being specifically designed to aid housing consumption or production. The increasing severity of constraints on government budget deficits has elevated the issue of HTEs beyond that of mere academic curiosity. Some governments have sought to curb their growth by reforming the tax treatment of housing.<sup>64</sup>

---

<sup>64</sup>Hills, (1991).



In the case of owner-occupied housing, the definition of a tax expenditure requires the identification of the normal tax treatment accorded to comparable assets or goods. Housing could be considered either a consumption good, an investment asset or a financial asset. The way in which housing is given favourable tax treatment depends upon the category in which housing is placed.

In analyzing housing tax expenditures, economists have tended to treat housing as an investment asset, in recognition of the fact that the taxable capacity of the owner-occupier is greater than that of the individual with the same money income, who is not a home-owner, but pays rent out of taxable income. This is because the house of the owner occupier is an asset that could, if let, generate a money income. In that event, the owner-occupier would be on par with the tenant, in having to pay for rental accommodation, but with greater money income, and liability to pay more tax. Also, taxation systems will distort the allocation of resources if they are not neutral between different types of expenditure. Increasing attention has been devoted to allocative distortions between owner-occupation and the private rented sector, and the ability of the housing sector to appropriate funds and resources that would otherwise have been channelled into capital investment in the industrial sector. This suggests that owner occupied housing and other investment expenditures are sensitive to relative rates of return, and a tax system seeking to minimize distortions should, therefore, accord housing the same tax treatment as other investment goods.

In traditional neo-classical economic models, perfect mobility of capital and labour is assumed. Capital flows into the tax subsidized sector in response to higher post-tax rates of return, and output increases until post-

tax rates of return across the economy are equalized by price adjustments. If there is no balanced reduction in government expenditure to offset reduced tax revenues, and if productivity levels in the tax subsidized sector are lower than the rest of the economy, there may be a detrimental effect on the long-run growth of national output. However, Wood (1990) states that such concerns about the "crowding out" of industrial investment by the housing sector, are unwarranted, unless productivity levels in the housing sector are relatively low. Econometric estimates using annual data from Australia from 1956-1985 do not indicate any "crowding out" of industrial capital, thereby not suggesting lower productivity levels in the housing sector<sup>65</sup>.

There is a potentially significant influence of HTEs on the governments' balanced budget. They tend to grow automatically with inflation, interest rates and real incomes and thereby erode tax revenues. There is little information on the cost of HTEs to governments in terms of revenue loss. Available evidence suggests that in USA the cost of HTEs is significant and has grown rapidly during the 1980s. In US the budgetary cost of HTE was \$49 billion in fiscal year 1988 as compared to direct budgetary outlays for low income rental households of \$11 billion <sup>66</sup>.

HTEs erode the tax base and thus affect governments' budget deficits. They also affect allocative efficiency, by influencing relative rates of returns on housing assets and consequently changing the behaviour of households and firms. Equity is affected, because they alter the relative tax

---

<sup>65</sup>Wood, (1990) .

<sup>66</sup>Wood, (1990) p 55.

burden among individual taxpayers, and between occupiers and tenants<sup>67</sup>.

There are conceptual problems in estimating the cost of tax expenditures. If they are ignored direct public expenditure totals are misleading, but replacement of tax expenditures by direct expenditure is difficult if they are not recognized as subsidies. HTEs are generally applied in the private housing sector, and are directed at consumption and provision of owner occupied and private rental housing. They have potential effects at three levels in the economy: a) in the national economy- by raising the rate of return on housing, they can reduce investment in other assets, such as business and thus negatively affecting employment; b) in the housing sector, by encouraging tenure shifts towards owner-occupation, and increased housing consumption and production; and c) in the urban housing market through unintentional but explicit impacts such as urban sprawl, income segregation in residential areas, population loss in central city areas and municipal government fiscal problems<sup>68</sup>.

The formal incidence of HTEs tends to be regressive<sup>69</sup>, as with a progressive tax rate structure, any given tax exemption or allowance generates a larger absolute reduction in the tax burden with rises in income. Also as the choice of owner-occupation has a positive income elasticity, a larger proportion of owner-occupiers fall in the upper income groups. The size of a tax exemption or allowance tends to be directly proportionate to the income of the household.

---

<sup>67</sup>Wood, (1986) p 9.

<sup>68</sup>Boleat, (1986).

<sup>69</sup>Wood, (1986).

As for the effective incidence of HTEs; the beneficiaries are purchasers as they are partly capitalized into house prices. This increases their cost to governments, because higher house prices increase the size of those housing costs and sources of housing income that are accorded tax allowance and tax exemption status. Higher house prices also lead to the requirement of a larger amount of subsidy needed to be given to lower income groups for housing.

Generally all types of housing tenure are subsidized through HTEs, and therefore households have an incentive to switch from non-housing expenditures to housing expenditures. The regressive nature of owner-occupied HTEs encourages higher income households to demand more housing, while preferential tax treatment of this tenure encourages growth in owner occupation at the expense of rental tenures. There may also be differential spatial effects. Since the demand for the quality and environmental attributes of housing is income elastic, demand may be greater in lower density areas such as suburbs, thereby encouraging urban sprawl.

Housing is a significant component of the macro-economy. In national capital markets HTEs can be the source of crowding-out pressures by raising the rate of return on housing assets. Housing would then be attracting finance that would otherwise have funded private sector investment. In labour markets, HTEs may have a detrimental impact on labour supply, if erosion of the tax base requires increases in marginal tax rates to maintain revenues.

Tax expenditures cause the demand for housing and house prices to rise in the short term<sup>70</sup>. In the long term, house prices are moderated by an expansion in supply. Tax provisions favouring owner occupiers increase the

---

<sup>70</sup>Wood, (1986) p 21-22.

proportion of owner-occupied housing in the housing stock, and expand the housing stock in the long term. House prices and production are increased more at the upper end of the market, and upper income households will exhibit a greater propensity to become owner occupiers.

HTEs may ultimately subsidize general consumption rather than housing, if households repeatedly realize their equity holdings in order to increase consumption expenditures. The secondary impacts (particularly, the degree of capitalization) of HTEs that arise as a result of behavioral changes by market participants, are of critical significance to a precise measurement of the effective incidence of tax benefits at different income levels. The filtering process has been used to justify the use of HTEs to improve housing opportunities of low income groups; but there is no evidence to support this<sup>71</sup>.

In principle HTEs can have the same macro-economic consequences as an equivalent direct subsidy program. They can encourage urban sprawl, but other factors such as improvements in transportation technology, real income growth etc. can be considered more significant in this respect. Income segregation and polarization in urban housing markets are frequently cited as a product of the unfettered operation of market forces. However, government interventions may lead to polarization and income segregation, if other impediments to tenure choice preclude entry by moderate to high income groups into rental tenures<sup>72</sup>.

#### **4.6 Significance of The Tax Expenditure Concept to Housing Policy**

---

<sup>71</sup>Wood, (1986) p 24.

<sup>72</sup>Wood, (1986) p 25.

The conceptual and measurement problems associated with tax expenditures have tended to preclude their close scrutiny. This is particularly true in the case of HTEs, as the consideration of taxation policy is examined separately from the administration of government housing programs. Often the HTEs have emerged as the tax system has evolved, rather than being designed to meet housing policy goals. Thus, HTEs are considered<sup>73</sup> to be the source of unintended impacts. This perception raises important issues for policy discussion, as it reflects a conflict between the principles and practice of taxation, the goals of housing policy and macroeconomic performance.

Tax allowances can be invoked in respect of either acquisition costs or occupancy costs. Acquisition costs are those that the purchaser must incur in securing housing stock by purchase, and include transaction costs, down-payments, mortgage interest and principal repayments. Occupancy costs are incurred in the process of consuming housing services yielded by the housing stock purchased and, include rates payments, depreciation, utility charges, maintenance and repair expenditures.

Some countries, such as UK, concentrate tax allowances almost exclusively on acquisition costs. This may be detrimental to the maintenance and improvement of the existing housing stock, as the pattern of tax allowances encourages households to choose newly constructed dwellings with low occupancy costs. Correcting this imbalance may encourage demand for older housing and stimulate maintenance and improvement. The importance attached to furthering maintenance and improvement of the existing housing stock, has prompted some OECD governments, such as France, Ireland and Sweden to

---

<sup>73</sup>Wood, (1990).

introduce new tax allowances designed to promote these objectives<sup>74</sup>.

#### **4.7 Tax Expenditures and Housing Finance Markets**

Many governments have introduced favourable tax provisions designed to promote the households' ability to make down payments for house purchase<sup>75</sup>. These provisions operate in combination with special savings schemes operated by HFIs. Preferential tax treatment of savings schemes commonly takes the form of tax exemptions accorded to the interest return and bonuses received by the savers. Though regressive in their formal incidence, these provisions enable HFIs to attract funds at a lower cost. This benefit can be passed onto the home-owner in the form of low interest mortgages. In some countries, such as Austria and France, the bonus and HTEs are critical to the system's ability to attract new entrants, which is necessary to meet outstanding loan commitments<sup>76</sup>.

Non-contractual savings schemes, such as those operated in Canada, carry no loan entitlement. They represent an attractive method of tax-free saving to meet down payment requirements. By limiting the access to tax-favoured schemes to prospective home purchasers (perhaps first-time), tax shelter possibilities are restricted.

There are potentially important repercussions of HTEs for the housing finance market<sup>77</sup>. These arise because a HTE will increase demand for housing and this in turn will raise the demand for mortgages. In general, HTEs will be

---

<sup>74</sup> Wood, (1990).

<sup>75</sup> Boleat, (1986).

<sup>76</sup> Boleat, (1986).

<sup>77</sup> Boleat, (1986).

partly capitalized into the interest rates prevailing on the assets and liabilities of HFIs. The extent of capitalization will depend upon the competitiveness of the housing finance market.

#### **4.8 Curtailing Tax Efficient Housing Investment**

Private rental housing in some countries, such as USA, has attracted such favourable tax provisions, that housing assets are being used as a means of sheltering other sources of income from taxation. This is costly in terms of revenue forgone, and is also a source of allocative distortions and efficiency losses. These circumstances are particularly evident in countries that use HTEs to encourage private landlords' acquiescence to rent controls. This is done by allowing deduction of operating costs from taxable income and exempting capital gains from taxation. With stringent application of rent controls, it is common for private landlords to incur losses that can be used to shelter other sources of income. If rents rise so that losses are eventually eliminated, tax burdens can be minimized by taking advantage of favourable capital gains provisions, and selling to owner-occupiers.

#### **4.9 Other Forms of Government Intervention**

Subsidies in the form of low interest loans may lead rents to fall eventually as more new building occurs; but eventually house prices will rise. Program funding is generally insufficient to provide subsidized dwellings for all eligible households, and therefore can lead to inefficient allocation of subsidized housing. An increase in the provision of housing at below market rents by non-profit housing agencies can result in lower house prices and rents in the short run, resulting in the eventual decline of the provision of other housing. If rents are set at historic cost levels, there may be considerable variation in the rent paid for equivalent housing. Such



administered rents provide no incentive to utilize the housing stock efficiently.

Application of rent controls also results in administered rents and if applied consistently across the rental tenure sector, the stock of rental housing will deteriorate and decline. This will be accompanied by a rise in house prices and an expansion of owner-occupied housing, resulting in higher land prices leading to the realization of holding gains by the owners of land upon which new housing is built<sup>78</sup>.

Home improvement subsidies reduce the cost of augmenting the existing stock of housing. If the price elasticity of improvement activity is low, there will be little net addition to the housing stock. The demand for, and prices of properties eligible for improvement subsidies may rise. The composition of net additions to the housing stock is likely to change in favour of conversion and renovation to the existing housing stock.

#### **4.10 Comparison between Tax Expenditures and Direct Subsidies**

Under strict assumptions, taxation, subsidies and direct controls are equally efficient<sup>79</sup>. If the production of a good results in costs to other firms and households nearby, the government may impose a tax on the producer that reflects the social costs at each level of output. In this way externalities are internalized and the decision makers will modify production in line with the true marginal social cost. Output will be reduced because the externality is taken into account and weighed against the benefits of

---

<sup>78</sup>This form of intervention is regressive, as it puts more income in the hands of property owners, who are already better off; at the expense of lower income tenants, who due to the contraction in the supply of rental stock, pay higher rents and/or make do with less housing.

<sup>79</sup>Whitehead, (1983).

production. Equivalently, a subsidy can be given as an incentive to curtail production in cases where social costs offset private benefits. In principle, the only difference lies in distributional effects, in the first case the producer of the external costs suffers a reduction in income, while in the second, the community rewards him for not causing additional costs to the society. Where the externality is costly, taxation is usually regarded as a more equitable approach, unless there are additional objectives of redistribution or the provision of merit goods. Taxation also provides a useful source of income, although its use may cause further problems of efficient allocation. Subsidies present similar allocation problems and require financing from somewhere. This presents a major problem for all governments, particularly in developing countries. Housing tax expenditures encourage private sector participation rather than government-centred decision making. By offering financial incentives on a voluntary basis, they avoid the use of coercive instruments of government intervention. Alternative indirect and direct subsidy programs are more likely to involve government controls over the provision/production of goods and services; and so run the risk of replacing market forces and inducing the withdrawal of private sector participation, as compared to the cooperation encouraged by HTEs.

The provisions of tax expenditure programs are simpler and easier to administer, as no new bureaucracy is required for the purposes of implementation. Further, as these programs are not subject to regular review and scrutiny, they are not changed frequently. They may be viewed as helping

to preserve the stability of a subsidy<sup>80</sup>.

Households respond more favourably to tax subsidies than to direct subsidies. An advantage of benefits paid to households through the tax system is that they are less likely to be made automatically. In contrast, direct subsidy programs tend to require a more time consuming and "visible" application process, which highlights the individual's receipt of subsidy. This can stigmatize potential claimants and induce a reluctance to initiate valid claims, thereby lowering take-up.

Tax expenditures can, in principle, assist the private rental and owner-occupier tenures equally<sup>81</sup>. Tax expenditures favouring the rental sector are normally indirect forms of assistance provided in the form of incentives encouraging the construction of new rental housing. Such measures offer the opportunity of designing more horizontally equitable HTEs. If horizontal equity is to be preserved, the housing allowance programs should be based on a consistent measure of housing costs across tenures.

Tax expenditures are seen as a form of government spending available to meet objectives that the government considers to require financial assistance. Any financial aid or incentive program may be written either as a tax expenditure or as a direct program, or a combination of both. The choice between tax expenditures and direct programs is not an easy one. Very little is known about just what factors influence such a choice or whether

---

<sup>80</sup> Wood, (1986). However, this is not true in the Indian context, as tax laws, especially those that confer tax expenditures are changed frequently, presumably after review and re-examination.

<sup>81</sup>Smith, (1981) p 456.

governments recognize that a choice is possible<sup>82</sup>.

Several negative characteristics are attributed to tax expenditures that are equally applicable to direct spending programs also:-

1. They pay recipients to engage in activities that they would engage in any way, that is, they have a windfall effect.
2. They distort the choices of marketplace and the allocation of resources. But, if it was not so, they would have only a windfall effect. The government assistance provided is the lever to bring about desired change.
3. They keep tax rates high.
4. They are open-ended, that is, they are available to any eligible taxpayer, who meets the eligibility requirement, and so their costs cannot be forecast accurately.
5. They allow taxpayers to decide on their own eligibility. This self-determination of eligibility, is present in direct spending programs also, where the beneficiary must apply for assistance.

Some other aspects of tax expenditures are either absent or are insignificant in direct spending programs. The prime example of these is the "Upside down effect"<sup>83</sup>. Tax expenditures work to the greatest benefit of people with the highest marginal tax rates. It is very unlikely that a direct tax program would be so structured. The upside down effect may be eliminated or mitigated in many ways; by using a method such as a taxable credit against tax; or by using a tax expenditure that vanishes at a certain income level and so benefits only people below that income. A refundable tax credit may counter

---

<sup>82</sup>Surrey and McDaniel, (1985).

