



The Subsidy and Housing

Author(s): Charles Abrams

Source: *The Journal of Land & Public Utility Economics*, Vol. 22, No. 2 (May, 1946), pp. 131-139

Published by: [University of Wisconsin Press](#)

Stable URL: <http://www.jstor.org/stable/3159026>

Accessed: 27/09/2011 20:06

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at <http://www.jstor.org/page/info/about/policies/terms.jsp>

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.



University of Wisconsin Press is collaborating with JSTOR to digitize, preserve and extend access to *The Journal of Land & Public Utility Economics*.

<http://www.jstor.org>

The Subsidy and Housing

By CHARLES ABRAMS*

THE subsidy is only a single aspect of housing policy; yet the form it ultimately takes will influence more than the housing program alone. In all its long history, both here and abroad, the subsidy has never been more significant than it is currently. It involves more than monetary outlay. The kind of economy in which we are to live may be influenced by the policy we devise for its dispensation.

The developments around the housing subsidy have taken place without benefit of maxim or definition. Each innovation creates its own precedent, forging another outward link to its further extension. Formulation of principles on the subsidy was never more crucial than it is today.

The Subsidy Defined

In the broad sense, a subsidy is any kind of grant or aid extended to an undertaking to which the public interest is imputed. The term has latterly been broken down into classifications embracing those subsidies which promote private operations in trade, industry, commerce, and agriculture and "grants in aid" made to assist other governmental units in their fulfillment of public purposes. A large number of government subsidies were prompted by economic or military considerations, such as the need to stimulate infant industries or to promote self-sufficiency in war. To-

day, however, a growing proportion of subsidies is used to advance infant social services. The government in recent years has committed itself to strengthening the nation's health and welfare, to encouraging employment, to reducing the hazards of insecurity. All of these social subsidies rest upon the proposition that government should intercede when private enterprise or private philanthropy proves unable or unwilling to meet the need.

Criteria For Subsidies

The principles governing use of subsidies have never been explored with the thoroughness devoted to some aspects of public finance such as taxation. Recent uses and abuses of the subsidy mechanism call for fresh examination of principles and their practical application to the changed American scene. As a background for discussion of the subsidy in relation to housing, five general criteria for subsidies are put forth here. Exceptions may be found but they should not affect their validity as general criteria.

A. The Subsidy Should Serve a Public Purpose. Opening the public purse and public privilege to private companies offers unlimited opportunity for abuse and even corruption. From the Yazoo land frauds of 1789-1795 down to the Elk Hills oil leases, the evils have been recurrent and obvious. The history of the United States is spotted with infamy rooted in the dispensation of public property to private interests on the pretext of public benefit.

Enlargement of the federal welfare power has opened almost boundless op-

*Lecturer, New School for Social Research, New York City; author, *Revolution in Land*. The principles and examples outlined in this article are not intended by the author as a complete exposition of the subsidy in housing. They are meant to incorporate some of the salient questions involved and are culled from a forthcoming book by the writer to be published in June 1946 by Harper & Bros.

opportunities for misuse. To prevent perversion of public funds, the states that always had the welfare power surrounded themselves with many checks—constitutional inhibitions, limitations upon their cities' expenditures, taxpayers' remedies, and supervision by courts. Many of these self-imposed limitations followed in the wake of local scandals. These limitations are absent on the federal plane. The problem is made doubly difficult by ambiguity and variability in the definition of public benefit at the national level.

In the housing field particularly, a public benefit can be attributed to almost every appropriation. It is to the general good that more people buy homes, that these homes not be foreclosed, that home-building be more active. Therefore, an ample supply of building funds seems beneficial to the public welfare. Government insurance of lending institutions as well as the small creditors who deposit the funds with them would tend to increase the supply of building funds. Housing shortages spell inflation and public inconvenience. Therefore, subventions to the builder seem authorized as well as yield insurance to lending institutions, and liberal credit aid to enable building of more homes. Slums are a menace to health. Therefore, authorization is claimed for urban redevelopment by private enterprise. The list can be drawn out endlessly and in each case an argument made that the public welfare is served.

More than ever, a greater responsibility for determining whether a subsidy is in the public interest now rests upon the electorate. Public vigilance and ability to distinguish public service from opportunism are more important than ever.

