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# Social Safety Nets, the Informal Economy and Housing Poverty – Experiences in Transitional Countries

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› **Abstract\_** *The social and economic conflicts that emerged during the transition periods of Central and Eastern European (CEE) countries forced governments to introduce changes to welfare systems. As the old soviet-type social safety net collapsed, new measures were needed to manage the challenges of transition. The question thus arises: what kind of welfare regimes have transitional countries moved towards, and is there a new model that combines elements of modern European welfare regimes with the 'socialist tradition'? There is no agreement among researchers as to whether it is possible to draw general conclusions on the development of welfare systems in transitional countries; the problem remains that reforms in the public sector (education, health care etc.) are unfinished, that institutions in different welfare sectors follow different principles even within one country, and that there is a big gap between rhetoric and the actual implementation of programmes. Most of the research is non-conclusive and there are too many inconsistencies in the different policy areas to allow the identification of a single welfare regime category. In this paper, housing policy in CEE countries is explored. The research approach is based on the 'soft structuralist' method, combining structural elements and a 'rational choice' (policy or agency choice) approach – a kind of contextualized rational choice theory. It is used in this paper to explain the nature and scale of emerging housing poverty. The paper is based on the analysis of changes in the Hungarian housing system, but examples from other regions are also used to support the arguments.*

› **Key Words\_** *East-European Housing Model; Housing Affordability and Poverty; Welfare Systems*

## **The Legacy of the East-European Housing Model: Different Theoretical Approaches to Transition**

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The main characteristics of the East-European Housing Model (EEHM) were the one-party political control of the housing market, the subordinate role of market mechanisms, the lack of market competition among housing agencies (due to bureaucratic coordination), and the broad control held over the allocation of housing services. The state, operating under the dominance of the communist party, was in economic/military competition with the western world, and the socialist ideology (commitment to egalitarian allocation and the elimination of private/market mechanisms) was an important element of its policies. However, within this model several sub-models or versions emerged; these were the responses of individual countries to particular challenges in the development of the socialist economy. While the main characteristics of the model could be interpreted as structuralist in approach, divergences were understood theoretically as 'policy options' taken by individual states. However, a conflict emerged in the course of socialist industrialization and urbanization that led to a critical juncture in the institutional development of the model. These structural conflicts (or 'cracks') were managed in various ways. Bulgaria, Russia and East Germany introduced strict control mechanisms, while Yugoslavia and Hungary permitted the quasi-market processes. Differences were explained partly by exogenous factors, such as the organizational development of the party and the state, and economic and social policy, and partly by the endogenous development of the housing institutions.

The EEHM had a common core model (a centrally planned economy and a politically determined power structure) that was implemented in the national context through legislation, tenure forms, regulations and so on. In Hungary, for example, the rental law that was developed during the Second World War was used with minor variations even in the 1950s, while in Germany there was no need to nationalize the urban housing stock as the legal framework allowed public use of privately owned stock. 'Path dependency', the legacy of the pre-communist system, and other 'accidental factors' had an effect on decisions related to the EEHM at critical junctures, but this explanation of how post-transitional housing markets developed is based on a variant of the rational choice theory, according to which agents choose from a limited number of options that are determined by structural constraints or political power.

The basic logic of the EEHM became moot after the transition. Following the political changes of 1989/1990, the economies of countries in the region went into deep recession. Despite differences in the economic strategies of different countries, from 'shock therapy' to soft reform, there was widespread price liberali-

zation and privatization of state companies, which led to the creation of a new economic/political system where capitalist interests (small and large, national and international) were strongly represented.