<sup>83</sup>Surrey and McDaniel, (1985).

the effect of exclusion of non-taxpayers. Almost by definition, tax expenditures are dependent on the regular tax rate structure, so, when tax rates are reduced, they also go down; when tax rates are increased, they become more expensive<sup>84</sup>. Tax expenditures enjoy lower visibility, as they are woven into the tax provisions. Tax expenditure budgets, which acknowledge their presence, are not widely circulated. Focusing on the tax aspect of the tax expenditure permits debate to shift away from the real issues.

It is difficult to predict the use of tax expenditures. They can be used to provide tax shelters. Most tax expenditure provisions initially have a narrow focus, but tax professionals soon learn to use them as tax shelters. This results in non-productive (for the economy as a whole) expenditure on middlemen- investors, brokers, lawyers, accountants and tax planners, thus encouraging rent-seeking activity. Tax planning, resulting in tax avoidance, somehow does not encounter similar societal censure as welfare fraud (which is misuse of direct subsidy); and thus goes largely unchecked. Tax expenditures are often viewed as escape routes for favoured individuals and corporations.

Tax expenditures are largely responsible for the complexity of tax laws and tax administration. They also lead to confusion over responsibility for programs. If a tax expenditure was rewritten as a direct spending program, it would be in the operative jurisdiction of the appropriate agency in the executive branch- without involving the treasury. But as tax expenditures they are administered by the treasury (or the finance ministry) which may lack the required expertise, and to obtain this expertise has to divert its resources. This results in, say, a housing tax expenditure being evaluated not by housing

---

<sup>84</sup>This again emphasises their regressive nature.

experts, or for its value in providing housing, but from the perspective of a tax administrator. Better co-ordination between the treasury and the appropriate agency, at least at the time of formulating and evaluating the tax expenditure, can ameliorate this situation.

Tax expenditures enjoy acceptability as subsidies in a capitalist economy, whereas direct subsidies from the government are viewed as being socialist in nature. They are more securely embedded than direct programs and are thus expected to remain in effect longer. Their implementation is made easier by the fact that they utilize an established framework of (tax) administration.

## CHAPTER FIVE

### HOUSING TAX EXPENDITURES IN INDIA

This chapter discusses the housing tax expenditures used in India. The first section, 5.1, discusses the nature of India's fiscal policy. Section 5.2 describes the various tax policies relating to housing in India.

#### 5.1 Introduction

India's fiscal policy is motivated primarily by the need to mobilize resources for economic development. It also focuses on social equity, maintenance of economic stability, and allocation of resources according to a predetermined scheme of economic priorities. This policy framework originated with the first Five-Year plan (1951-56) and developed in new directions as the planning process became complex and pervasive. Under Indian conditions, the fiscal policy has a longer reach and a different connotation than in other countries, perhaps because it is a principal instrument to augment public saving, influence private saving both in magnitude and disposition, finance public investment, and determine the pattern of income distribution<sup>85</sup>.

The Indian investor is fiscally oriented and a very large proportion of savings accessed by the government are the result of fiscally oriented schemes. The availability of fiscal concessions determines to a significant extent the resource flow to a particular sector or activity. By offering a variety of tax incentives, Indian fiscal policy has influenced the allocation of disposable income of the household sector, the corporate sector, and the non-incorporated enterprises. It has been used to induce the household and other parts of the private sector to hold their savings in desired investment

---

<sup>85</sup>Khatkhate, (1991) p 254.

instruments<sup>86</sup>. Some investments enjoy tax preferences to such an extent that the resulting return to the investor is extremely high.

## 5.2 Taxation Policies Affecting Housing in India

**Table 5.1: Taxation in India of housing and other incomes**

	Investment	Interest payments on amounts borrowed for investment	Return	Capital gains
Owner-occupiers	20% allowed as tax credit*	Tax-relief upto Rs. 10,000 per annum	Imputed rent is taxed	Taxed
Private Landlords	20% allowed as tax credit*	Tax-relief upto Rs. 10,000 per annum	Rents taxed	Taxed
Other business investment	Exemption for specified sectors	Interest is fully deductible	Taxed- after allowing depreciation	Taxed
Other consumption	No relief	No relief	No Tax	No Tax
Other savings- such as bank deposits, approved savings	No relief	Fully Deductible	Tax relief upto Rs. 7,000 per annum	Not applicable
Shares	Exemption for specified sectors	Fully deductible	Dividends taxed- relief allowed for new approved companies	Real gains taxable

Source: Constructed with information from the Indian Income Tax Act, 1992, and subsequent amendments.

\*\* The total investment eligible for tax credit is limited to Rs. 10,000 per year.

Table 5.1 highlights the features of taxation relating to housing in India. Such policies influence the housing situation for taxpayers only. Considering that less than one per cent of the total population pays income-

<sup>86</sup> by allowing interest paid on them; and sometimes the amount invested also; to be deducted from the taxable income.



tax (only 8 million out of a population of 900 million are income tax payers in 1994<sup>87</sup>), tax policies that give a fillip to direct investment in housing can only have limited impact.

Increased housing activity has a large employment and skills multiplier effect in addition to backward and forward linkages with related industries, such as, construction materials, furnishings, paints, accessories and consumer durables. As most housing construction in India is done manually by unskilled or semi-skilled labour who come from the lowest income group, fiscal policies to boost housing activity are sure to have a positive effect on the income of the poorest sections.

To encourage investment in housing for low-income groups, who are generally not income tax payers, weighted concessions are given to employers who invest in housing for their employees. This policy has improved housing conditions of factory and plantation workers. However these workers and their families are assured of housing only as long as one of their family members is employed in that concern. Also, as such housing is not owned by the people residing in them, there is very little contribution by the residents in improvement and maintenance of the housing stock.

To ameliorate the housing situation of the urban poor, government has to either itself, or by provision of finance to the private sector, ensure building of housing on a massive scale. For this, the main requirement is of financial resources that can be raised by channelling the savings in institutions set up specifically for financing housing. If their income is taxed at concessional rates then these institutions can provide housing loans

---

<sup>87</sup>The Economic Times (10th February 1994).

at lower interest rates. Deposits to such institutions can be attracted through tax rebates and these deposits can be used to finance building or purchase of houses.

Table 5.2: Home Loan Account Scheme in India

Loan as a multiple of accumulated savings	Amount of loan (Rs.)	Annual interest <sup>88</sup> Rate (%) of
4 times	Upto 50,000	10.5
3 times	50,001-100,000	12.0
2 times	100,001-200,000	13.5
1.5 times	above 200,000	14.5

Source: Rao, (1991) p 74.

The Home Loan Account (HLA) Scheme is a loan-linked saving scheme introduced by the NHB, which was set up in July 1988 to fill the lacuna in the Indian housing finance system that has been a major inhibitor in the growth and development of the housing sector. The HLA scheme was introduced from July 1, 1989. It is basically a deposit linked loan scheme that offers users a positive real rate of return of 10% (compounded annually), tax concessions on savings and an assured loan (with tax concession on installment repayment) for house building after a period of 5 years (3 years in the case of purchase of a house/flat in projects financed by NHB). Any individual, not owning a house anywhere in India can open a HLA with any branch of designated scheduled banks. The account holder has to save regularly for a period of 5 (or 3) years after which a multiple of accumulated savings can be availed of as a loan. As Table 5.2. shows, the scheme is favourable to lower income groups, who are eligible for getting a larger multiple of their savings as loan, and at a

---

<sup>88</sup>The annual interest rate charged by banks in India was 18% in 1991. The indigenous bankers and informal credit sources give mainly short term loans on which they charge monthly interest at rates upto 5% The annual compounded rate of interest on such loans may be as high as 75%.

lower rate of interest.

The savings under the HLA scheme qualify for tax concessions. Twenty percent of the payment of principal of the loan (up to Rs. 10,000 per annum) is eligible to qualify for a tax credit under section 88 of the IT act. Interest on the loan is eligible for deduction in the computation of income from house property under section 24 of the IT act. Similarly the amount of accumulated savings under the HLA Scheme, together with the interest is exempt from Wealth Tax (WT), subject to the overall ceiling of Rs. 500,000.

The housing situation in India for the middle income groups<sup>89</sup> is also far from satisfactory. Making interest on mortgages tax-deductible, fully as in the USA, or upto a certain limit as in UK.; will give a boost to housing activities. This will directly increase investment in housing for the middle income groups and will benefit the poor through the process of "filtering" whereby the total housing supply increases and vacated middle income accommodation becomes available to the poor.

Rationalization of stamp duties and registration fees<sup>90</sup> on residential property transactions would encourage their registration and perhaps reduce the influence of parallel economy on this sector. The parallel economy is sizable and is disproportionately present in the housing sector. Residential

---

<sup>89</sup> The middle income groups in urban areas have income ranging from Rs. 12,000-50,000 per year. They usually pay income tax, which is levied above the threshold income of Rs. 35,000 per year (from fiscal year 1994-95). (The main reason for only 1% of the total population being tax payers, is that agricultural income (primary source of income for about 70% of the population) is exempt from IT and WT. Also income of tribals residing in tribal areas is exempt. This accounts for another 7-8% of the population. So out of the remaining 22-23%, 1% pays IT. If people employed in the informal sector are also excluded, then the population that is taxable, works to about 10%. So, it can be said that 10% of the taxable population pays income tax.)

<sup>90</sup> These are charged on the market value of property. However, property values are generally heavily understated.

property and land are among the main assets in which speculators and black marketeers invest their undeclared profits. A fiscal and municipal taxation policy, including a levy of tax on vacant urban land and residential property in order to curb speculative activities, will result in increased supply of land and buildings and will lower their prices.

In India, there is a shortage of supply of building materials, such as cement and steel. The prices and supply of these items are controlled by the government. There is need for rationalization of the structure of manufacturing duties levied on these items to ensure increased production and supply. As the supply of traditional building materials, such as cement, steel, bricks and timber is likely to remain limited and subject to the vagaries of sudden price hikes, a concerted and organized effort to provide alternative building materials is needed. Promotion of use of non-conventional materials, like agro-industrial wastes can reduce cost of construction, and is more environmentally friendly than traditional building materials. For this, tax concessions similar to those given to institutions engaged in scientific research should be given to institutions involved in research for alternate and low-cost building technology.

Several tax incentives and concessions have been given by the government to individuals and companies for housing, but they are of peripheral nature and their real value has diminished due to inflation over the years. These require re-examination with a view to enlarging the scope of existing tax concessions and introducing new fiscal measures to attract private and corporate savings and expenditure on housing.

HUDCO and NHB have been allowed to issue capital gains bonds<sup>91</sup>, and this

---

<sup>91</sup> capital gains are invested in bonds, or fixed deposits carrying preferential tax treatment

should contribute to a faster rate of growth of the housing finance sector<sup>92</sup>. The amount invested in these bonds carries a preferential rate of interest, and if the sum invested was out of sale of capital assets, the amount invested could be deducted from taxable capital gains. However, these bonds have become less attractive, as in 1992, the section providing exemption for capital gains reinvested in capital gains bond was removed from the statute.

The 1992 Central budget withdrew many fiscal concessions earlier available to the housing related activities and house property income. The annual deduction of Rs. 3,600/- allowable from the annual value of a house property in respect of new residential units for a period of five years from the date of completion has been withdrawn. The facility to set off loss from house property against income from any other source was also withdrawn. The carry forward loss of any year from house property is now allowed to be set off only against income from house property of subsequent years. The loss in income from house property arises mainly from the imbalance between high rates of interest payable on housing loans and realization of rent (in case of rental property). This imbalance persists in the initial 10-12 years of borrowings whereafter rental income and interest payment match. Under the new provisions, the borrower would be required to wait for an inordinately longer period to avail of the facility to set off the losses incurred in earlier years. This is likely to affect the level of future investments in housing.

Total exemption from tax on capital gains arising out of transfer of a residential house property where the total sale consideration was upto Rs.

---

and/or rate of interest.

<sup>92</sup> Buckley et al, (1989).

200,000 and proportionate exemption on sales exceeding Rs. 200,000 were allowed till 1992. Now these exemptions are withdrawn; and residential houses on sale are taxed for capital gains like other assets. These concessions have been withdrawn as a part of rationalization of tax laws; and their effect has been nullified to some extent by lowering of overall tax rates. However the withdrawal of such concessions specific to investments in housing, means that now the housing sector competes for investment along with other sectors. Considering that less than 1% of the Indian population pay income tax, and the tax threshold is fixed at a very high level (Rs. 35,000 as against annual per capita income of Rs. 10,000); the negative effect of such withdrawals will be only on people in the upper-middle-income and high-income brackets. In fact, as the high income group have less of an incentive to invest in housing, the price of housing may come down, making it more accessible to the middle and low income groups. Also these groups will also have greater access to loans for housing, as the rich will no longer have the incentive to take large housing loans as the interest deduction from these has been limited, to Rs. 10,000<sup>93</sup>.

As of 1993, one residential house is exempt from Wealth tax. Transfers of houses are subject to payment of Stamp duty (at the rate of 3%); capital gains tax and gift tax like other assets. Any allowance received by the tenant for payment of rent is not included in taxable income. This deduction is not available to persons living in their own house. To calculate income from house property, annual value, which is the actual rent received or the sum for which the property can be rented for, less property tax paid (if rented) is

---

<sup>93</sup>The limit of Rs. 5,000 for deductible interest has been raised to Rs. 10,000 in 1994.

taken as the base. Other deductions, such as, a sixth of annual value for repairs, insurance premium, ground rent, land revenue and interest paid on borrowed capital- upto Rs. 10,000 annually, are allowed while computing the taxable income.

From business income, a deduction of up to 40% of total income is allowed, for reserve created for investment in a financial corporation, or a public company engaged in providing long-term finance for construction/purchase of residential houses.

A deduction is also allowed in respect of part of the rent paid, in case of persons living in rented houses. A tax credit is available at the rate of 20% of payments made (upto Rs. 10,000) for any installment paid for financing purchase or construction of residential house property, repayment of housing loan, stamp duty and registration fees.

Property tax is the major instrument for mopping up unearned increases in land values. The municipalities in India administer a municipal property tax and the rates vary. A few cities, such as Delhi and Madras, also tax vacant land. Most Town and Country Planning Acts have specified betterment charges, in areas where some improvement has been brought about through a development scheme by a public authority. This is a difficult levy to assess and is generally disputed. A tax on unearned increase in property prices is also levied at the time of transfer, the principle being that half the appreciated value be recovered by the public authority<sup>94</sup>.

---

<sup>94</sup> Ribiero, (1985). The stiff penalty is imposed to prevent people from profiting by sale of property allotted to them at concessional rates by the government. However, this is generally avoided by understating the resale price- resulting in a double loss for the government- loss of stamp duty (calculated as a percentage of the sale price); and creation of black money (through unreported income).

In India, owner-occupiers and private landlords are treated in similar ways. However, in terms of tax relief, residential property investors get a lower return on their investment, as their income, whether actual or imputed, is subject to lesser allowances than business investments. For example, in the case of business assessment, interest paid, depreciation and other expenses incurred are fully deductible; while from house property income, depreciation is not allowed, and expenses such as interest, repairs, cost of collection of rent etc. are subject to ceiling limits. Moreover while business losses are allowed to be set off against other incomes of that year and subsequent years, losses from house property income are restricted and can be set off only against income from house property in subsequent years. This discriminatory treatment of house property income reflects the thinking that house property income is not fully reflected in monetary terms of earned or imputed rents, but the return of house property also includes intangibles, such as the satisfaction, security and status obtained from owning a house. Rents in the India are not a reflection of the value of the property, as the rate of return is low, but the capital gains realized on transfer of property are very high. The only tax advantage house-owners in India have over their business counterparts is that they can claim a tax credit for a part of the amount spent towards purchase or construction of the house. The incidence of this incentive is not regressive among tax-payers, as the amount of investment, is not deducted from the taxable income, but a tax credit at the rate of 20% is given<sup>95</sup>. Clearly this step is in the direction to encourage investment into housing, rather than consumption and other business assets.

---

<sup>95</sup> However, non-tax payers, do not get any tax credit refund.