Subsidies to improve health and safety should occupy a prime place in the definition of public welfare. Here profit to private agencies should not be the primary end of the subsidy but should exist only as a by-product in the performance of the main aim, in the same way as contractors would benefit from the building of a school.

B. The Administration of the Subsidized Operation Should Be Public or Be Publicly Controlled. Usually no private agency should get a subsidy for any public purpose if it can be administered by a public agency. It cannot, of course, be said summarily that subsidies should go only to public agencies, for there are fields in which private companies, given some public aid, might function more beneficially. The subsidies to encourage the aviation industry are a current example. A condition in most cases should be continuing regulation by the government. Sometimes rigid regulation may be dispensed with, as where a slum site is bought by public enterprise, cleared, and then resold through public bidding to private enterprise for private development. Here, use zoning or covenants running with the land might properly be used to protect the future public interest.

Sometimes rigid regulation is not practical, as when industries are induced to settle in a community—a subsidy of dubious wisdom—or when homesteads or eleemosynary activities are encouraged by tax exemption. Here, if the subsidy be granted, the aim should be to make the opportunity available by general law and to a broad general group rather than by special arrangement, or to a specially selected few, or worse still, to a single company.

C. The Subsidy Should Be Defined

and Certain. Hidden or devious subsidies are often preferred to minimize complaints from taxpayers. Examples are loans at low interest or none, favorable tax policies, free city services or facilities, and insurance predicated upon presumably sound but untested actuarial schemes. The word "insurance" has a soft tonal quality since it presupposes no cost at all to the taxpayers—until the actuarial formula breaks down.

It seems obvious, too, that the terms of subsidies should be fully known to both the taxpayer and the recipient, so that the public may weigh the benefits or the subsidy against the costs, and the recipient may base his commitments on the sum-certain subsidy payment.

D. The Subsidy Should Burden the Taxpayer as Little as Possible. No argument against excessive subsidies is needed. But there is often confusion over the question of when a subsidy is excessive. The capital grant for housing is an example. The issue over the capital grant became heated when the Wagner-Steagall Bill, which subsequently became the United States Housing Act, was being formulated. Instead of annual subsidies for a period of sixty years, an outright capital grant was advocated by the then Secretary of the Treasury, Henry Morgenthau. Great Britain, Holland and Norway had abandoned lump-sum payments. There is no reason why sixty years of deficits should be fused into one and paid off in a single year. We do not do this for education or other governmental commitments. The annual grant is more practical from the budgetary standpoint, too, since the subsidy can be adjusted upward in hard times when tenants pay less, downward in good times when tenants pay higher rents, as during the second world war.

On the other hand, the capital grant tempts the recipient to build more expensively and affords no opportunity for adjustment to the variations of the economic curve.

Another example of excessive subsidies is the exemption of building funds from income tax proposed by the National Association of Real Estate Boards. This would exempt wealthy investors from taxes on the income placed in bonds for land acquisition and housing construction. A housing unit costing \$2,000 for land and \$40,000 for building and receiving \$131.00 in annual federal contributions under the United States Housing Act, would entail, under the tax-abatement plan, a capital grant equivalent to \$4,800, if the investor were in the 80% tax bracket.¹

Sometimes the subsidy and the method of paying for it create more nuisance than is justified by the benefit. An instance is the local housing subsidy of New York City, raised through an occupancy tax of \$1. per \$1,000 of rent paid on all gainfully occupied premises (minimum of \$1, maximum \$6). In 1943-1944, the tax yielded \$456,000 and had to be paid by 350,000 people, though it could rehouse less than 3500 families. To make that microscopic nick in the housing problem, every business in New York has to fill out an elaborate form each year and remit an average of \$1.30. Taxes like this make subsidies unpopular without accomplishing anything substantial.

E. The Subsidy Should Be One That Can Be Practically Administered. Excessive supervision is one factor that may increase the costs of the improvement or service and neutralize the value

¹ See Address by Sen. Allen J. Ellender before the National Public Housing Conference, published in *Public Housing*, April 1944.

of the subsidy. Here, a distinction must be drawn between public and private recipient agencies. Local public agencies administering a subsidized program should have the greatest measure of administrative freedom consistent with carrying out the purpose practically. They should not be looked upon as dependents on the federal bounty but as auspicious instrumentalities for carrying out state and national purposes effectively.