The introduction of the multi-party political system, radical privatization and fast decentralization were clear signs of the transition from the 'planned' to the 'market' society. Two approaches have dominated the research on housing policy changes in transition countries. The first is a normative approach based on the enabling housing policy of the World Bank (World Bank, 1993), which aimed to identify and describe well-defined legal institutions (property rights, building regulations, flexible planning structure etc.) and market institutions (finance systems for housing, property management etc.), and to introduce well-targeted social programmes (see, for example, Pichler-Milanovich, 2001; Tsenkova, 2009). However, this approach did not take into consideration the fact that, although the hegemony of the communist party had been replaced by a multi-party political system based on a democratic election system, due to the lack of democratic traditions, there was a high risk of demagoguery, or of political forces resorting to the playing of populist and nationalist 'cards' – the danger of a kind of 'south-Americanization'. Policies related to the welfare sectors (housing, education, health care, pension systems etc.), being rooted in socialist norms and ideas (that have little to do with the reality of 'existing socialism' in the past), have always been easy targets of demagogic attacks.

The second common approach to research is the Anglo-Saxon tenure-oriented approach, which classifies housing systems according to basic tenure type. In this system, (Lux, 2001) there are 'fast privatizers' (Hungary, Slovenia, Estonia etc.) and 'slow privatizers' (Poland, Latvia and the Czech Republic), with one strong outlier: Bulgaria – a country that had low levels of public housing even at the beginning of transition. The case of Bulgaria highlights the limitations of the tenure-oriented approach; the typology does not help in understanding how Bulgaria went through the transition or how affordability problems were managed by social housing policy there. Besides this, privatization has not, in fact, stopped; it is predicted that 75% of stock in the Czech Republic will be sold, 80% will be privatized in Latvia, and privatization also continues to take place in Russia.

This paper offers a third approach which focuses on institutional changes conditioned by the behaviour of different actors (households, municipalities, political groups, etc.) in the process of coping with the conflicts of the transition.

## Transitional Recession and Poverty

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As a consequence of the economic recession described, the living standards in CEE countries dropped sharply and did not start to recover until the beginning of the twenty-first century. Unemployment (an unknown phenomenon in the socialist period) had become one of the most difficult social and economic problems. During the 1990s, poverty became one of the most significant social issues in Eastern Europe and the former Soviet Union, as income inequality increased substantially, though with great variability (Mitra and Yemtsov, 2006). Generally, while the average income decreased, income inequalities increased dramatically in the first part of the 1990s, and have remained stable since around 2000. For example, in Hungary the ratio of average income in the lowest percentile to that in the highest percentile increased from 4.6 in 1987 to 7.6 in 2004. The economic recession associated with transition increased spatial inequalities in the region as well. In Hungary the net income per capita is 50% higher in the most developed region than in the two least developed regions. A rapid shift in demographic trends took place in most of the transitional countries, which saw decreases in their populations. The populations of most CEE countries (except Albania) are expected to continue to decline, as fertility rates are lower than the reproduction level and the proportion of older people is therefore increasing more quickly. In transition countries, the ageing of society is taking place at a much lower level of economic development than in the western world. Even in developed countries, ageing puts an extra burden on fiscal policies in the welfare sector (pension systems, health systems etc.), creating political tensions around public finance issues. Transition economies face much larger problems as they are not only poorer than developed countries, but their populations are shrinking and economic growth is further being slowed by the out-migration of young, educated workers.

The growth of the informal economy was a typical reaction to transitional conflicts, though there are no reliable and commonly accepted indicators for its real size. According to Glovackas (2007) in the EU the average size of informal economies is 9%, in the new EU member states it is 20%, and in the Commonwealth of Independent States (CIS), 48%. In Hungary the informal economy was estimated to be as large as 25-33% of GDP between 1990 and 1997 (Laczkó, 2000), and informal transactions are widely accepted today by consumers (Semjén et al., 2008). The existence of the informal economy affects the efficiency of welfare programmes for two reasons: first, tax revenues provide limited resources for welfare programmes while tax rates are very high and second, social security programmes are very poorly targeted due to the lack of income information available on those in need of welfare. The economic recovery and social/political transition of post-socialist countries varied a great deal. The new EU member states experienced a faster economic recovery and less social polarization than low-income CIS

countries. The dividing line between the accession countries and the other new countries of the former Soviet Union is also apparent in the various housing systems of these countries.