Revisions to the income tax code (Sections 80L-exemption of interest earned on certain deposits; 24(i)(vi)- deductibility of interest paid on housing loans; and 80CC- exemption of amount invested in the equity of certain companies) would make certain deposit services offered by HFIs more attractive to their customers, thereby enhancing their ability to raise funds<sup>96</sup>. The set of tax laws that affect the distribution of financial savings in India are very important to a firm's ability to mobilize resources. They are also very complicated and difficult to evaluate in isolation. e.g., interest earnings of upto Rs. 7,000 per year, paid on deposits of upto Rs 140,000 with financial institutions are eligible for tax deduction, while deposits with the UTI are eligible for another Rs 3,000 deduction<sup>97</sup>.

NHB had announced in 1991, a Voluntary Deposit Scheme for mobilization of black money<sup>98</sup> and its partial use for construction of houses for the poor. Under this scheme 40 percent of the total collection of over Rs. 800 million are available for providing housing for the poor. Though the final outcome of this scheme in terms of the actual numbers of housing created for the poor is yet to be evaluated, the theory of utilizing black money for augmenting the housing stock is innovative and useful as it proposes to bring about re-distribution of income.

Few Indian families have to concern themselves with tax provisions;

---

<sup>96</sup>Buckley et al, (1989) p 23.

<sup>97</sup>Buckley et al (1989) p 24.

<sup>98</sup>Black money is the income not reported for tax purposes. The Voluntary deposit scheme was an amnesty program for one year, to allow declaration of hitherto unreported income. Amounts deposited in the notified account with NHB, were taxed at the highest marginal rate, but no penalty or interest was charged. Similarly no questions were asked regarding the source of the income.

since most household savings are of a size not affected by tax provisions. For access to household savings the most important taxes are not taxes at all. They are the implicit regulatory "taxes" that affect and constrain return and maturities of deposits and the ability to provide various types of financial services on a monopolistic basis; e.g. life insurance. The effects of these kinds of taxes are very difficult to infer<sup>99</sup>. For the allocation of savings of corporations and the profitability of competing financial institutions, tax considerations are more important. However, as Buckley et al (1989) report, they are no less difficult to evaluate.

This complicated and multi-layered environment makes it impossible to answer quantitatively questions such as, which tax regulations are essential for ensuring housing financial institutions success in mobilizing resources. Or, which tax code provisions favour the sector at the expense of the economy and vice versa? However, by the same token it is obvious that such a complicated tax code is not in the best interest of either the housing sector or the financial system. Hence, rather than trying to perform provision by provision analysis of relevant tax provisions, taxation issues need to be reformed comprehensively and consistently, along with broader financial reform.

---

<sup>99</sup>Buckley et al, (1989).

## CHAPTER SIX

### HOUSING TAX EXPENDITURES IN OTHER COUNTRIES

Housing tax expenditures in countries other than India are discussed in this chapter. Section 6.1 describes the HTEs used in OECD countries, while Sections 6.2, 6.3 and 6.4 discuss their presence in Britain, Canada and USA respectively.

#### **6.1 OECD Countries**

It is difficult to generalize about what actually constitutes housing tax expenditures (HTE) given the variations in taxation procedures in OECD countries. OECD member countries may be divided into 2 groups<sup>100</sup>. The first, corresponding to English speaking countries, are characterized by a heavy reliance on direct taxes applied to income and profits. The second group exhibits a high ratio of indirect taxes on goods and services to direct taxes, and relatively higher social security contributions. (e.g. Spain, France and Greece). These differences are reflected in the tax treatment of housing assets, with the former group placing a greater reliance on taxes levied on housing returns, and the second group concentrating more upon taxes applied to transactions in housing assets and recurrent property taxes.

The most common HTEs afforded for housing construction are exemption of profits from corporation tax or granting of preferential tax allowances to the producers of low to medium income housing. Reduced indirect tax rates, such as Value Added Tax (VAT), are applied to the sale of new housing. In most OECD countries income from rental housing is subject to personal income tax or corporation tax. The preferential treatment of deductible operating costs

---

<sup>100</sup>The discussion of fiscal policies in OECD countries is based on Wood, 1990.

constitutes a principal source of tax expenditures for rental housing. Rental housing is also exempted from (or is subjected to lower rates of) taxes applied to real property, and transfer duties.

Tax expenditures are a key component of most OECD governments' policies to promote home ownership. HTEs for home ownership-saving schemes are deployed either through tax-free interest and bonuses, or deduction of savings deposits from taxable income. In the taxation of imputed housing income and deduction of owner-occupiers' expenses; most countries allow mortgage interest to be deducted from income for tax purposes, though ceilings and conditions are generally applied. The addition of the property's imputed rental value to the owner occupier's income is less common. Tax allowances are also invoked by some OECD countries in respect of expenditures, such as, property taxes, expenditure on energy saving, repairs and improvement expenditure and depreciation. The taxpayer's main residence is generally exempted from capital gains tax. However, this can be subject to various conditions such as re-investment of the sales proceeds in the purchase of a new residence, and the length of occupation.

The taxation of owner occupiers' imputed net rental income entails logistical and political problems. Notional rental income values are based on administered assessments that require significant policing and enforcement costs. Since assessed values are generally below market values, and current expenses are commonly accorded tax allowance status, the revenue yield tends to be low. It is also difficult to politically justify the "fairness" of a tax levied upon an intangible income stream. Prompted by these considerations the governments of United Kingdom, France, Ireland, Australia and West Germany have abandoned the taxation of imputed net rental income, even though some of

them continue to treat current housing expenses as tax allowances. In the United Kingdom, owner-occupiers receive tax relief on their mortgage interest payments at their highest marginal tax rates on the first 30,000 pounds of a mortgage. Under the Mortgage Interest Relief at Source (MIRAS) scheme; households not liable for income tax make mortgage payments net of "relief" at the basic rate of tax. In West Germany the owner-occupiers can take advantage of a depreciation allowance that amounts to five per cent of the historic cost of purchase in each of the first eight years of ownership (the allowance is only available once and the accumulated aggregate cannot exceed DM 300,000). The United States grants generous allowances to home owners.

In contrast, the imputed net rental income of owner-occupiers is taxed in Denmark, Finland, Greece, Luxembourg, the Netherlands, Spain and Sweden. Generally, imputed rent is arrived at as a percentage of the property's assessed capital value, generally below market values. Exemptions are frequently employed, further reducing the impact of tax liabilities. Since current expenses are deductible from assessable income, imputed net rent can often be negative in the initial years of ownership<sup>101</sup>.

OECD governments have introduced provisions designed to place a ceiling on mortgage interest relief. However this is matched by the introduction of new tax expenditures designed to promote new housing construction and housing improvement and repair.

---

<sup>101</sup> Finland typifies taxation provisions in this respect. Since 1973 Finnish home-owners have been subject to the payment of income tax on net imputed rent. The gross imputed rent is set at 3 per cent of the administratively assessed capital value, which normally lies below market values. Those properties whose assessed capital values is below 215,000 Finnish marks are exempt. Home owners subject to tax, can deduct annual mortgage interest payments in excess of 600 marks and up to 25,000 marks from gross imputed rent. As a result, only 2 per cent of Finnish home-owners were taxed on net imputed rent in 1983. (Wood, 1986).

In some OECD countries, tax expenditures are explicitly granted to private landlords in order to encourage their acquiescence with rent controls. Since rent controls depress rent levels, these tax arrangements normally result in losses being incurred during the early years of investment, which may be deducted from other sources of income. This "negative gearing" represents an attractive means of sheltering other sources of income. When there is positive taxable income from rental housing, owners may avoid tax entirely on housing returns by taking advantage of the exemption of capital gains from taxation, which becomes available after a minimum possession period of two years.

Most OECD countries treat the capital gains realized on owner-occupiers' principal residences as exempt from taxation. In countries where they are taxed, deferral provisions nullify their effect. For example, in the US homeowners can defer taxes if the realized gains are put into a more expensive home. There is also a one-time capital gain exclusion up to a ceiling of \$125,000, for owners aged 55 or more. In Sweden capital gains are also subject to taxation on a deferred basis, provided they are re-invested in the owner-occupiers' principal residence. In Canada capital gains from the sale of principal residence are exempt, while in respect of other residential properties, income tax provisions apply to realized nominal gains, but 25% of all gains are exempt. In most OECD countries capital gains realized on private rental properties are subject to taxation, but the practice varies in regard to the use of nominal or real capital gains as the tax base. In Australia, real capital gains are taxed under income tax provisions. Until the 1986 Tax Reform Act (TRA), the US subjected the realized nominal capital gains of private landlords to a preferentially low tax rate. Taxation provisions differ

in Germany where capital gains are entirely exempt beyond a minimum possession period of 2 years.

All European community countries except Denmark and Britain have local taxes on property. Britain has a business property tax but abolished domestic rating in favour of a Community Charge or Poll Tax. A new system, called a "domestic tax," was scheduled to replace the Community Charge in 1993. Recurrent property taxes are levied by local tiers of government in almost all OECD countries. The tax base generally consists of land and buildings that have been assessed for tax purposes, and the tax is levied at rates established by municipal government revenue needs. As the tax is local, there is wide variation in assessment procedures both within and between OECD countries. Some countries, such as USA, allow deduction of property taxes from assessable income under federal tax provisions.

Greece is one of the few countries to include residential property in the tax base of a recurrent wealth tax introduced in 1982. In response to the public's vociferous reaction, the tax rates have been reduced sharply, and apply to administratively assessed capital values that are deliberately kept below market values. Thus the impact of this wealth tax is negligible.

Examples of non-recurrent taxes are the stamp duty levies in Australia and UK, and the transfer taxes payable in Greece and Portugal. Home owners in Greece are subject to a number of non-recurrent indirect taxes (NRIT) to which many tax expenditure provisions apply. The NRIT comprise a real estate transfer tax applied to the sales of residential property, and an inheritance /gift tax that is applied to the transfer of property by means of an inheritance, gifts and parental assistance. Since 1982, the tax base has been valued in both cases by administered methods resulting in below market values.

Similar tax provisions with significant NRIT on residential property are also found in Portugal, Spain and Turkey.

In Canada, France, Germany, Japan and Luxembourg an important aspect of the tax treatment of home-owners is the tax expenditures accorded to facilitate down-payment requirements. Since 1988, USA allows contributions of upto \$20,000 towards a first home savings account to be treated as a tax allowance. In France, post offices, savings banks and trading banks are able to offer Housing Savings Plans that grant tax-free interest, conditional on the use of accumulated funds for the purposes of acquiring residential property.

The British, Irish and US governments have traditionally protected specialist Housing Finance Institutions (HFIs) by means of preferential tax provisions. The aim of such measures is to bring about greater stability in the flow of mortgage finance. The specialist US savings and loans institutions (S&Ls) were originally exempt from federal income taxation. This exemption was removed in 1951 and replaced by a tax allowance for bad debts, and a maximum tax rate provision. This enabled S&Ls to avoid paying taxes, provided 82% or more of their total assets were held in home mortgages or US government securities.

Less common among OECD countries is the use of tax expenditures to facilitate the issue of mortgage backed securities. In the US, state and local government are entitled to issue mortgage revenue bonds, that are tax exempt, and the revenue can be used to fund below-market interest rate mortgages, or the construction of low-income rental units. Mortgages are targeted on first-time buyers, on low to moderate incomes, who are purchasing in "economically distressed" areas.



Resistance to taxation of imputed rents is on the ground that it represents an "invisible" income stream. In an inflationary environment with a tax base measured in nominal terms, taxing imputed rent becomes a tax on real wealth. This problem is particularly sensitive issue with respect to housing, as housing equity generally forms the largest component of many households' net worth.

Table 6.1 describes the chief features of the taxation of owner-occupiers and private landlords in some OECD countries and India. The Australian and Canadian tax treatment of housing assets differs according to whether they are owner occupied (when they are treated as non-income generating consumer goods), or privately rented (treated as income generating investments and taxed accordingly). UK, Ireland and France exempt capital gains and the imputed net rental income of home-owners, while allowing deduction of mortgage interest payments which is inconsistent with the normal tax treatment of either investment assets or as consumer goods. Thus, home-owners are unambiguously granted preferential tax provisions as compared with private landlords. In practice, the same situation prevails in USA, as the deferred basis of taxation of capital gains and a generous one time exemption means that most home-owners do not incur a liability. The Netherlands and Sweden are distinctive in having a consistent and more tenure-neutral set of tax provisions, treating housing assets mainly as investment goods. India, also treats both landlords and owner-occupiers in a similar manner, except for not levying any wealth tax on owner-occupied houses.

**Table 6.1: Taxation of Owner-occupied and Rental Housing in India and Selected OECD Countries**

Country	Preferential tax treatment to savings	Transfer Tax or Stamp Duty	Allow Deduction of Mortgage Interest	Tax imputed / Net Rental Income	Tax Capital Gains	Annual Wealth Tax	Recurrent Property Tax
INDIA	Both	Both	Both	Both	Both	Landlords	Both
AUSTRALIA	None	Both	Landlords	Landlords	Landlords	None	Both
CANADA	None	Both	Landlords	Landlords	Landlords	None	Both
Finland*	No	No	Yes	Yes	No	No	No
FRANCE	Owner-occupiers	Both	Both	Landlords	None	Both	Both
GREECE	None	Both	Both	Both	None	Both	None
IRELAND*	No	Yes	Yes	No	No	No	No
Netherlands	Both	Both	Both	Both	None	Both	Both
Sweden	None	Both	Both	Landlords	Landlords	None	Both
UK	None	Both	Both	Landlords	Landlords	None	Both
USA	None	None	Both	Landlords	None	Both	Both

Source: Adapted from MacLennan and Williams (1990). Information about India is from The Indian Income Tax Act, 1992.

\* Relating to owner-occupiers only.

The Greek housing tax provisions are distinctive and are representative of that group of countries which rely more heavily on indirect taxes and social security levies. Though both homeowners and private landlords are subject to the same array of taxes on housing assets, home-owners are granted significant tax allowances and part exemptions.

Recent reform measures in OECD have not, in general, changed housing subsidy provisions towards a tenure neutral subsidy/tax system. The new tax provisions introduced in recent years reflect concerns ranging from the cost

of tax expenditures, to using tax expenditure provisions in order to favour particular purchasers, activities or segments of the housing stock.

Measures designed to curb foregone tax revenues have a disproportionate impact on high income groups, as they generally involve limitations on the use of tax allowances. Some countries<sup>102</sup> preclude the application of tax allowances at the tax payer's marginal rate. In Greece, reforms introduced in 1988, restrict the tax benefit from mortgage interest tax allowance to the base of the income tax rate scale. Similar flat rate deduction provision has been employed in France since 1983, with rebates on mortgage interest charges calculated at the flat rate of 25 per cent. The introduction of a ceiling on the extent of allowable cost deductions is increasingly common. If this is not adjusted in line with inflation the real value of tax allowances will be gradually eroded; resulting in a convenient way of phasing out tax allowances. Tax credits are also used to both curb the cost of tax expenditures, and ameliorate their regressive nature.

The situation regarding fiscal policies that affect housing in three OECD countries that publish tax expenditure budgets, and where such policies have been studied and analyzed is discussed next.

## **6.2 BRITAIN**

"Housing in Britain is the subject of a web of subsidies, benefits, and tax concessions; which has grown steadily more tangled as the years have gone by."<sup>103</sup>

In Britain, housing as an economic sector has a very significant magnitude. It represents 4 per cent of national output; housing construction

---

<sup>102</sup>Wood, (1990).

<sup>103</sup> Hills (1991) p 3.

employs a million people and housing makes up a fifth of the gross investment in fixed capital in the economy. It has been recognized that the housing market is driven by economic change, particularly in terms of incomes, interest rates and household formation<sup>104</sup>.