On the other hand, private companies carrying out public purposes require rigid regulation. For such regulation the public too often pays an excessive price. Either few honorable companies agree to the restraints imposed or there is evasion and reaping of secret benefits. For this reason, the performance of public functions by public agencies is indicated.

Examples of subsidies not practically administered are the FHA limited-dividend formula, which in the effort to limit return on speculative building operations produced few bona fide applicants, and the PWA subsidy for public housing where much of the subsidy was cancelled out by over-rigid federal over-seeing.

The Subsidy and State Governments

Only one state, New York, has joined with the federal and local governments in a subsidy for public housing yet, as a long-range welfare program, housing should have state support. Either the current, federal-city formula should be revised to provide tri-partite participation, or the states should launch independent programs. More favorable federal treatment of localities aided by states would be an effective inducement.

Some governors have voiced demands for restoration of states' rights which

they feel have been injured by the federal government's social programs. Though New York State's limited contribution could not possibly solve the slum problem without federal aid, Thomas E. Dewey of New York, in his first gubernatorial campaign of 1938, said the federal slum clearance program was an "invasion of the business of the states" and that it meant "increasing concentration of power in Washington." The general emphasis on states' rights was again in evidence when Republican governors of states that contributed no state aid to housing opposed federal aid.²

Rights cannot be separated from responsibilities. The state officials who suggest that federal welfare programs be scuttled because they encroach upon the state's domain have a first duty, it would seem, to prove their readiness to take up the burdens carried by the federal government. The legislatures of forty states made it possible for local housing authorities to exist and to receive federal aid. Having approved the federal program and set up the agencies, the states must either continue to let federal money cross their borders, substitute state cash, or repeal the laws. In any case, federal participation in housing does not usurp any of the powers reserved to the states.

The Cash Subsidies

The cash subsidy, as noted earlier, is the most honest and respectable type but is apt to be the least popular politically. In times of stress, welfare activities supported by such a subsidy make an easy target for economy marksmen who specialize in cancelling out welfare appropriations. Too often, the taxpayer's feel-

² But in his later addresses Governor Dewey seemed to veer toward a greater federal recognition of its welfare responsibilities including slum clearance.

ing for his fellowmen is lost in the seams of his purse. Hence, we find that municipal governments eschew any cash grants to their local housing authorities, taking the alternative of tax exemption which, on the surface, seems less costly because nothing is paid out.

Lending of Superior Credit

Lending of superior public credit is a variety of subsidy despite a prevalent illusion that a government loses nothing in the transaction. The element of risk is generally present and often undeterminable. There is no certainty, for example, that FHA insurance reserves will be enough to cover the losses, particularly since its whole experience so far is based upon a rising real estate market and a shortage in homes. A substantial increase in the public debt, or extensive use of the federal credit, may ultimately affect the marketability and interest rate of federal bonds. In any event, monetary loss should not be the true test of subsidy. Responsible endorsement of a note can create substantial income for the maker from the funds borrowed. The endorser may never be called upon to make good but he still makes a contribution of substance. One's credit is as much an asset as one's cash and the use of either for another's benefit brings it within the subsidy classification whether or not anything is lost in the transaction.

Use of superior credit is effected through guarantee or insurance by the government of mortgages or yields, or by federal borrowing and re-lending of the borrowed funds at its cost to the government. This form of subsidy has stirred the imagination of private real estate groups, particularly since it costs the government nothing on paper. They are urging that speculative builders be given government loans and subsidies

under the same terms as extended to local housing authorities, on the claim that private enterprise could then build for the low-income group. The cases where social motivations and private profit will go hand in hand are rare, the dangers of abuse too patent to be ventured. The rigid regulation that would be necessary to guard against such abuse would reduce the quantity of honorable applicants to a trickle.

Interest Subsidies

An *interest subsidy* may take several forms. It may be represented by a subsidy payment equivalent to the interest or by a loan of principal with the interest waived.