## Transformation of Housing Systems

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Privatization and restitution had an important effect on the housing systems in transitional countries. Privatization was a typical response to the social conflicts generated by the transition process (a 'shock absorber' (Struyk, 1996)), and the social rental sector has basically disappeared from most transitional countries. It is not clear whether the exceptions (e.g. Czech Republic, Poland and Russia) represent another model, or if it is only that privatization in those countries has been at a slower pace. Privatization had a regressive social effect. Low-income households became trapped in the social rental sector as they were unable to buy their homes even at the discounted price offered by the housing privatisation packages. The social rental sector has thus become a small and residual sector, in which society's most vulnerable groups are concentrated. The sector is changing in terms of tenure rights, rent regulation and allocation rules, but, for political reasons, these changes do not seem to be achieving full impact in terms of moving towards a transparent and sustainable system. As a consequence of restitution (for example in Czech Republic, Slovenia and Poland, but not in Hungary) a new private rental sector has emerged, which has become an arena of conflict between those private tenants who remained sitting tenants in restituted homes (with private landlords now instead of the state), and private landlords. In most countries (new) property owners were relatively successful in increasing rent and putting the cost of housing on tenants and the government (by means of rent subsidy).

The state-dominated housing finance system collapsed in 1990 and it took 10-15 years for market-based mortgage finance to develop. The new, privatized banking system started lending after 2000 and grew very quickly, indicating that new EU member states are starting to catch up with the more developed European countries. The mortgage finance system has grown in importance across the region since 2000, and the ratio of outstanding mortgages to GDP has increased substantially. In some countries (Estonia, Latvia and, to a lesser extent, Lithuania) the development of mortgage finance was influenced by a speculative demand fuelled by the increase in house prices; in other countries, the growth of the market was fast but seemed more balanced (e.g. Czech Republic, Hungary, Poland, Slovakia and Slovenia); while in still others, the market has only really started to develop in the last 4 years (Romania and Bulgaria) (Hegedus and Struyk, 2006).

In most of the region, foreign currency loans – particularly in Euro and Swiss Francs – have proven popular, including in Croatia, Poland, Romania and, after 2005, Hungary. The interest rates of loans issued in foreign currency were lower than those offered in national currencies, but the individual household had to accept the risks involved in exchange and interest rates; the related affordability issues only started to become obvious with the 2008/9 recession, for example in Hungary. As a result of these processes, household debt has increased very quickly in the region since the beginning of 2000, but even the most developed transitional countries are a long way behind EU countries; the average ratio of outstanding loans to GDP is 7% in CEE countries, while in the EU zone it is 38%. House prices began to increase, especially in capital cities, and globalization and speculation (fuelled by the newly emerged mortgage markets) led to a housing price bubble in some countries in the region.

In almost every country in the region, the need for social housing that arose following mass privatization and economic recovery was recognised in politics, and in housing policy. There were several programmes aimed at increasing the social rental sector, but none seems to have led to any real breakthrough in this area; a frequently quoted example of where good progress has been made is the social building associations in Poland, called and usually referred to as TBS („towarzystwo budownictwa społecznego”) – a society for social housing involving special housing companies and local governments. A number of other programmes in the Czech Republic, Slovakia, Romania, Hungary and Serbia have produced results that, while interesting, are sometimes questionable. Extension of the social housing sector has typically been nominal, and more importantly, the social and financial sustainability of the new social housing stock is very weak. The operation of the sector has required huge subsidies to bridge the difference between market rent and ‘social’ rent: extensive tenure rights remain in place; allocation principles have not always been transparent; the requirement of a down-payment as a pre-condition to entering the sector indirectly affected the selection of possible tenants in a regressive way; and a number of negative issues have emerged, such as the non-payment of housing costs, the deterioration of property and so on.

Countries within the region developed their own, specific institutional structures for housing, including different government agencies, non-profit institutions and private sector organizations such as banks, developers and construction companies. However, programmes and networks founded on the notion of cooperation between different agencies have not been stabilized, which is why it is very difficult to make generalizations about the new housing regimes. Certain important developments have come about, however, in the ‘governance of housing’: institutional models for social housing, housing funds at national level, different models of housing allowances, and programmes for the renewal of high-rise housing estates.