Table 6.2: Taxation in UK of Housing and Other Incomes

	Interest payments	Return (cash/imputed)	Capital gains
Owner-occupiers	Tax-relief upto 30,000	Tax-free imputed rent	Tax-free
Private Landlords	Interest is tax deductible	Rents taxed-no deduction for depreciation	Real Gains taxable
Other Business Investment	Interest tax deductible	Income taxable	Real gains taxable
Other consumption	No Interest Relief	No Tax	No tax
Personal equity plans	No Interest relief	No Tax	No Tax
Pensions	No Interest relief	Advantage from contribution relief and tax- free lump sums	Not applicable
Shares	No Interest relief	Dividends taxed	Real gains taxable
Building society and bank accounts	No interest relief	Nominal return Taxed	Not applicable

Source: Hills (1991)

In Britain, owner-occupiers were treated originally in a way similar to private landlords. The return on their investment, the imputed rent was taxed, after deduction of expenses, including interest payments and maintenance costs. Over the years the tax system changed, resulting in improving the tax position of owner-occupiers. Their imputed rents and capital gains are not taxed, and they also receive tax relief on the first 30,000 pounds of their mortgage. Private landlords cannot deduct depreciation or imputed expenses, nor set off losses on property income against income from other sources for

<sup>104</sup>MacLennan and Gibb, (1993) p 12.

tax purposes- thus having a disadvantage over other businesses, as well as owner-occupiers. Housing is largely free from VAT, although it is charged on spending by owners and landlords on improvements and repairs. Stamp duty is charged at 1 per cent of any transaction of 30,000 pounds or more.

Table 6.3: TAX SUBSIDIES TO OWNER-OCCUPIERS IN UK (Pounds)

Gross Annual Income Band	Mortgage Interest Tax Relief	Imputed rental Income Tax <sup>105</sup>	Real Capital Gains Tax
600	191	417	3455
2600-5199	126	291	2645
5200-7799	284	306	2937
7800-10399	300	291	2499
10400-12999	405	290	2888
13000-15599	440	308	3078
15600-20799	488	375	3456
20800-25999	748	605	4699
26000-31199	888	619	5545
31200>	1002	608	4330

Source: Maclellan and Gibb (1993) p 20.

In Britain, home-owners receive several tax subsidies in the form of MITR- Mortgage Interest Tax Relief; and non-taxability of imputed rents and capital gains. MITR rises steadily with income. The subsidy associated with imputed rents is governed by the length of residency and outstanding mortgage debt, therefore its pattern is less clear with respect to income. The absence of a capital gains tax, benefits higher house price areas and does not have a particularly strong relationship with current incomes. Overall, tax subsidies fail to provide a progressive distribution of subsidy, they are inefficient and sometimes arbitrary and in no way can be said to confirm to rational

---

<sup>105</sup> imputed rental income tax is the tax that would be levied on the net equity owned by the household, it is net of debt which receives MITR. The exemption from real capital gains tax refers to the taxable gain made after allowing for inflation, a pound 5000 allowance and assuming sale in 1988 and original purchase in 1982.

housing policy objectives<sup>106</sup>. Table 6.3 shows the regressive nature of tax subsidies received by owner-occupiers.

The level of owner occupation in Britain has increased rapidly in the last 40 years rising from 3 million dwellings (31 % of households) in 1951 to 15.4 million dwellings (67% of households) in 1991. Since 1970, there has been rapid house price inflation with national average house prices rising from pounds 5,000 to 60,000- an increase of 1,100 per cent. These two trends, expansion of home ownership and rapid house price inflation, have led to major changes in the role of owner occupation in personal wealth holdings. The value of dwellings as a proportion of all net personal wealth increased from 18% in 1960 to 37% in 1975 and 52% in 1989<sup>107</sup>.

Value-added-tax (VAT) is a method of taxing final consumer spending in the domestic economy. It is a multi-stage tax that falls on all final consumer goods and services, except those that are explicitly exempted. New building is exempt from VAT, presumably on the grounds that housing, like other exempt or zero-rated items, is a necessity.

The tax and subsidy system in Britain discriminate markedly between housing tenures. The owner occupier mortgagor receives 25% tax relief on interest payments on the first 30,000 pounds of their mortgage. As an asset holder, they are exempt from capital gains and income tax. As a consumer, owner occupiers do not pay VAT. Low income owner occupiers, borrowers and outright owners, have no recourse to income-related housing benefit which is restricted to tenants. Mortgagors who qualify for income support can, however,

---

<sup>106</sup> MacLennan and Gibb, (1993).

<sup>107</sup> Hamnett and Williams, (1993) p 137.

get help with their interest payments. Tenants on low income are eligible for housing benefit, although this is restricted in the private rented sector where a rent officer can determine whether the rent is reasonable and therefore eligible for benefit expenditure. Social sector tenants may also receive some sort of price subsidy through mediation from central government and also implicitly through historic cost accounting and rent pooling.

Evidence suggests that formal subsidy to owners, outweighs that received by tenants at relatively low household incomes (5000 pounds per annum) and that HTEs are regressive, e.g. the top third of owners receive 2/3rds of MTR<sup>108</sup>. Further, HTEs, in the face of inelastic housing supply, are probably capitalized into higher house prices with implications for the cyclical nature of the housing market.

Table 6.4: Main Forms of Financial Subsidy by Tenure in UK

Owner occupation	Local Authority	Private Rented	Housing Association
Mortgage Tax Relief at source (MIRAS)	Housing Revenue	Housing Benefit	Housing Association Grant
Non-taxation of Imputed rent and Capital Gains	Account Subsidy	Improvement Grants to Landlords	Housing Benefit
Improvement Grants	Housing Benefit	Business Expansion Scheme Tax	
Council Houses		Benefits	
Sales Discounts			

Source: Willis and Cameron (1993) p 54.

Willis and Cameron (1990) show that while the amounts of housing benefit and Housing Rent Assistance (HRA) decrease with rising income bands (no

---

<sup>108</sup> Hamnett and Williams, (1993).

housing benefit for people having income over 13,000 pounds p.a., and no HRA for incomes above 10,400 pounds p.a.); MITR increases with income, with the largest increase happening when income moves from pounds 20,800-26,000 income band to pounds 26,000-31,200 income band. Means tested housing benefit is strongly progressive, going mostly to renters in the lowest income groups, while MITR is strongly regressive, giving the most benefits to those in the highest income groups. In between, the lower to average income bands have average benefits from financial subsidies which are substantially lower than those at upper and lower extremes on the income groups.

The Business Expansion Scheme (BES) was set up in 1983 to assist new businesses in raising capital<sup>109</sup>. Individual investors get income tax relief in the year they buy shares of companies raising funds under the BES. If a shareholder retains the shares for at least five years, no capital gains tax is paid on chargeable gains realized by any subsequent sale of the shares. In 1988, the benefits under the BES were given to assured tenancies also. It is estimated that during the first 2 years, 544 million pounds were raised and almost 10,000 properties would be acquired from these funds. In its first two years BES stimulated a supply of new and higher standard rented housing in locations where private renting was not usually found and which had been let to a wide range of tenants. Just over one half of BES tenants said they found it easy to afford the rent. The BES has resulted in an additional supply of private rental housing that would not otherwise have been created. Company directors said they could not have raised money for private renting without this or some other subsidy.

---

<sup>109</sup> This discussion is based on Crook and Kemp (1993), p67-85.



Preliminary evidence suggests that the long term impact of BES is likely to be negligible. Most companies did not think they had a long term future, and perhaps would ultimately sell their properties into owner occupation and wind up the company. Few of them thought that they could raise funds without subsidy under the current housing finance system because rents did not give a competitive return. The returns from rents were insufficient to attract long term finance. In the view of the company directors tax breaks or some other subsidy are needed to make returns from rental housing attractive.

Table 6.5 summarizes and compares the housing subsidies taxation and benefits applicable to owner-occupiers and the private rental sector in UK.

Table 6.5: Housing Subsidies, Taxation and Benefits in UK

PRIVATE RENTED SECTOR	OWNER-OCCUPIERS
Taxation of landlords: -rents taxable -Interest deductible  -Capital gains taxed -No depreciation allowance -New Business expansion Scheme concessions -Stamp Duty charged	Taxation: -Imputed rents not taxed -Tax relief on first 30,000 of mortgage (MITR) -No Capital Gains Tax  -Stamp Duty charged
Rent Regulation	
	Insulation grants
Improvement Grants	Improvement grants
Housing benefit for tenants' rents (rent rebate/ allowances)	Income support payment of mortgage interest
Rates net of housing benefit	Rates net of housing benefit
Exemption from VAT (except for repairs and improvements)	Exemption from VAT (except for repairs and improvements)

Source: Hills, Berthoud and Kemp (1989) p 2.

### 6.3 CANADA

In Canada, housing is the most costly item in most people's budget. If furnishings and household expenses such as heat and property taxes are

included, it absorbs, on average, almost 25% of household income<sup>110</sup>. For homeowners, the dwelling generally is the household's largest capital asset.

The various forms of housing assistance available in Canada are listed in Table 6.6. The scope and range of this assistance is enormous- for 1979, the major federal expenditures for housing assistance were in the range of \$ 8 billion<sup>111</sup>. Almost 80 per cent of federal housing expenditure is in the form of tax expenditures.

**Table: 6.6 Major Federal Expenditures for Housing in Canada, 1979.**

Type of Expenditure	Subtotal*	Total*
CMHC grants, contributions & subsidies:		840
social housing (public housing, non-profit housing, cooperative housing etc.)	288	
market housing (AHOP, ARP, interest forgiveness)	52	
land assembly & municipal infrastructure	130	
community relations	133	
other	237	
Implicit interest subsidies on outstanding loans		100
Implicit subsidies in NHA** insurance fees		15
<b>Federal Tax expenditures:</b>		<b>6360</b>
non-taxation of imputed net rent	3,700	
non-taxation of capital gains	2,500	
RHOSPs	115	
MURBs	45	
Rent control costs		225
<b>Total non-capital items</b>		<b>7540</b>
CMHC commitments for loans and investments		350
<b>Total federal housing assistance expenditures</b>		<b>7890</b>

Source: Smith (1981) p 455.

\* \$ millions

\*\* National Housing Act

The affordability of accommodation and profitability of the housing sector have been a major preoccupation of governments in most OECD countries. In Canada, as in the USA, reliance on private sector housing is greater than

<sup>110</sup>Statistics Canada, (1989), as reported in Harris (1991).

<sup>111</sup>Smith, (1981) p 455.

in most countries of Europe. Similarly home ownership is ideologically espoused more than rental housing<sup>112</sup>. During the recession in 1973-1985, social housing expenditures were controlled but, restraint in direct expenditures was offset by HTEs for private-sector housing. One reason for the difference in treatment was the necessity to offset the rising problem of affordability for the middle classes in the context of recessionary pressures<sup>113</sup>.

Social housing subsidies (nonprofit and cooperative) usually involve direct subsidies and loans. In addition to these, home ownership and private rental housing are subsidized through tax expenditures, such as the Registered Home Ownership Saving Plan (RHOSP) and the Multiple Unit Residential Building (MURB) program. MURB mainly helped developers and investors. Direct subsidy programs, such as the Assisted Home Ownership Program (AHOP) and the Assisted Rental Program (ARP) accounted for a smaller portion of these expenditures.

For the ownership sector, AHOP was expanded and RHOSP was introduced "to assist young people in accumulating the capital required for a down payment on a house" and as a means for providing "an important new source of mortgage funds to finance the construction of new housing we require". For the private rental sector the ARP was initiated and the MURB tax provision introduced, creating a tax shelter for wealthy investors by permitting capital allowances on new rental projects to be written off against other income<sup>114</sup>.

By maintaining RHOSP and MURB, future middle-class home owners and

---

<sup>112</sup> Lithwick, (1985).

<sup>113</sup> Hulchanski and Drover, (1987) p 53.

<sup>114</sup> Hulchanski and Drover, (1987) p 58.

wealthy individuals in the top tax bracket retained the subsidies on their housing investments in spite of restraint. RHOSP helped address the high cost of becoming a home owner and MURB addressed the lack of profitability in the private rental sector<sup>115</sup>. Tax expenditures in general, and HTEs in particular mainly benefit the higher-income households. The greater one's income, the greater is the HTE benefit received. HTEs are not only regressive, but are also many times greater than direct spending programs on housing (Table 6.6). In most other budgetary categories, the relationship between the two types of spending is just the opposite: tax expenditures are less, between 30-50 per cent of the direct expenditures. As more was spent on HTEs, which benefitted higher income groups more, it is inevitable that more federal housing assistance was received by the persons earning higher income. As tables 6.7, 6.8 and 6.9 depict, this pattern of expenditure resulted in higher home ownership rates for persons in the higher income quintiles, while persons in the lower income quintiles shifted towards rental housing.

Table: 6.7 Federal Housing Tax Expenditures in Canada 1979.

Income Group	Average HTE benefit per tax filer
Under \$5,000	\$32
5,000-10,000	171
10,000-15,000	314
15,000-20,000	619
20,000-25,000	964
25,000-30,000	1312
30,000-50,000	1994
50,000-100,000	3670
\$100,000 and over	6753

Source: Hulchanski and Drover (1987) p 64.

---

<sup>115</sup>Hulchanski and Drover, (1987) p 62.

Table: 6.8 Changes in Home-ownership Rates in Canada

Percentage of households owning their house

Income Quintile	1967	1973	1977	1981	Change 1967-81
Lowest Quintile	62.0	50.0	47.4	43.0	-19.0
Second Quintile	55.5	53.6	53.3	52.4	-3.1
Middle Quintile	58.6	57.5	63.2	62.7	+4.1
Fourth Quintile	64.2	69.8	73.2	75.0	+10.8
Highest Quintile	73.4	81.2	82.3	83.5	+10.1
TOTAL	62.7	62.4	63.9	63.3	+0.6

Source: Hulchanski and Drover (1987) p 65.

Table: 6.9 Changes in Renter Households in Canada.

% of households renting

Income Quintile	1967	1973	1977	1981	Change 1967-81
Lowest Quintile	20.4	26.6	29.1	31.1	+10.7
Second Quintile	23.9	24.7	25.9	26.0	+2.1
Middle Quintile	22.2	22.6	20.4	20.3	-1.9
Fourth Quintile	19.2	16.1	14.8	13.6	-5.6
Highest Quintile	14.3	10.0	9.8	9.0	-5.3

Source: Hulchanski and Drover (1987) p 67.

In recent years, tax subsidies to owner-occupiers have far out-weighted the moneys spent on "social housing". The immediate effects are socially regressive: owners are generally more affluent than tenants, while the most affluent, living in the largest homes, have received the greatest subsidies of all. Thus, the poor are in effect subsidizing the rich. The larger effect of promoting home-ownership has been to bolster the developing economy by boosting the demand for goods and credit.

In Canada policy providing deep, sustained subsidies to small numbers has been chosen over modest subsidies spread over a larger number of people. This choice has left a large number of low-income Canadians with serious

affordability problems<sup>116</sup>.

#### 6.4 United States of America

Even though the concept of tax expenditures was developed relatively recently, in USA, the tax code has been used to subsidize particular activities since the first income tax law enacted after adoption of the 16th amendment to the Constitution. In 1913, deductions for mortgage interest and state and local taxes on homes owned by taxpayers, as well as deductions for some non business state and local taxes, were allowed<sup>117</sup>. Government intervention to strengthen the supply of housing credit in the US dates from the Depression. Thrifts were legally required to invest in housing loans; if they devoted 80% of their business to this, they received tax exemptions<sup>118</sup>.

Table 6.10 Major Activities Subsidized by Tax Expenditures in USA: 1990

Activity	Billion \$	% of total
1. Retirement	87.0	27.9
2. <u>Home ownership</u>		
mortgage interest	25.4	
Property taxes	8.1	
Capital gains treatment	13.7	
Subtotal	47.2	15.1
3. Health and health insurance	44.4	14.2
4. Municipal Bond interest	20.7	6.6
5. Investments	18.4	5.9
6. State and Local Taxes	19.2	6.1
7. Charitable contributions	10.5	3.4
8. Capital gains at death	5.4	1.7
9. Other Activities	59.5	19.1
Total: all Tax Expenditures	312.3	100.0

Source: Peterson (1991) p 61.

---

<sup>116</sup>Lithwick, (1985) p 53.

<sup>117</sup>Peterson, (1991) p 61.

<sup>118</sup>Karn and Wolman, (1992) p 102.

Table 6.10 shows that among the activities subsidized by tax expenditures, housing gets the second largest subsidy. The details of housing tax expenditures for individuals are given in Table 6.11.