Interest subsidies when made to public agencies for public purposes are in a different category from those made to private companies, particularly where the public borrower is carrying out a common public purpose. Under the United States Housing Act, the government lends to local housing authorities at $\frac{1}{2}$ of 1% above the going federal rate when it should be made at the cost of the money. RFC refused to lend to authorities at less than the rate it charged private borrowers, then over 4%. The federal government should not profit here, though it might properly pass on part of the administrative cost of borrowing. There is a marked difference between loans of money to private individuals at higher than government cost, as in RFC private loans, and loans to public agencies for performance of common public purposes. In the latter, the recipient is as much in the category of an agent or co-operator in the public welfare as it is a borrower, and the superior government should not seek to effect a profit.

Land as a Subsidy

Land grants are a common and useful form of subsidy. The federal government still owns 24% of continental United States, but little of this land is suitable for housing projects. State-owned lands are likewise of little use.

Cities own both unusable and usable land. Property acquired for non-payment of taxes usually consists of undesirable land on the outskirts, or of isolated plots in the central areas. Lands used for municipal purposes, such as parks and playgrounds are well located but such areas should not be diminished in the planning of housing projects though the projects can often be advantageously laid out around a park; playgrounds have been relocated and expanded as a result of soundly planned housing developments.

City streets represent the principal type of land that can be used, especially in congested areas where streets were laid out on the gridiron plan. Considerable land has been wasted in the laying out of these streets and less street area may be needed today in a properly designed project. A substantial part of street land can be used for buildings and open spaces, at the same time effecting a smaller land coverage and a more livably-designed undertaking. In many metropolitan projects, for example, thirty per cent or more of the project site consists of old streets, a great deal of which can be better utilized by relocation.

While the conveyance of streets for public housing is a desirable subsidy, where the streets remain in public hands, donation to private interests (as in the Stuyvesant Town project in New York City) should be discouraged.

Instead of giving tax exemption as a

subsidy to private interests, cities might undertake to assemble privately-owned land and sell it at or below acquisition cost to private developers for higher rent developments. The distinction between these two kinds of aid is important because of recent agitation for large-scale assemblage in blighted areas for post-war private building. The key to understanding is that in spite of the high cost of slum areas, the land cost is not the dominant investment. It should be clearly understood that, generally, the high land cost in slum areas bears a small ratio to the tax revenues that the city would gain through the construction of private projects. The new buildings might be worth two or four times as much as the land, depending upon the coverage deemed desirable. Taxed on that basis, they would frequently provide handsome repayment for the city's "loss" in the land sale.

To illustrate, suppose that a city buys land in a slum area at market price and resells, through public bidding, for private development at a price near its use value. The city would suffer a temporary loss in the difference between the buying and selling price, but it would count continuing dollar gains out of new taxes after the project was built. There would be no subsidy at all. Here the city acts as a frugal proprietor while carrying out its public functions. It would be good business judgment to encourage as much new taxpaying private construction as possible.

*Leasing or Sale of Projects
to Public Agencies*

This type of subsidy has been used by federal agencies in the past and may be employed again. Both PWA and the Farm Security Administration built and leased dwellings on terms that consti-

tuted a subsidy. PWA projects were government-built, then leased to local housing authorities for a rental that would enable the authorities to accommodate low-income families. Homes built by the Farm Security Administration were rented at prices the tenants could afford.

The principal objection to the leasing plan in public housing is that it may check local initiative and eliminate the possibility of local private financing which is more feasible when the property is owned in fee.

A good subsidy by sale of public property might be made if the government's war housing projects were sold to local housing authorities. It would be a useful and worthy subsidy and a justifiable shift in the use of public property from the public-wartime-federal to a public-peacetime-local-federal use.

Subsidies Based on Project Cost

The great bulk of public housing in the United States was built under the United States Housing Act, which prescribes a serial subsidy equal to the going federal interest rate plus one per cent of the development cost of the project.

The advantage of this plan is the flexibility which permits adjustment to varying local costs and conditions and changing national conditions. Since the subsidy is based upon development cost rather than upon the number of persons rehoused or the number of dwellings built, slum clearance with its higher costs is not discouraged.