## **Housing Affordability and Housing Poverty – Institutional Changes and Household Coping Strategies in Hungary**

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Since the transition and as a result of price liberalization, housing related costs have increased much more than household incomes. Because of the privatization and residualization of public rental housing, rent in the social rental sector makes up only a negligible share of these costs at macro level, while a greater part of the increase is due to rising energy and utility prices (water services, garbage collection and district heating, and in multi-unit buildings: maintenance and management fees). One of the principle causes of social tension in the 20-year post-transition period has been increasing poverty, which is strongly linked with affordability issues in terms of housing costs. Increasing housing costs put a huge burden on households, both in the owner-occupied sector and in the shrinking public sector. As a consequence, a relatively high percentage of households are facing the problem of arrears because they cannot afford water charges, district heating, electricity, communal services and – in the public rental sector – the rent. In Hungary 14-18% of households have serious difficulty in paying their housing related bills, which means that a growing number is in arrears. Energy related services represent the biggest share of household costs; in 2007, they constituted almost 70% of housing-related expenditure (Hegedüs et al., 2010). As a result, energy poverty has become a general phenomenon in post-socialist countries (Buzar, 2007). The problem is aggravated in privatized multi-unit buildings by the fact that the burden of unpaid utility bills has to be shared amongst the owners.

Different levels of affordability are not determined exclusively by income disparities, but also by the behaviour of different actors in specific sectors including local governments, service providers and interest representation bodies. Service providers with a monopoly, for example, may only be interested in maximizing revenue, precluding an interest in solutions to cut back turnover or consumption unless expenses will still be covered. These service providers usually ensure that losses are in-built in their tariffs and do not consider arrears as a serious problem as long as their tariffs/prices are accepted by consumers and the (central or local) government. However, the central government, local governments and interest representation bodies can force service providers to change their income-maximizing attitude into a more cooperative one. There are several good examples to illustrate this phenomenon such as the installation of individual water meters in the early 1990s, and the installation of individual sub-meters for district heating. Cooperation and conflict between actors in specific sectors have led to the adoption of several different models and solutions; this is reflected in the differing tariffs and price-setting mechanisms that have developed and that cannot be fully explained by disparities in income or technology. Because of their financial and technical resources, service providers are usually in a better interest representation position

than the state, and central/local control of housing tariff increases is therefore not very efficient. However, as the owners of service providers or as tax levy authorities, central and local governments do have an interest in increasing housing service fees, since these fees equate to indirect taxes.

The affordability problem can be handled in two ways: by increasing household incomes or by decreasing household expenditure. Typically, the deficit of low-income households could not be compensated through the scarce central and local resources in post-socialist countries, and households were therefore forced to increase their income through the informal economy, releasing housing equity or using remittances. Household strategies could include several elements at the same time, such as applying for additional income benefits using other programmes (e.g. childcare benefit or a medical grant), taking on informal jobs, getting help from family, or the migration of several family members. Those unwilling or unable to take up these options experienced an accumulation of debt. The general reluctance of social policy makers to introduce means tested social assistance has meant an increasingly wide gap not only between formal but also informal income and expenditure. In addition, the lack of trust between different sectors and actors has resulted in a totally incoherent system of housing allowances. The magnitude of the informal economy is partly the reason for, but also partly the consequence of under-financing. The welfare system would be far more efficient if social benefits were means tested as otherwise those in relatively good financial positions in the informal economy are eligible for the same benefits as those who are in genuine need. On the other hand, those who drop out of the labour market have no choice but to enter the informal market in order to sustain an acceptable standard of living. The lack of transparency in the system inevitably leads to conflict between households and the administering authorities. However, from an objective perspective, this must be considered a weakness or failure of the entire system, rather than something wholly attributable either to the local authorities or to the families concerned.