Table 6.11: Housing Tax expenditures for Individuals in USA (\$ millions)

	1983	1984	1985	1986	1987	1988
Deductibility of mortgage interest on owner-occupied houses	25065	27945	30130	32785	35305	37,950
Deductibility of property tax on owner-occupied houses	8765	9535	10480	11710	13215	14980
Exclusion of interest on state and local government housing bonds for owner-occupied housing	450	485	475	445	415	385
Exclusion of interest on state and local government bonds for rental housing	285	355	430	510	585	665
Deferral of capital gains on home sales	3770	4895	5625	6000	6480	7030
Exclusion of capital gains on home sales for persons age 55 and over	1255	1630	1875	2000	2160	2345

Source: Modified from Surrey and McDaniel (1985) p.p. 7-14.

A comparison of tax expenditures and income transfers shows that in the fiscal year 1989, overall transfers (that is direct expenditures) were 2.5 times greater than tax expenditures. However, housing and commerce are among the few activities, where tax expenditures were many times larger than transfer spending. The dollar value of tax expenditures for housing and commerce is 103.7 billions ( that is 35.4% of tax expenditures), as compared to transfer spending of only \$20.8 billion (representing a mere 2.8% of

transfer spending)<sup>119</sup>. This signifies that housing and commerce are subsidized primarily through the tax system- exclusions and deductions from income plus tax credits, rather than by direct outlays.

**Table 6.12 Distribution of Housing Tax Expenditures in USA: 1990**

INCOME CLASS	Percentage distribution of returns (1981)	Real Estate Deduction (in million dollars)
Less than \$10,000	36.7%	3
\$10,000-20,000	26.1%	87
\$20,000-30,000	18.4%	358
\$30,000-40,000	14.5%*	670
\$40,000-50,000		645
\$50,000-75,000	3.6%**	2,264
\$75,000-100,000		1,210
\$100,000-200,000	0.6%	1,884
Over \$200,000	0.1%	1,208
TOTAL	100.0%	8,329

Source: Peterson (1991) p.p. 86 and 88.

\* returns filed by income class 30,000-50,000

\*\* returns filed by incomes class 50,000-100,000

The data in Table 6.12 indicates that the distribution of tax expenditures by income class is heavily weighted towards persons and families in the upper ranges of the income scale. The proposal to eliminate tax expenditures pertaining to deductibility of interest on home mortgage during the debate and discussion leading upto the Tax Reform act of 1986, was met with such a large protest that the idea was dropped. The value of this HTE in 1988 was \$27.7 billion, which was equal to 10.7% of the total tax expenditure of that year. Persons and families with incomes of over \$100,000 (2% of the total return filers) got 22.1% of this benefit. On the other hand, families and persons with incomes below 30,000 (70.5% of the return filers) got only 10.1% of the total benefit. The paradox of providing subsidy through tax expenditures is brought out in this quotation from Peterson (1991):

---

<sup>119</sup>Peterson, (1991) p 72.



"The purpose of the home ownership interest deduction is to encourage home ownership by Americans, but doing this through the tax expenditure route results in large subsidies to a relatively small segment of the population. If legislation were proposed in the Congress saying, in effect, that the nation will provide quite small direct subsidies to encourage home ownership to the roughly 70% of the population with incomes below \$30,000, and that these subsidies would increase rapidly as family income increases above this level, would such legislation pass? The question answers itself, yet this is the way the majority of tax expenditures work".

## 6.5 Developing Countries

Very few studies have been done in developing countries of tax expenditures. The studies relating to the effect of tax expenditures on housing are even fewer.

Urban housing shortages are exacerbated by rapid population growth and high rates of urbanization in developing countries. Lower gross domestic products of these countries preclude large-scale subsidization of housing by the governments. While the problem of housing shortage is deeply rooted in the socio-economic circumstances of developing countries, housing itself plays a significant role in their economic development. Government housing policy and housing planning are critical factors in determining the socio-economic effectiveness of housing. It is paradoxical that even though governments in developing countries extensively use tax expenditures to steer investment in certain sectors, there is hardly any analysis or evaluation of their effect<sup>120</sup>.

The Indonesian fiscal system was replete with tax incentives prior to 1984<sup>121</sup>. Most of these were discontinued as evidence indicated that few if any of the incentives yielded the desired results. They caused "massive

---

<sup>120</sup>Maktouf and Surrey (1990) p 204.

<sup>121</sup>Gillis, (1990) p 89.

hemorrhages from the treasury" and when effective had a bias towards capital intensity, as large investments received longer tax holidays. They also often created intractable problems in tax administration, as they required higher tax rates on taxpayers not benefitting from them; and discriminated against smaller firms who lack the resources and the influence to file for and receive incentives.

Hong Kong and Singapore are among the few developing countries which have achieved success in public housing policies and programs<sup>122</sup>. In the pursuit of development through rapid industrialization, many developing countries ignored investments in large scale public housing projects, as the productivity of housing investments was considered too low to be economically efficient. While most developing countries were reluctant to allocate funds to housing, Hong Kong and Singapore began large scale low-income public housing programs. They viewed housing as an integrated part of development and achieved success in both housing and economic growth<sup>123</sup>.

Public housing programs in both Hong Kong and Singapore are considered to be essential components of the political strategies for economic and social development<sup>124</sup>. Both these countries have complex and well-administered systems for public housing, consisting of a statutory body which is responsible for all aspects of public housing including planning, finance, design, construction, allocation and management. This administrative body has a structured organization, and each component has clearly defined

---

<sup>122</sup>Shen, (1986).

<sup>123</sup>Shen (1986) p 38.

<sup>124</sup>Shen, (1986) p 39.

responsibilities.

The public housing program in Hong Kong began in 1954, after a fire in December 1953 destroyed homes of 58,000 persons in Shek Kip Mei, a squatter settlement in Kowloon. The Hong Kong government constructed emergency accommodation<sup>125</sup>. Rents lower than those paid earlier by the occupants for their huts were charged for these units. Till 1972, the low-income public housing programs were mostly financed directly through government revenue or through low-interest loans provided by the government. These programs received government subsidies and were allotted land at less than market value<sup>126</sup>. Since 1973, public housing in Hong Kong has been administered by a single organization- The Hong Kong National Housing Authority. Its activities are financed primarily through government revenue and through rents received by the authority. After 1976, land for low income housing was provided free by the government.

In Singapore, the Singapore Improvement Trust- a government organization in charge of building public housing, has been in existence since 1927, long before the establishment of the Housing Development Board (HDB) in 1960. The setting up of HDB, a statutory body, marked the beginning of the construction of large scale public housing programs dominating the housing sectors of Singapore. Capital for the construction of public housing was provided by loans from the government to the HDB<sup>127</sup>.

The use of Central Provident Fund (CPF) savings for the purchase of

---

<sup>125</sup>Shen, (1986) p 32.

<sup>126</sup>Shen, (1986).

<sup>127</sup>Shen, (1986) p 34.

public housing, is central to the housing policy of the Singapore government. The rate of contribution to the CPF as a proportion of the gross salary was increased from 10% in 1955 to 50% in 1984. Under the CPF housing finance scheme, members could withdraw upto 80% of their total CPF savings for housing<sup>128</sup>. Almost the entire reserve of CPF savings has been invested in government securities. A major portion has been used to provide substantial funds to enable home buyers to meet their initial and mortgage payments, and to finance public housing programs.

It is interesting to note that both Hong Kong and Singapore achieved success in tackling housing problems, not through tax expenditures, but mainly through land reforms, and through public housing programs financed by the government. In Singapore, investment in CPF was made compulsory, and not attracted through fiscal incentives (unlike most countries). However, the circumstances of Hong Kong and Singapore are unique, as they have full employment and tightly controlled migration policies. Both the countries have utilized savings to finance the public housing programs. In Singapore, compulsory savings in the CPF are akin to a tax on salary, whereby both the employer and employee each deposit 25.3% of the salary in the fund. It is difficult to transplant similar policies with comparable success to India, due to significant unemployment and the presence of an informal labour sector. There are also no restrictions against migration to urban areas in India.

This survey of housing tax expenditures in countries other than India, shows that HTEs distinctly influence the housing situation. The various ways in which HTEs effect housing are discussed in the next chapter.

---

<sup>128</sup>Goh, (1988) p 155.

## CHAPTER SEVEN

### Effects of Housing tax Expenditures on Housing

The effects of housing tax expenditures on housing, housing finance and the national economy are described in this chapter. The relevance of these effects for India, is discussed at the end of each section.

#### 7.1 Growth in Home-ownership

The national impact of housing tax expenditures is reflected in the nature of urban housing markets. Table 7.1 depicts the post-war trend in the rate of home-ownership in selected OECD countries and India. With the exception of Canada, all countries experienced a significant increase in the rate of home-ownership in the early post-war years. As HTEs lower the cost of owner-occupied housing, it is reasonable to argue that favourable tax treatment will enable a greater expansion in owner-occupation than would otherwise be the case. Even if the price elasticity of housing is zero, this expansion can come about through tenure transfers.

Table 7.1: Home Ownership in India and Selected OECD Countries

Countries	1950	1960	1970	1980	1986
INDIA <sup>129</sup>		46.27%	47.12%	53.61%	
AUSTRALIA <sup>130</sup>	45%	71%	67%	68%	69% ('88)
CANADA	65.6%	66%	60%	64.3%	63% ('87)
DENMARK	N/A	45.7%	48.6%	52%	66%
FINLAND	55.9%	60.8%	60.4%	64%	N/A
FRANCE	35.5%	41.6%	44.7%	47%	51% ('84)
NORWAY	N/A	52.8%	52.6%	N/A	67%
SWEDEN	N/A	36.2%	35.2%	39% ('75)	55%
UNITED KINGDOM	N/A	41.8%	49.2%	52%	64% ('87)
UNITED STATES	55%	61.9%	62.9%	65.6%	63.8% ('88)

Source: Wood (1990) and National Institute of Urban Affairs (1989)

<sup>129</sup> Refer to urban areas only, and in the census years, i.e. 1961, 1971 and 1981.

<sup>130</sup> Figures for Australia refer to the nearest census year.

It is difficult to gauge precisely the effect of HTEs, as the trend in home-ownership rates in their absence cannot be observed. However empirical studies of the tenure choice decisions indicate that in US the removal of favourable tax provisions would lead to a fall of 4.4% in the incidence of owner-occupation<sup>131</sup>. It is also estimated that after allowing deductions for all operating costs, the long-term effect of taxing imputed income would be a 6.5% reduction in owner occupied households.

In the US, encouragement to the private sector has been eroded through tax changes. The remaining subsidies, notably through tax-exempt bonds, have been limited, and they are too shallow on their own to prompt investors to build for the group most in need, namely low-income households. The result has been a marked drop in the production of property for lower-income and even moderate income groups, either for renting or home-ownership.

It has been estimated that between 1963 and 1979, the number of home-owners in US was nearly 50 per cent more than it would have been without the financial incentives to home-ownership. In both US and UK the most powerful stimulus has been the preferential tax treatment of homeowners<sup>132</sup>.

In Britain the tax incentives to home-owners apply equally to resold and new housing and probably have more effect in raising the prices of existing housing (by increasing demand from persons wanting to avail tax incentives) than in encouraging production.

Developing countries have high rates of owner-occupation, despite low per capita income, primarily because owner-occupation is higher in rural

---

<sup>131</sup>Wood, (1990).

<sup>132</sup>Karn and Wolman, (1992) p 121.

areas, and there is less urbanization<sup>133</sup>. The urban areas have lower rates of owner-occupation. In India also, owner-occupation is higher in rural areas. Home-ownership in urban areas has been growing, but there is no empirical study linking this growth to the use of tax expenditures.

## 7.2. Urban Sprawl

A feature of the growth in home-ownership has been its development on the outskirts of metropolitan areas, and the emergence of suburbanisation and urban sprawl. Factors such as advances in transportation technology, employment change, and fall in energy costs have played a role in the decentralization process during 1960s and early 1970s. However HTEs are also a factor as there is evidence that they have aided the demand for larger single family units in the suburbs of metropolitan areas<sup>134</sup>. This has led to other fiscal problems for the government, as expansion of the urban area requires heavy public capital expenditure in infrastructure, while out-migration erodes the economic and fiscal base of the central city. This leads to higher municipal taxes in the central city, and can reinforce the suburbanisation process as households move out to avoid high taxes. As labour market location constraints are less binding on higher income households, inner city areas may have an increasing proportion of households with low incomes. These low incomes can preclude maintenance and improvement of the housing stock vacated

---

<sup>133</sup>Asher, (1989). As per World Development Report, 1992, Urban population accounted for only 38% of total population of low income countries (p.278).

<sup>134</sup>Wood (1986).

by high income groups<sup>135</sup>. Spatial concentrations of poor quality housing are symptomatic of the problem.

Indian cities have been growing, both in numbers and area. This growth in urban sprawl, appears to be more due to increase in urban population<sup>136</sup>, rather than because of HTEs.

### **7.3 Distributional Impacts and Tenure choice**

It is widely believed that the tax system favors owner-occupied housing; because the services of owner-occupied housing are untaxed while rental payments are treated as taxable income. Even though landlords are permitted tax deductions not available to homeowners, as long as there is some positive tax on rental income, owner occupied home ownership is said to be tax-favoured.

Home ownership has been favoured by the tax code in UK and home ownership and residential investment have been strong in recent years (Table 7.2). Imposition of taxes that discourage home ownership may result in substantial dead-weight losses given the presence of pre-existing distortions.<sup>137</sup>

Do tax policies favouring investment in the housing finance promote home ownership at the expense of those preferring or needing to rent, such as mobile households and the poor? There appears to be evidence suggesting this,

---

<sup>135</sup> This is true in India also, where inner city areas of cities are degenerating, and are being mainly turned to commercial uses (as warehouses or godowns) or are being occupied by low income groups. Developing countries also show higher percentages of owner-occupation in urban areas, as dwellers of the squatter colonies are not "renters".

<sup>136</sup> Urban population in India has grown fourfold in 40 years from 61.6 million in 1951 to 240 million in 1991.

<sup>137</sup> Gordon et al, (1987).



both in the vast difference in the cost of HTEs in the favour of homeowners and direct subsidy to tenants in the US, and as the figures in Table 7.2 show home ownership is rising. The distributional effects of the current system of subsidies, benefits and taxation in UK show that the value of tax advantages is low at the bottom of the income distribution, rises slowly for most of the income range, but rises sharply for the highest income groups<sup>138</sup>. This indicates that taxation policies alone will mainly affect the housing decisions of the richest.

TABLE 7.2 Households by Tenure in UK and USA

	1971*	1981*	1983*	1985*	1987*
<b>UNITED KINGDOM</b>					
Home-ownership	49.2	57.1	59.9	62.1	64.1
Public-sector rental	31.0	32.7	30.9	29.7*	28.4**
Private rental	19.8	10.1	9.2	8.3	7.5
Total rental	50.8	42.9	40.1	37.9	35.9
<b>UNITED STATES</b>					
Home-ownership	62.9	65.3	64.7	63.5	64.0
Public-sector rental	n/a	2.4	2.6	2.7	2.5
Private rental	n/a	32.3	32.7	33.8	33.5
Total rental	37.1	34.7	35.3	36.5	36.0

Source: Karn and Wolman (1992) p 43.

\*As % of total households

In US the federal tax expenditure in 1987 for housing amounted to \$55.4 billion or 1.2% of the GNP. In Britain estimated tax expenditures for housing amounted to pounds 5.1 billion or 1.8% of GNP in 1982, including slightly more than 2 billion for mortgage interest tax relief and 2.8 billion for capital gains exemption. All this goes to the owner-occupied market, whereas in US, a substantial amount goes to the private rental sector<sup>139</sup>.

Both the US and the UK employ a variety of tax incentives to stimulate

<sup>138</sup>Hills, (1991).

<sup>139</sup>Karn and Wolman, (1992) p 78.

demand in the housing sector. These devices ultimately encourage supply. They also encourage expansion of housing demand. In both countries home-owners may deduct mortgage interest costs from their taxable income, thus reducing income-tax liability by the amount of the deduction multiplied by the taxpayers' marginal tax rate. This in effect lowers the cost of home ownership to the home-owners and increases housing demand, investment and production. In Britain, since 1988, loans for improvement of the property no longer qualify for tax deduction. In the US the deduction is unlimited and applies to improvement loans and to vacation and second homes also.