The central government does not automatically pay out the maximum sub-

sidy to the local housing authorities. It pays only the sum required to bridge the gap between rental income and total carrying costs. The maximum annual contributions have never been reached. For project fiscal years ending in 1941 the contributions actually paid averaged 88.2% of the maximum permitted for these projects. Because of rent increases due to increasing income of tenants, the percentage of maximum paid each year has declined steadily until for project fiscal years ending 1945 only 51.2% of the maximum was actually paid. As families whose incomes have increased above the limit for continued occupancy are moved out of projects and as lower-income families move in, it is expected that annual contributions will again increase.

The subsidy based on development cost may sometimes encourage purchase of expensive land, since local political considerations favor the demolition of slums and construction by the housing authorities on slum sites. Another objection to this subsidy is that the public finds it hard to understand, a condition which has been capitalized upon by the opponents of public housing. An innovation in American fiscal practices, the workings of the formula are still muddled in many Congressional minds.³ Laymen can more easily grasp the fact that a federal subsidy amounts to \$100 annually for each family rehoused, but a subsidy based solely upon so much per family rehoused has objections to it too, as the English learned after the Chamberlain formula of 1923.⁴

There are few formulae which are objection-free. Most depend for their successful operation upon sound administration. While the subsidy based on

³ The subsidy is often exaggerated by multiplying the annual contribution by the number of years it is to be given, a calculation which assumes that given conditions will persist unchanged for 60 years. See Congressional Record, No. 84:3452.

⁴ Rise in costs, differential costs in various communities, and changes in the interest rates would complicate the working of the formula.

project cost may not be all-perfect, it has functioned reasonably well and despite these few objections ought to be continued for the present. Wider publication of the cost per family of the subsidy and the more liberal dissemination of information generally on the program would help keep the public apprized of the cost.

Rent-Certificate Subsidies

Subsidies paid directly to the tenant are advocated by real estate groups. Among the many objections to this plan, one is that it would make the tenant a permanent recipient of public charity. There is a vast spiritual difference between paying the required rent on a government-owned building and being on a permanent dole. In any case, this so-called rent certificate plan or slum dole (advocated in November 1943 by the National Association of Real Estate Boards) would operate to perpetuate the slums, not remove them. Since every landlord would seek to benefit from as much of the payment as possible, he would make little if any expenditure. Administration would be difficult if not impossible for each building would require separate and continuing inspection. During the depression in the 1930s, New York City's emergency relief bureau spent \$30,000,000 annually for rent—a sum which, if paid annually, would have been sufficient to subsidize modern, low-rent housing for more than half of the city's slum dwellers. Yet, not a single family got a decent home. If standards were raised adequately, the landlords would not have complied and the tenants would not have gotten homes. The dumbbell flats that were thirty per cent empty simply filled up with the undoubling of families encouraged by rent re-

lief and slum values zoomed. The plan would produce no new housing for slum dwellers and would extend the life of the old ones.

Tax Exemption as a Subsidy

There is a distinction between tax exemption granted for private housing and that granted for public low-rent housing. This must be grasped, particularly because of the indiscriminate tendency to extend huge tax exemption grants to urban redevelopment companies and other private operations.

The realty tax revenues on which a city depends for its support are not constant. As some real property depreciates and its valuation shrinks, other revenues from new construction take their place. If the city depended solely upon existing properties, declining values resulting from their physical depreciation would soon wipe out a major part of its revenues. Its future solvency is therefore hinged to the existing, as well as to the potential revenues resulting from replacements or other new construction.

When, therefore, exemption is extended to private development for a higher income tenantry, the city is deprived of the potential revenues which would have accrued to it when private enterprise in the normal course of events got around to providing dwellings for that group. Exemption of a project housing those whom private enterprise could provide for, either through new or acceptable used housing, is a gift of public moneys for a private purpose.

When, however, the city exempts low-rent public housing projects from tax on the improvements (charging only the old levy existing prior to the building of the new project), it loses no potential revenues since the low-income families are

not prospective customers for the potential private enterprise market. Therefore, such exemptions on public housing, while technically they may be subsidies, represent no out-of-pocket loss. The tax exemption on such projects represents a dollar loss only to the extent that payments in lieu of taxes run less than the taxes paid on the site prior to its reconstruction and here it must be matched against the social and economic gains resulting from rehousing.