Thus, despite the efforts made through different income benefit programmes (including housing allowance programmes) that were introduced in most countries to help low-income households, benefit programmes could not bridge the increasing gap between housing costs and income, as a consequence of which the number of households that had difficulty paying housing costs increased. The inefficiency of housing allowance programmes are in part related to the fact that governments set the eligibility income ceiling too low, so that there is no guarantee that the housing costs of households struggling to survive will be paid. Moreover, in-depth analysis of supplemental housing-related benefits proves that it is very fragmented; central government, local governments and non-profit foundations sometimes cooperate and sometimes compete with each other, but mostly they



simply ignore each other's programmes. In this chaotic system, characterized by its lack of information and perspicuity, the families concerned can easily become lost and even more defenceless.

One possible consequence for households with accumulated arrears is having to move to a less valuable home and to use the equity to pay back the utility companies, or – as is more and more common – the utility companies start foreclosure procedures. This type of 'downward mobility' was not common in these countries prior to transition, but it is now the typical outcome for households that have not been able to adjust household consumption to within their budgetary constraints. In Hungary, there is a specific type of crime that is closely related to the affordability issue; households with high utility debts (that usually also have other social problems) are cheated by the so-called 'real estate mafia', which offers an inhabitable home (typically in a dead-end village or the slum area of a city) in exchange for the indebted apartment; between 2001 and 2003 more than 400 such cases were registered, though this is only a small portion of the total number of indebted households and it is, in any case, merely the tip of the iceberg, as downward mobility continues to contribute to the 'slumification' of remote villages and certain urban areas (though other factors also contribute to this process). In such villages, there is little chance to enter the labour market and the education and health systems, or to access other welfare benefits. From a social perspective, a much more efficient option would therefore be to decrease energy costs. Although several programmes were initiated in the 2000s, the system of supplemental income benefits did not motivate households sufficiently to rationalize their energy consumption.

In general the effect of different welfare programmes depends on household adjustment strategies to macroeconomic and macro-sociological circumstances. Individual household strategies are influenced not merely by characteristics of the household – including its position in the labour market, its social network and social capital – but also by the various institutional and organizational mechanisms available to it.

The social consequence of the affordability problem with regard to housing access was the increasing role of intergenerational transfers – transfers of family savings and inheritance. This is the only explanation for how the housing market could exist with such a high P/I (price-to-income) ratio and low housing affordability index. Sociological surveys provide evidence that in housing finance, intergenerational transfers play an important role; in Hungary, for example, 50% of households that had recently bought a house or apartment received help from family to do so (Hegedüs-Somogyi, 2005).

Housing market processes also contribute to the exclusion of disadvantaged social groups, not only the Roma but other low-income groups as well. This is the point at which the two types of affordability problems connect with each other;

the social exclusion created by housing market agents (local government, banks, developers, and so on) increases the effect of market exclusion. For example, in some cases, local governments offered cash grants to Roma people in order for them to move from the city to more rural, remote areas. In other cases, developers have used subsidy programmes to build new but very poor quality houses in segregated areas in villages.

### **Conclusion: Towards a New Welfare Regime?**

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This overview of housing affordability shows that the housing sector contributes to the social inequality created by the labour market and the education system, both through market processes and institutional mechanisms, or through a combination of its legal framework and the discrimination perpetuated by housing market agents. Further research is needed to understand the behaviour of different actors in the housing system with regard to the welfare system, as well as the social mechanisms which lead to the strengthening or weakening of inequality and conflicts among different groups in society. The biggest challenge for the makers of housing policy in transitional countries is to provide institutional assistance to those social groups who have become vulnerable due to structural changes in the economy, including the privatization of housing and the commoditization of public services.

In CEE countries, the main trend in housing systems seems to be a move towards a housing and welfare regime in which the state's public housing plays less and less of a role. In the new, post-transition environment of unemployment, informal economies and so on, social institutions did not have the capacity or resources to operate an efficient safety net, and could provide help only to the neediest families: those with very low incomes and those in crisis situations. This appears close to a combination of the liberal and 'rudimental' welfare regimes as described by Barlow and Duncan (1994), but the institutional structure of the welfare regime is still in the process of change and such a categorization may thus be premature.

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