In both US and UK, the preferential tax treatment given to home-owners has been criticized as an ineffective mechanism for increasing production and investment in housing. It encourages home owners to consume more housing, but as the relief applies to both existing and new housing, the additional housing consumed is not necessarily new. The ending of relief on home improvements is seen as being counter-productive, and leads to poor maintenance of existing housing. The equity and efficiency of the system are in doubt, because tax relief gives greatest financial assistance to those who would be most likely to be able to purchase without assistance and so does little to increase access to home-ownership for marginal buyers. The system leads to over-consumption of owner-occupied housing, which distorts the housing market, is wasteful of resources, and may even draw investment away from other sectors of the economy<sup>140</sup>.

Tenure-neutral tax reforms would subject owner-occupiers and private landlords to the same tax provisions relevant to the investment good status of

---

<sup>140</sup>Karn and Wolman, (1992) pp 94-95.

housing. In competitive market conditions, these changes would significantly limit allocative distortions. These reforms, if aimed at providing housing within the means of lower income groups; would increase the cost of housing for middle and higher income groups who are existing home-owners. The larger the fraction of a country's housing stock which is owner occupied, the more politically unattractive these measures become.

In India, there is no discrimination in the tax treatment of owner-occupiers and landlords, except for exemption of owner-occupied housing from wealth tax. Thus the HTEs do not affect tenure choice. Any tax incentives designed to encourage owner-occupation, should be carefully formulated to be neutral across income classes, as otherwise they will be regressive and will discriminate against low and middle income groups, thereby exacerbating their housing problems.

#### **7.4 Tax Incentives and Rental Property**

Unfavourable tax treatment, combined with rent control and security of tenancy, account for much of the vast difference between US and UK in the private rental housing supply. Between 1973-1987 the private rental stock in UK declined by more than 1.1 million units, while in the US it increased by more than 8 million units<sup>141</sup>.

Mortgage interest on rental property is deductible in Britain, but landlords pay tax on their rental income, while owner-occupiers do not pay any tax on their imputed rent. Landlords are also disadvantaged vis-à-vis other investors, as depreciation on rental property is not deductible, while on other business assets it is. This has the effect of discouraging investment in

---

<sup>141</sup> Karn and Wolman, (1992) p 95.

rental units relative to other investments.

Several tax incentives are given to the private rental sector in the USA. Mortgage interest for rental property is deductible as a business cost. "Tax syndication", a mechanism for producing lower-cost rental housing through co-operation between profit-making and non-profit making organizations, allows business partners to classify investment in real estate as a loss to offset tax liabilities resulting from other income. The biggest incentive to producers of rental housing has been the favourable treatment with regard to the depreciation of rental property for tax purposes. Limitations on depreciation allowances in 1979, caused disinvestment and a boom in the conversion of rental apartments into condominiums (group-ownership schemes)<sup>142</sup>. The effects of tax changes were again demonstrated in 1981, when the shortening to 15 years of the period over which real capital costs could be depreciated increased the attractiveness of investment housing relative to home-ownership. This resulted in the rapid expansion of capital flow into real-estate syndicates for investment in income-producing property (primarily commercial but also residential). The Tax Reform Act of 1986 reduced the tax subsidy to landlords very substantially by reducing the favourable depreciation provisions, by putting an end to tax syndication; and through the taxation of all capital gains (including residential) at the same rates as ordinary income<sup>143</sup>.

In India there are no HTEs designed specifically to encourage production of housing for the private rental sector, though the same is not discriminated

---

<sup>142</sup>Karn and Wolman, (1992) pp 97-98.

<sup>143</sup> Karn and Wolman, (1992).

fiscally vis-à-vis the owner-occupied sector. The constraints to the private rental sector are provided chiefly through the Rent Control laws, which regulate the amount of rent chargeable and also restrict the rights of the landlord in terminating the rental contract, and raising the rent. These provisions have led to serious problems in the supply of rental housing. Rents fixed at below economically viable levels<sup>144</sup> result in poor maintenance of the rental property. The perceived difficulties in getting rental premises vacated result in higher deposits being demanded. In big cities, people prefer to keep their properties vacant rather than letting them out. It is estimated that removal of rent control laws would bring such properties on the market, and aid in addressing the housing shortage<sup>145</sup>.

#### **7.4.2 Policies for Financing Private Rented Property**

Many countries have been experiencing a rise in the relative price of housing in both the owner-occupied and rental sectors<sup>146</sup>. The increasing price of housing services leads to high rent-to-income ratios, particularly for the poor. The affordability issue is perceived to be an important policy problem, and is the prime motivator of much of the intervention in private rental housing markets. A common way to deal with the affordability problem has been to enact rent controls. Although there is no evidence that controls solve the affordability problem in the private rental market of any country, there is evidence that the existence of rent controls leads to various other

---

<sup>144</sup>This is particularly evident in the inner city areas of metropolitan cities, such as Delhi, Bombay and Calcutta, where rents fixed in 1940s (at the rate of Rs. 10-20 per month) continue to be charged for prime residential property.

<sup>145</sup>India Today (1993).

<sup>146</sup>Gyourko, (1990).

interventions, many of which are economically wasteful, in order to help generate increased stock in depressed rent-controlled private rental sectors<sup>147</sup>. One such example is the British Government's Business Expansion Scheme which involves potentially huge tax expenditures to subsidize investment in private rental stock.

In addition to direct intervention via controls on rents, many countries use direct and indirect subsidies for rental housing producers and/or occupants. The indirect subsidies usually take the form of tax expenditures targetted towards the suppliers of rental housing. Most of these are difficult to justify on purely economic grounds, but they often appear to be the consequence of societal preferences to alter the distribution of resources. However, they appear to benefit the supplier of rental housing more than the tenants.

There are direct subsidies to both builders and renters. Most prominent direct subsidies tend to be in the form of rent allowance schemes to poorer renters who choose not to live in traditional public housing. This is particularly prominent in the USA which has a very small public housing sector. Many other countries have similar programs, and these direct subsidies tend to be income subsidies. The actual formulae used differ widely across countries leading to large differences in renter household coverage across countries. Direct subsidy for builders may or may not be linked to new production. The result of direct subsidy is to allow access to reasonable quality housing for poorer households.

Direct subsidy programs are linked with national budget conditions.

---

<sup>147</sup>Gyourko, (1990).

Overall direct subsidy amounts appear to vary with the degree of fiscal crisis in the country, as housing budgets are among the first to be cut when a fiscal crisis occurs. However fiscal crises do not squeeze tax expenditures so severely. Tax expenditures are the most important form of indirect subsidy to the private rental sector. The legal incidence of tax expenditures in this sector is on property owners. Laws do not allow tenants to write-off housing expenses against income solely because they are tenants. The true economic incidence of the tax expenditures is not clear.

USA has most assiduously followed the tax expenditure strategy with private rental stock owners. 1981 tax code revision allowed high levels of accelerated depreciation (15 year economic lives for rental properties) and made it easy to use paper losses to offset other income. Consequently many projects that were true losers economically were turned into large positive net present value deals. Revision of the tax code in 1986 removed most of the tax expenditures<sup>148</sup>.

There is evidence that investors did respond to the subsidies as large fluctuations occurred in the production of new multi-family units around the time of the tax code changes. However, there is no evidence that the tax expenditure programs have done anything to solve the affordability problem of poorer households. In the US, these programs appear to have led to some increased investment in middle and upper income rental housing with the subsidy benefits being split between the owners and occupants of that stock<sup>149</sup>.

---

<sup>148</sup> Gyourko, (1990).

<sup>149</sup> Gyourko, (1990).

In an attempt to attract capital into its small and weak private rental sector, UK enacted a major tax expenditure program through its Business Expansion Scheme (BES)- which allows a tax write-off to investors who buy shares in a new company that provides new private rental units. There is no taxed capital gain if there is no sale for 5 years<sup>150</sup>. There is evidence that this plan is attracting capital to the private rental sector<sup>151</sup>. There is a possibility that the new rental units will not remain in the rental sector, as the highest bidder for these properties may convert them to owner-occupied status.

The US and British tax expenditures are not typical to other countries' programs. Tax expenditures are off-budget and effectively hide the real cost of the economic distortion from the public. The truly large tax expenditures are targetted towards the owner-occupied sector, and the tax expenditures for private rental housing are dwarfed by them.

In Australia, attempts made in 1985 to restrict tax expenditures pertaining to residential rental sector had to be partly reversed in 1987. This shows that rental income alone was not enough to make investment in this sector attractive. However, Badcock et al (1991) say that the effects of the changes to taxation policy in 1985 and 1987 were amplified by other exogenous factors, such as the sharp rise in interest rates, the cyclical slowing of housing investment, and the resurgence of the stock market in October, 1987.

---

<sup>150</sup> Many BES companies have announced that they will not pay dividends for 5 years. At the end of that period (when they will not be liable for capital gains tax), they plan to sell the properties and then distribute the proceeds to shareholders. This indicates that the investment in private rental sector, is motivated by the desire to reduce tax liability, by using the tax incentives for BES companies.

<sup>151</sup> Gyourko, (1990).



These events worked in tandem with the shifts in taxation policy, so as to confirm both Treasury officials and industry lobbyists in their impression that the restricting of negative gearing and the taxing of capital gains were principally responsible for the temporary shortage of rental accommodation experienced in Sydney. As the government continues to use tax incentives as an instrument of housing policy, expansion of supply of affordable private rental accommodation is dictated by the structure of opportunity costs to the investors, rather than responding directly to needs of the tenants.

In India, residential property is generally not built exclusively for private renting. Apart from rental housing provided by employers, most low- and middle-income tenants rent a portion of housing, that is otherwise owner-occupied. HTEs directed to encourage investment in private rental sector can be useful only if the constraints placed by other policies such as rent control laws are simultaneously addressed.

#### **7.5 Housing Credit Institutions**

In Britain, governments have given building societies considerable indirect support through the tax system. For many years investors in building societies have had their interest taxed at a lower rate than income from other investments. As a consequence, more savings are channelled into housing credit institutions than would otherwise have occurred<sup>152</sup>. In 1981, banks entered the mortgage market, and were extended some of the tax advantages for depositors available to building societies.

In India, preferential tax treatment of housing credit institutions is still comparatively recent (1988) and there are no empirical studies regarding

---

<sup>152</sup> Karn and Wolman, (1992) p 100.

their effect. However, Ahluwalia (1979) has reported that the interest elasticity of private investment exceeded two, which would suggest that a tax policy aimed at altering the rate of return could be stimulative<sup>153</sup>. Similar effect can be expected from the tax incentives favouring housing credit institutions.

#### **7.6 Tax Relief on Borrowing**

In both the US and the UK, the fact that home-owners can deduct mortgage interest payments from their gross income for income-tax purposes provides a substantial public policy incentive for households to own rather than rent their house.

Lower income homeowners in both UK and USA receive very little benefit from tax relief. This is partly because tax relief applies to those owners with mortgages, and lower-income families are less likely to have mortgages, because they are more likely to be elderly people; and if young, they are more likely to have failed to qualify for a conventional mortgage both because of their incomes and the type of older property they often have to buy. Higher-income owners also receive more tax relief as they are subject to higher marginal tax rates. In Britain- the impact of tax relief has been narrowed by allowing it only on the first 30,000 pounds of any loan. In 1988, another loophole was closed by restricting the tax relief only to one loan per property.

In the United States there is no ceiling on the amount that may qualify for tax relief, owners may claim relief on more than one property at the same time, and may claim relief on real estate taxes as well. As a result, the

---

<sup>153</sup> Ebrill (1990) p149.

combined effect of mortgage interest and local real-estate tax deductions has been much more dramatically regressive in US than in Britain. Nearly all high-income families have been able to take advantage of these savings, whereas only a very small proportion of low-income families was able to do so<sup>154</sup>.

In India, tax relief on borrowing for housing investment is allowed in the form of deduction of interest. The quantum of relief is restricted and it can be set off only against income from house property. The relief is paid only for borrowings from formal financial institutions, thereby covering only a fraction of the total finance used in the housing sector. Absence of any provision for tax credit for non-tax payers also restricts the potential effect of the relief. It is also regressive as interest paid is deducted from taxable income, resulting in larger tax relief for persons paying higher marginal tax rates.

#### **7.7 Promotion of Home-ownership by Lower-income Groups**

In both Britain and US there have been periods when policies have been particularly directed at increasing home-ownership among the lower- or moderate- income groups. In the US this was between the late 1960s and the mid 1970s, and in Britain from 1979 onwards. In Britain, the Option Mortgage Scheme, originally announced in 1966, was designed to bring home-ownership within the reach of lower-income households, notably those whose income was below the basic income-tax threshold and who received no subsidy on their mortgages. Originally the subsidy involved a government contribution, directly to the lenders, of 2 per cent of the interest on the outstanding loan of anyone opting into the scheme. This was still less than the implicit rate of

---

<sup>154</sup>Karn and Wolman, (1992) p 124.

subsidy given to basic-rate taxpayers through MITR, so in 1970, the scheme was revised to allow the subsidy to vary with the tax rate, thus keeping the two subsidies roughly equivalent. With the basic tax rate of 30%, the option mortgage thus required the mortgagor to pay only 70% of his mortgage interest payments, with the government paying the remaining 30% to the lending institution. The importance of option mortgages has varied according to the relationship between the tax threshold and the level of income needed to purchase, if a large number of people with incomes below the tax threshold were able to buy, then the take-up of option mortgages was high. The advent in 1984 of "Mortgage Interest Relief at source" (MIRAS) which required mortgagors to pay only the net (post tax) mortgage payment to mortgage-lending institutions, placed all basic-rate taxpaying and non-tax paying homeowners on a similar footing with regard to subsidy, regardless of income and in effect eliminated the separate option mortgage. Until 1990, higher-rate tax payers continued to reclaim rebates over and above MIRAS, so they still received a larger subsidy. Other schemes to help low-income home-owners were for the sale of public sector properties, discounted sales of council properties under the "Right To Buy" clauses of the Housing Act 1980.

In India, there are no direct tax expenditures aimed at lower income groups for promotion of home ownership. A scheme drawn on the lines of MIRAS in UK would be useful, but will benefit only those who are able to avail credit from formal sources. As such credit is scarcely available to the poor, there is a potential danger in such a scheme resulting in more discrimination towards them. However, tax incentives are provided to businesses and corporations, for making deposits in funds used to provide housing for these groups. Also, private developers and builders have to provide a certain

percentage of the housing they construct to lower income groups, and this expense is allowed weighted deduction for tax purposes. Similar weighted deduction is also allowed to employers for providing housing to their lower income employees. The actual incidence of such schemes is not known in the absence of any empirical study.

#### **7.8 How Fiscal Preference Affects Different Income Groups**

Hills et al(1989) have described how fiscal incentives affect different income groups in Britain. Support for owner-occupation reaches the better off because it is they who tend to buy houses, and because the benefits are positively associated with income. In general, support for rental sector reaches the worse off because they tend to rent (and so receive the benefits of subsidies such as the means tested housing benefit and Housing Rent Assistance) and because rent rebates are inversely related to income. This difference in the incidence of the two types of subsidy produces an X-shaped graph, clearly showing that the current strategies provide an incentive for rich people to become owner-occupiers (though no incentive is needed). But poor people are forced to remain as tenants- there is no benefit for low income owner-occupiers. The current structure of subsidies stands in the way of the government's objective of extending owner-occupation to people with below average incomes. In comparison with the X-shape of the current system, a tenure-neutral scheme would have two identical lines, each horizontal or downward sloping<sup>155</sup>. It is important to note this potential discriminatory effect of HTEs against low-income owner-occupiers when recommending formulation of housing tax expenditures.

---

<sup>155</sup>Hills, Berthoud and Kemp, (1989) p 38.

## CHAPTER EIGHT

### CONCLUSIONS AND RECOMMENDATIONS

This chapter concludes the discussion regarding the effect of fiscal policy on housing and details specific recommendations to promote urban housing in India. The chapter starts with Section 8.1, wherein the limitations of the study are given. Section 8.2 lists the major conclusions of the study. Implications of these conclusions and recommendations for India are presented in section 8.3. Section 8.4 suggests areas for future research on this subject.

#### **8.1 Limitations of the Study**

Before presenting the conclusions of the study and making suggestions regarding fiscal policy measures that influence housing, the limitations of this study are reviewed. The study suffers from the constraints placed by the limited availability of both qualitative and quantitative data. Though there is a vast literature on the individual topics of both housing finance and fiscal policies, very little appears to have been written on how housing finance is influenced by fiscal policies. There are some readings on this subject, but they pertain mostly to the developed countries. This is surprising, as most developing countries use fiscal policy measures to attract resources for investments in certain priority areas, in a bid to bring about social and economic change. One probable reason for the lack of literature in this field in developing countries may be that direct taxes form a small percentage of national revenues. As the incidence of direct taxation touches few people, the behaviour of the majority of the population is not expected to be influenced by fiscal policy. The effects of these fiscal policies, are also difficult to evaluate in isolation, as their provisions are very

complicated<sup>156</sup>.

## 8.2 Conclusions

The efficacy of tax incentives has seldom been evaluated, despite their widespread use in developing and developed countries<sup>157</sup>. However, recently there have been many empirical studies which suggest that savings and investment are quite sensitive to tax-induced changes in the expected rate of return. Most of these studies are focused on the United States. Their main conclusion is that the aggregate level of saving is not particularly sensitive to tax-induced changes in the rate of return, although tax factors may alter the composition of financial savings<sup>158</sup>. Increasing private savings may not be the goal for tax policy in a developing country but, it may seek to increase the share of those savings that flow through organized financial markets. Although there is some evidence that investments in certain forms of financial assets may be responsive to such inducements, it is not clear that these benefits are worth the cost incurred in terms of fiscal losses, economic distortions, and diminished equity<sup>159</sup>.

Among governments of developing countries, it is a widespread practice to operate schemes which give tax concessions. Due to conceptual difficulties in measurement and the inadequacy of data available, even those countries that have made most use of fiscal incentives have rarely evaluated them. The contradiction between the developing countries' extensive use of tax

---

<sup>156</sup>Buckley et al, (1989) p 23.

<sup>157</sup>Bird and Oldman, (1990) p 131.

<sup>158</sup>Bird and Oldman, (1990), p 141.

<sup>159</sup>Bird and Oldman (1990) p142.

incentives as a major instrument for achieving government objectives and the absence of any tax expenditure analysis is striking<sup>160</sup>.

Detailed analysis and evaluation of tax expenditures has been done mainly in developed countries that prepare a tax expenditure budget, such as Canada, the UK and the USA. This is the primary reason for detailed examination of these countries' housing tax expenditures in this study. The main conclusions deduced are:-

1. Most countries intervene in the housing market to address shortages. Tax policy instruments are employed extensively to promote the housing sector.
2. Housing tax expenditures used are generally regressive in their incidence, as they directly impact only the tax payers, and benefit the rich more than the poor.
3. Empirical studies show that tax incentives encourage the growth of home-ownership, especially in the UK and the USA.
4. Housing tax expenditures are perceived to be one of the factors responsible for causing urban sprawl. It is argued that such tax policies encouraged increased consumption of housing, thereby causing people to move to sub-urban areas.
5. Housing benefits and tax incentives provided by countries such as UK and USA tend to favour high-income owner-occupiers and low-income tenants. This is primarily because tax expenditures for owner-occupiers tend to grow with income, while benefits provided to tenants taper off with increase in income.
6. Tax incentives are useful in directing savings towards formal financial institutions including housing finance institutions.

---

<sup>160</sup> Maktouf and Surrey (1990) p 204.



7. Tax reliefs for contractual saving schemes for housing encourage public participation. Similarly tax expenditures on borrowings for housing finance, encourage people to avail them.

8. Housing tax expenditures usually have only an indirect impact on low income groups.

The implications of these on urban housing in India are discussed in the next section.

### **8.3 Policy Implications and Suggestions for India**

Government intervention in the housing sector is essential to promote investment in this area. Taxation is one of the instruments through which governments intervene to direct investment towards priority sectors. Tax policies designed to stimulate housing can lead to an increase in the overall supply of housing, thereby making it accessible to larger sections of the population. It is seen that most countries recognize this, and use fiscal policy measures related to housing. Conclusions listed in the preceding section show that tax policies designed to promote housing may have certain important implications, which should be kept in mind while making any policy suggestions regarding taxation policies formulated to increase housing finance.

#### **8.3.1 Regressive incidence of Housing Tax Expenditures**

The regressive incidence of HTEs of the countries studied are not inherent in their structure. The regressiveness is due to the way these tax expenditures have been designed and implemented. This problem associated with HTEs can be addressed through their redesign as has been done to some extent in MIRAS in UK. The real danger with tax expenditures is that, as they are not generally subject to open and thorough public scrutiny, it is easy for such

regressiveness to creep in and go unnoticed by the public.

If housing tax expenditures favourably impact the richer members of the society<sup>161</sup>, then the crucial question is how should such policies be used for a developing country like India, where per capita income is very low and a sizable section of the population lives below the poverty line. As the population of tax-payers in India is very limited, the effect of fiscal policy measures directed at them, is restricted in scope and magnitude. A housing tax expenditure system designed on the lines similar to the HTEs used in USA or UK which explicitly favors rich owner-occupiers would not be suitable for India, as it would exacerbate the housing problems of the poor. A system like Indonesia, where all tax allowances, including those favouring housing, have been abolished, will also not suit India, as then there will be no additional incentive for anyone to invest in housing. Even the negative impact on owner-occupied housing, will fall partly on the tenants, as most owner-occupiers rent a portion of their dwelling. The current system of HTEs in India does not discriminate between the owner-occupiers and the tenants. The potential regressive effects of HTEs have also been reduced, by placing limits on the deductions available, and by providing tax credits at the basic tax rate.

### **8.3.2 Housing Tax Expenditures encourage Home-ownership**

This effect of HTEs is also not inherent, but is due to the fact that HTEs have been explicitly designed to encourage home-ownership. This design reflects the political policy of the countries studied, where home-ownership

---

<sup>161</sup>This is what the experience of the countries studied shows. This regressivity of HTEs is not inherent, but is a result of the way in which they are formulated. However, academically it is possible to design and administer progressive HTEs for the benefit of the poorer sections of the society. The continued use of regressive HTEs, is a commentary on the political and social setup, that allow such instruments to exist, that favour the rich at the cost of the poor.

has been promoted because it has been considered politically desirable and acceptable to do so. Similar promotion of the cause of landlords who supply private rental housing, may not be accepted equally as a valid political aim as it would be seen as promoting the interest of the landlord, not the tenant. To promote the cause of the tenant, HTEs designed in the form of deduction or allowance of rent paid, could be used. The fact that none of the countries studied use such a tax expenditure, shows that these countries consider home-ownership desirable. However, in some countries, such as Canada and UK, direct subsidy based on the amount of rent paid is given to low-income groups. This direct subsidy is an open hand-out, which is subject to being restricted in times of fiscal crises. It is not to say that tax expenditures are permanent, but as Hulchanski and Drover (1987) have shown subsidies are more susceptible to be pruned in times of fiscal restraint.

In India, taxation policies treat both owner-occupiers and landlords in a similar manner, and so do not encourage one at the expense of the other. This manner of treatment is useful, as there is comparatively little private housing built expressly for the purpose of renting only. Private rental housing is generally in the form of partly let out owner-occupied housing. If private landlords are allowed to deduct allowances similar to business income from house property income, then that would result in more housing being built for renting. However to assist the tenant, there is need for tax allowances based on the rent paid by them. To ensure that such tax policies are progressive, they should be subject to a ceiling limit and should be allowed at the basic tax rate. However, such a policy would not help the poorer tenants, who do not pay any taxes, and in the long-term may even affect them adversely, as the tax paying tenants would be ready to pay higher rents,

thereby causing inflationary trends in rents. It is difficult to promote a progressive private rental housing policy in India, through tax policy measures only.

#### **8.3.3 Housing Tax Expenditures cause Urban Sprawl**

Tax expenditures have been shown to cause urban sprawl in OECD countries. However, in India there is no evidence to this effect. Theoretically HTES designed to encourage housing, would lead to an increase in demand for housing, and will cause urban sprawl. It is essential to be aware of this potential effect, and take measures to address it, as urban sprawl in India would result in expensive and difficult to afford infrastructure costs.

#### **8.3.4 Housing Tax Expenditures and Mobilization of Savings**

Lack of financial resources is a crucial constraint to housing activity for most individuals in India. At the same time the rate of savings at the household level is significant. There is considerable scope for capturing the potential savings, including that of the informal sector, through contractual savings schemes linked to guaranteed loans and access to shelter. Tax incentives designed specifically to stimulate provision of loans by the HFIs to low income groups would be particularly useful, as the informal finance sources that these groups depend on are more expensive than formal finance. Similarly tax concessions for deposits with HFIs that provide long-term finance for housing will also encourage the growth of finance available for housing.

Provident and pension funds should be allowed to invest in company deposits/bonds of housing finance institutions (HFIs). This would help the cash-strapped industry in mobilizing resources from the household sector. Considering the importance of housing finance in urban growth, it is necessary

that HFIs get incentives similar to those enjoyed by the Unit Trust Of India<sup>162</sup>. HFIs should also be exempted from interest tax as the borrowers of housing loans are generally in the low and middle income groups, and this will lower their cost of borrowing. In addition to granting exemption to assesseees from capital gains tax on purchase/construction of a residential house, the option of investing the capital gains in approved bonds/deposits schemes of HFIs should also be given. Since HFIs give long-term loans and are thus at greater risk, they should be allowed to claim deduction for bad debts from their taxable income.

Mandatory housing finance programs have been operating in countries like France, Brazil and Mexico. Such schemes are established legislatively and require a proportion of salaries/ wages to be allocated by the employer and employees, for contribution to the housing fund<sup>163</sup>. An attractive feature of the mandatory contribution system is a flexibility of choice of alternatives in the disposal of funds. Similar programs may be adopted in India by introducing enforcement measures for the large/medium sized commercial firms and industrial undertakings.

The success of a financial system will be dependent on the cost of intermediation that would be reflected by the rate of interest at which a financial institution can lend. This cost will be determined by factors such as the cost of savings, management expenses, bad debt provision and after-tax profit. Government may provide indirect subsidies such as tax advantages to the finance institutions for the savings received by the mobilization of idle

---

<sup>162</sup>Interest on deposits with UTI are subject to an additional allowance of Rs. 3000.

<sup>163</sup>Urban India, (July-December, 1990).

funds of household sector, which would otherwise be kept in non-financial asset forms. Tax advantages to HFIs may only be applied to certain lending programs that provide that a significant proportion of these subsidies will go to the targeted low income groups.

#### **8.3.5 HTEs do not directly impact low-income-groups**

One characteristic inherent in housing tax expenditures is that their direct effect is limited to tax-payers only, and the non-taxpayers, who generally belong to lower income groups<sup>164</sup> are not directly affected by them. However, by increasing the total amount of housing activity, HTEs have indirect impacts in the form of generation of manufacturing activity and employment opportunities for mainly unskilled and semi-skilled labour. This results in increase in income of these groups, and thereby enhances their chances of securing better housing. Increasing housing activity would also make more housing available to them by the process of "filtering". HTEs can also result in provision of more housing for the lower income groups through tax incentives given to employers to provide housing for their employees, especially those in lower income brackets.

It is often advocated that housing for the poor should be provided at subsidized prices, but subsidies limit the extent to which public services can contribute to increase in housing supply, especially for the poor. If users have to pay for the cost of the service according to quality, they will choose the level of quality commensurate with their ability and willingness to pay; and the public agencies will have an incentive to provide services at

---

<sup>164</sup>This is not always true in India, as incomes of agriculturists and certain other groups are exempt, even though they may earn large incomes. However in large urban areas, such exemptions rarely apply.

standards reflecting people's willingness to pay. Where subsidies are widely applied, this incentive is generally absent at the level of the household and the public agency. However, subsidized supply of housing should be limited only to the poorest sections and care taken to ensure that it is selectively and properly administered. Planning for low-income housing should ensure that after initial government grants or loans for housing, a revolving fund for repairs, improvement and maintenance of housing is developed.

Some other implications of housing tax expenditures are discussed in the following sub-sections.

#### **8.3.6 Do HTEs Divert Resources from Other Sectors?**

Will the use of fiscal policy instruments to attract investment to the housing finance sector result in the deprivation of other areas of the economy? Savings mobilization with the aim of housing investment would not necessarily mean reduction of deposits in other financial institutions or instruments, but rather a shift from informal sector financial relations to formal institutional relations. The results of research carried out in India show that a contractual savings scheme by which people save a certain sum of money over a period of years in return for an entitlement to a mortgage loan can increase the share of assets held by participants in financial forms<sup>165</sup>. Participants have not simply shifted financial assets among different instruments, but have reallocated their savings in favour of financial assets that would be available for investment anywhere in the economy during the saving period. Thus, channelling of household savings through financial institutions can contribute to the strengthening of the financial market in

---

<sup>165</sup>Bickicioglou, (1992). Such savings schemes would also increase the total volume of saving, by reducing wasteful expenditure and conspicuous consumption.

the country as a whole.

#### **8.3.7 Rationalization of Tax Policies**

Fiscal incentives provided under the laws relating to taxation of income, wealth, gifts etc. need to be rationalized to channel savings into HFIs and to promote investment in housing activity. For those not eligible for such incentives, alternative incentive schemes, need to be designed. Provision of concessions in taxes and duties on transfers, conveyances, leases and mortgages between developers or approved financial institutions and the first home-owners will be useful in encouraging the property to be registered at its actual value, besides reducing the financial burden on buyers from the lower- and middle-income groups.

Fiscal and municipal tax policy should be simultaneously applied by the state and local governments in order to curb speculation in vacant land and to release such land for housing and urban development. The proceeds of such a tax should go towards a shelter fund. A penalizing levy on vacant land would bring most of the really excess land into use or circulation<sup>166</sup>.

A partial solution for the housing shortage lies in recognizing the construction business as an industry. Lending agencies offer better terms and interest rates to businesses with industry status. Industries are also eligible for several tax concessions, such as reduced rates of income tax.

A problem with the Indian housing market is that it operates partly in the underground economy. Very few properties for resale are advertised, and those that are listed do not show the price at which the property is offered for sale. This is primarily due to the fact that a significant proportion of

---

<sup>166</sup>D'souza (1992).



the price is paid (and accepted) in black money- that is undeclared income. Government's attempts to counter such use and proliferation of black money, through acquisition of ostensibly undersold properties, is made largely ineffective by procedural and legal delays. If more fiscal incentives are given for investment in residential property, then people may be encouraged to reveal the true cost of the property, thereby reducing the influence of the underground economy. In the present situation, when the housing market operates significantly in the underground economy, fiscal incentives will not benefit the persons who are investing their unreported income in housing. As the use of black money becomes more and more costly (through higher fiscal incentives) it may become less prevalent in the housing sector, resulting in the formalisation of this sector. Reduction of flow of black money in the property sector, may eventually lead to a reduction in house prices.

#### **8.3.8 Designing of Efficient Housing Tax Expenditures**

There is a general consensus that an efficient tax system is one with a broad base, with simple rules to permit effective enforcement, and moderate marginal rates. The increased use of tax expenditures to meet the needs of preferential social policies can make it more difficult to maintain a broad consensus on what constitutes a fair tax system. Nevertheless tax expenditures, especially housing tax expenditures, remain a useful tool in the hands of governments to achieve social policies.

Gillis has listed three rules for incentive-oriented tax designers<sup>167</sup> in developing countries. The first rule, is to keep it simple. Complex provisions and attempts to "fine-tune" the economy are not suitable in the circumstances

---

<sup>167</sup> As quoted in Bird and Oldman (1990) p131-132.

of developing countries. Tax incentives in such countries should therefore be few, simple and preferably be limited in duration, both to increase their impact on investment timing and to comply with the third rule stated later. The second rule, is to keep good records on who gets incentives, for how long and at what estimated cost of revenue forgone. In the absence of such information, there is little chance that incentives will play any useful role in development policy. Finally, tax incentives should always be subject to "sunset" provisions, requiring them to be explicitly evaluated in quantitative terms periodically, and if not found worthwhile, terminated. It is probably best to keep only simple incentives in the tax law and to charge the tax administration explicitly with the task of maintaining the required records. To quote Bird and Oldman (1990)

"The path of wisdom for most developing countries is to avoid extensive and detailed attempts to deflect private investment into preselected channels, often with no follow-up to see what really happens and with no set procedures for ensuring that the infants so expensively fostered grow up to be full taxpaying citizens."<sup>168</sup>

Broadening of tax base contributes to redistribution, because excluded income is largely received by high income families. Studies of the impact of the budget on income distribution, in countries as diverse as the US, Colombia, Malaysia and Chile strongly indicate that if the budget is to serve redistributive purposes effectively, the primary emphasis must be placed upon the expenditure, not the tax side of the budget<sup>169</sup>. Payroll taxes and tax incentives for investment, by definition do not impinge directly on the

---

<sup>168</sup>Bird and Oldman (1990) p 132.

<sup>169</sup>Gillis, (1990) p 81.

incomes of the poorest 40% of the population in most developing countries<sup>170</sup>.

The idea that taxes are desirable corrective devices in those cases where government intervention is warranted has been popular among economists at least since Pigou in the 1930s. The conflict between the tax expenditure view that direct expenditure programs are the desirable means of government intervention, and the welfare economist's view that taxes are the preferred instrument for government to alter the allocation of resources, has not yet been addressed<sup>171</sup>.

#### **8.4 Recommendations for Further Study**

This thesis has reviewed the ways in which fiscal policies impact housing and housing finance. Even though tax incentives are widely used, the jury is still out on the question of their efficacy. This is not surprising as the notion that tax incentives are in effect tax expenditures and thus should be evaluated in equivalence with direct subsidy programs, is comparatively new, being expounded by Stanley Surrey in 1973<sup>172</sup>. While evaluation of tax expenditures as an economic tool is difficult as their effect cannot be determined in the absence of any "control situation", their effectiveness as a social and political policy is even more difficult to analyze. These problems are compounded in a country like India, where public policy is formulated in an overall interventionist framework and tax laws are complicated.

There is considerable scope for further research in the ways tax expenditures influence investment in certain sectors. Very little empirical

---

<sup>170</sup>Bird and Miller, (1990) p 427.

<sup>171</sup>Bruce, (1990) p 23.

<sup>172</sup> Surrey, (1973).

research has been done in developing countries, including India, regarding the ways in which tax incentives, such as housing tax expenditures influence investment decisions. The Indian Income Tax Act contains a large number of tax incentives, allowances and credits to promote a variety of activities. There are frequent alterations, deletions and additions in these tax expenditures, but no study has been done regarding either their cost in terms of taxes foregone, or whether they have succeeded in achieving their purpose. When these concessions are introduced, they are generally welcomed by the sector they favour, but there are also demands to extend their coverage, in terms of time and amount of concession. Any attempt to delete or curtail them is met with vociferous opposition. However, there are no studies to show how these tax expenditures fared in achieving their objectives. The need for such a study is immense, as only then can fiscal policies be successfully formulated to attain what they were designed for.

In view of the present and predicted shortages of urban housing, it is essential to explore ways to increase the amount of housing finance available. However, the problem of urban housing shortage in India is very large and complex, and any attempt to solve it through an instrument such as housing tax expenditures, that by definition directly impacts only the tax payers (only 10% of the urban population), is likely to have only a limited success. Nevertheless tax policy is a useful instrument to address housing shortage, as it impacts persons who have the money to invest. It would be useful to examine tax incentives designed to encourage investment in a fund that can be used for providing housing finance to low-income residents in urban areas. Such a fund could be given special tax incentives, similar to the Unit Trust of India, and the amount of finance so mobilized can be used for providing credit to persons

in the low-income groups for housing. Such a scheme would substantially increase the funds available for low-income housing. It would also be useful to formulate tax incentives for mobilizing deposits towards finance of housing built through cooperative group housing schemes.

One of the main constraints for housing in urban areas is the shortage of land. Paradoxically in urban areas in India, large tracts of land lie vacant, despite the acute shortage of land and housing. This is partly due to the laws imposing a ceiling on urban holdings. The land recognized as excess under this law is generally not available for development, due to litigation pending in courts against acquisition of such land. Land, and housing property are also held vacant for investment purposes, as land and property prices escalate at a rate faster than inflation. There is a need to devise ways in which such vacant land and property is brought onto the market to eventually increase the supply of housing. This can be in the form of vacant land tax as is levied by Taiwan. This will increase the opportunity cost of keeping these properties vacant, and may result in their being offered for rent or sale. The proceeds of the tax can be used to provide finance for housing low-income groups. The increase in land supply should result in a fall in land prices, thereby making it more affordable.

Another reason for the limited supply of serviced land in big cities of India, is the fact that only a few government agencies are allowed to develop such land (for example in Delhi, only the Delhi Development Authority can develop and supply large tracts of land; private developers are not given land). This restricts the amount of land that comes onto the market and thus increases the cost, exacerbating the housing shortage. Allowing private developers to develop land, and construct housing would increase the total

amount of housing. Competition among developers may result in lower prices and increase in quality of housing. To provide low-income housing these developers may be required to supply a percentage of their production for these groups at subsidized prices.

A combined empirical research from the perspective of both urban planners and tax policy makers would be particularly useful in addressing the problem of housing finance shortage. This research would provide a significant insight into the designing of fiscal policy measures to successfully increase availability of finance for urban housing in India.

## BIBLIOGRAPHY

- Acharya, S. (1988) "India's Fiscal Policy" in Lucas, R. E. B. & G. Papanek (eds.) "The Indian Economy: Recent Developments and Future Prospects" Westview Press, Boulder. pp 287-318.
- Asher, M. G. (ed.) (1989) "Fiscal Systems and Practices in ASEAN: Trends, Impact and Evaluation" Institute of Southeast Asian Studies, Singapore.
- Badcock, B. & M. Browett (1991) "The Responsiveness of the Private Rental Sector in Australia to Changes in Commonwealth Taxation Policy". HOUSING STUDIES vol. 6 no. 3, pp 182-192.
- Bickicioglu, H. N. (1992) "Access of the Low Income Households to Better Housing Conditions Through Regulations in the Housing Finance System" in "Housing Finance for Sustainable Development" Fannie Mae, Washington D.C.
- Bird, R. M. (1992) "Tax Policy and Economic Development" Johns Hopkins University Press, Baltimore, USA.
- Bird, R. M. & B. D. Miller (1990) "Taxes, User charges, and the Urban Poor" in Bird and Oldman (1990) pp 426-435.
- Bird, R. M. & O. Oldman (eds.) (1990) "Taxation in Developing Countries" The Johns Hopkins University Press, Baltimore, USA.
- Boleat, M. (1986) "Innovations in Housing Finance Instruments and Institutions" in Wood (1986) pp 83-98.
- Boskin, M. J. & C. E. McLure (ed.) (1988) "World Tax Reform: Case studies of Developed and Developing Countries" ICS Press, California.
- Bruce, N. (1990) "Pathways to Tax Expenditures: A Survey of Conceptual Issues and Controversies" Working Paper no. 90-1. Tax Policy and Legislation Branch; Department of Finance, Canada.
- Buckley, R.; C. R. Dunham; J. C. Walker and T. Persaud (1989) "Private Housing Finance for Low-income Households in India: Final Analysis of the Housing Guaranty (HG-002) Project with the Housing Development Finance Corporation" The Urban Institute; The World Bank.
- Chen L. (1988) "Urban Housing Policy and Housing Commercialisation in Socialist Countries: China and Hungary" Masters Thesis, Planning, UBC.
- Crook T. & P. Kemp (1993) "Reviving the Private Sector?" in MacLennan and Gibb 1993, pp 67-85.
- Dowler R. (1983) "Housing Related Tax Expenditures: an Overview and an Evaluation". University of Toronto, Centre for Urban and Community Studies, Major Report 22, Toronto.

- D'Souza J.B. (1992) "Urban Rules and Regulations: Myth and Reality" *The Hindu Survey of The Environment*. p54-55.
- Dunkerley H.B. (1983) "Urban Land Policy: Issues and Opportunities" *The World Bank, Oxford University Press, USA*.
- Ebrill L.P. (1990) "Taxation, Savings and Investment in Developing Countries" in Bird & Oldman (1990) pp 143-150.
- Feldstein, M. (ed.) (1987) "The Effects of Taxation On Capital Accumulation" *The University of Chicago Press*.
- Gillis M. et al (1987) "Economics of Development", 2nd edition, New York: W.W. Norton; New York. (as quoted in Bird and Oldman(eds.) (1990))
- Gillis M. (1990) "Micro and macroeconomics of tax reform: Indonesia" in Bird and Oldman (eds.) p 76-95.
- Goh L. E. (1988) "Planning that Works: Housing Policy and Economic Development in Singapore" Journal of Planning Education and Research vol. 7, no. 3, pp 147-162.
- Gordon, R.H.; J. R. Hines, Jr., & L. H. Summers (1987) "Notes on Tax Treatments of Structures"; in Feldstein M.(ed.) "The Effects of Taxation on Capital Accumulation"; National Bureau of Economic Research, The University of Chicago Press.
- Government of India (1992) "Economic Survey, 1991-92", Ministry of Finance, New Delhi.
- Government of India (1992a) "National Housing Policy" Ministry of Urban Development, New Delhi.
- Government of India (1993) "Economic Survey, 1992-93", Ministry of Finance, New Delhi.
- Gyourko, J.(1990) "Controlling and Assisting Private Rented Housing" in MacLennan and Williams.
- Harris, R. (1991) Housing; p 350-379 (Statistics Canada, 1989 Family expenditure in Canada 1986 (Ottawa: Minister of Supply and Services, Table 1)).
- Hamnett, C. & P. Williams (1993) "Housing Inheritance in Britain: Its Scale, Value, Incidence and Uses" in MacLennan and Gibb, pp 137-161.
- Hills, J. (1991) "Unravelling Housing Finance: Subsidies, Benefits and Taxation" Clarendon Press, Oxford.
- Hills, J.; R. Berthoud & P. Kemp (1989) "The Future of Housing Allowances" Policy Studies Institute; London.



Hoffman, M.; B. Haupt & R. J. Struyk (1991) "International Housing Markets: What We Know; What we need to Know" The Urban Institute; Fannie Mae Working Paper.

Hulchanski D.J. & Drover (1987) "Housing subsidies in a period of restraint: the Canadian experience." in "Housing Markets and Policies under Fiscal Austerity" edited by Willem van Vliet. Greenwood press. p51-70.

India Today August 1993, New Delhi.

Indian Income Tax Act (1992) Ministry of Finance, Government of India, New Delhi.

Karn, V. & H. Wolman (1992) "Comparing Housing Systems: Housing Performance and Housing Policy In The United States and Britain" Clarendon Press, Oxford.

Khatkhate, D. (1991) "National Economic Policies in India" in Salvatore D. (ed.). "National Economic Policies" vol. 1 North Holland. pp 231-275.

Lall V. D. (1985) "Institutional Development and Fiscal Policy" in K. S. R. N. Sarma (ed.) "Financing Urban Development in India" Centre for Urban Studies, Indian Institute of Public Administration, New Delhi.

Lea, M. J. & M. S. Johnson (1984) "House Prices and Local Government Activity" in Research in Urban Economics vol 4 "The Changing Economic and Fiscal Structure". Jai Press inc. Greenwich, Connecticut; pp 257-272.

Linn J.F. (1983) "Cities in the Developing World", The World Bank, Oxford University Press, New York.

Lithwick H. N. (1985) "The Decline and Fall of Housing Market" in A. M. Muslove (ed.) "How Ottawa Spends" (ed.) Methuen, Toronto, p 30-57.

MacLennan D. & R. Williams (eds.) (1990) "Housing Subsidies and the Market: an International Perspective" Joseph Rowntree foundation Housing Finance Series

MacLennan D. & K. Gibb (1993) "Housing Finance and Subsidies in Britain" Avebury, Aldershot, England.

Maktouf, L. & S.S. Surrey (1990) "Tax expenditure analysis in Less Developed Countries". in Bird And Oldman (1990) pp203-209.

Merrett S. (1989) "The Taxation of Housing Consumption" Housing Studies vol.1; no. 4; pp220-227.

Mohan, R. (1982) "Problems and Prospects for Shelter Finance in Urban India: Some Policy Issues" Nagarlok, Vol. XIV no. 2, pp 1-10.

National Institute of Urban Affairs (1987) "The Nature and dimension of Urban Fiscal crisis" New Delhi.

National Institute of Urban Affairs (1989) "Urban Poverty: A Status Paper".

New Delhi.

National Institute of Urban Affairs (1989a) "Rental Housing in India: An Overview" New Delhi.

National Institute of Urban Affairs (1992) "The Informal Finance for Urban Housing: Status and Prospects". New Delhi

Peterson, W. C. (1991) "Transfer Spending, Taxes, and The American Welfare State". Kluwer Academic Publishers; Boston.

Pugh, C. (1990) "Housing Finance, the Economy and Housing welfare in Housing and Urbanization: A Study of India" Sage Publications, New Delhi.

Rao, P.S.N. (1991) "Housing Finance: The HLA Advantage". Urban India July-December 1991. National Institute of Urban Affairs. New Delhi. p72-79.

Ribiero, E.F.N. (1985) "An Overview of Urban Land Policies and Land Use Control Measures in India" in Kwok, R. Y. & K. S. Pun; "Planning in Asia: Present and Future" University of Hong Kong.

Shen, Q. (1986) "Low Income Public Housing in Hong Kong and Singapore 1950-1980: A Comparative Analysis" M.A. Thesis; UBC.

Shukla, V. (1988) "Urban Development and Regional Policy in India: An Econometric Analysis" Himalaya Publishing House, Bombay.

Sivasankaram E. (1991) in The Economic Times 15 September 1991.

Sivashanmugam, M. (1987) "Household Savings as a Potential Source in Housing Finance Intermediation" Urban India, vol. VII, no. 2 July-Dec. 1987. (pp 71-88) National Institute of Urban Affairs, New Delhi.

Smith, Lawrence B. (1981) "Housing Assistance: A re-evaluation", Canadian Public Policy, vol. vii no. 3, pp454-463.

Surrey, S. S. (1973) "Pathways to Tax Reform" Cambridge, Massachusetts: Harvard University Press.

Surrey, S. S. & P. R. McDaniel (1985) "Tax Expenditures" Harvard University Press; Cambridge, Massachusetts.

Tanzi, V. (1990) "Fiscal Policy for Growth and Stability in Developing Countries: Selected Issues" in "Government Financial Management: Issues and Country Studies" Edited by A. Premchand; IMF. p.p. 15-27.

The Economic Times, 10th Feb. 1994, New Delhi.

The Economic Times, 11th Feb. 1994, New Delhi.

The Planning Commission (1992) "Report of the Working Group on Finance for Housing Sector for Eighth Plan (1992-97)" New Delhi.

The Urban Institute (1989) "India's Urban Challenge" Washington D.C.

United Nations (1978) "Non-conventional Financing of Housing For Low-income Households", New York.

Urban India, (July- December 1990) "Review of Draft Housing Policy" National Institute of Urban Affairs, New Delhi.

UNDP (1992) "The Human Development Report 1992" Oxford University Press, New York.

Whitehead, C.M.E. (1983) "The Rationale for Government Intervention" in Dunkerly H.B. (ed.) p.p. 108-131.

Willis J.R.M. & P.J.W. Hardwick (1978) "Tax Expenditures in the United Kingdom" Heineman Educational Books, London.

Willis, K. G. & S.J. Cameron (1993) "Costs and Benefits of Housing in The Newcastle Area: A Comparison of Alternative Subsidy Definitions Across Tenure Sectors and Income Distributions" p51-64. in MacLennan and Gibb, 1993.

Wood G. A. (ed.) (1986) "Tax Policies and Urban Housing Markets". OECD Urban Affairs Programme, Paris.

Wood G. A. (1990) "The Tax Treatment of Housing: Economic Issues and Reform Measures". in MacLennan and Williams, p43-75.

World Bank (1992) "World Development Report 1992" Oxford University Press, New York.