# 1 Reducing housing inequity: What can governments do?

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Housing affordability and quality are pressing policy concerns in most OECD countries. Rising house prices have worsened housing inequality, with low-income households facing major housing affordability and quality gaps. Subnational governments play critical roles in housing policy through responsibilities like social housing provision, land use regulation and property taxation. There has been a trend towards greater decentralisation of housing functions, and well-designed policy reforms by national and local governments can promote more affordable, equitable housing markets. However, trade-offs exist between objectives like efficiency, sustainability and inclusiveness. Key to effective housing policy is aligning national and local approaches to address housing challenges comprehensively. Thoughtful policy design and coordination of national and subnational policies are essential to balance competing goals and facilitate inclusive, responsive housing markets.

The authors are Senior Advisor to the OECD Network on Fiscal Relations across Levels of Government, Consultant to the Network and Chair of the Network, respectively. This introductory chapter is based on the large volume of work done in the context of the OECD Horizontal Project on Housing. Two volumes (*Brick by Brick*, Volumes 1 and 2) have summarised this work. Apart from these two volumes, the OECD Housing Policy Toolkit also includes a Housing Dashboard and Country Snapshots that allow comparing indicators of outcomes and policy settings across countries.

## 1.1. The housing equity challenge

OECD governments, whether local, regional or national, pursue multiple housing policy objectives, such as promoting or providing good-quality, affordable shelter or reducing the carbon footprint of housing. However, less than half of the OECD population reports that it is satisfied with the availability of good, affordable housing (OECD, 2021[1]). Affordability is a pressing challenge and central objective of housing policy in many OECD countries. Housing-related equity concerns are also the focus of this book.

As house prices have increased rapidly in most countries over the last decades, housing is, on average, the largest spending item in household budgets and its share has grown over time. Housing has become less affordable for many households in the OECD area, pushing the issue to the forefront of the policy debate. Many low-income households spend over 40% of their income on housing and are more likely to live in lower-quality dwellings. Affordability gaps are particularly severe among low-income households, renters in the private market and youth. Housing affordability also tends to be more challenging in job-rich urban areas relative to rural areas, with some countries recording large differences in house prices across cities and regions. For example, house prices have risen twice as much in inner London compared to the rest of the United Kingdom since 1995; similarly, over the same period, house prices in the Los Angeles metropolitan area increased twice as fast as those in the Chicago metropolitan area. More recently, with work-from-home becoming more prevalent after the pandemic, gains have been concentrated on the peripheries of major cities, a trend analysed in Chapter 2. Ahrend et al. (Chapter 2) show that this trend shift of housing demand was more pronounced in certain cities that had larger house price disparities, more green space access at the periphery and better high-speed internet availability.

Many low-income households face both housing affordability and quality gaps. Low-income households are also more likely to live in poor-quality dwellings. They may not be able to afford regular maintenance or improvements to their dwellings, while at the same time facing barriers to move to better-quality housing. In nearly all countries, households in the bottom quintile have a higher rate of overcrowding than those in the middle or top-income quintiles.

Affordable housing shortages can contribute to homelessness, which, before the COVID-19 pandemic, had increased in a third of OECD countries over recent years (2023[2]). Rising housing costs are among the many factors that lead to homelessness, which before the COVID-19 crisis affected at least 1.9 million people in the OECD. Official statistics are likely to underestimate the extent of homelessness.

Rising house prices mean that many households are missing out on the benefits of owning a home. Developments in housing markets have repercussions for household consumption and the macroeconomy via wealth effects. Rising house prices also have implications for wealth inequality. Indeed, housing is an essential part of wealth as it is the single and biggest asset for a majority of households. Changes in house prices translate into changes in household wealth and this can in turn redistribute wealth between different types of households such as renters and homeowners. Given the importance of housing and mortgage debt in household balance sheets, especially for the middle class, housing contributes to equalising the net wealth distribution. This is because housing is more equally distributed than other assets, such as financial assets, which are concentrated at the top of the income distribution (OECD, 2022[3]).

These issues raise the question of what is the best level of government to apply a property tax, which is usually a local tax. The unusual case of Korea's progressive national property tax is explored by Kim in Chapter 4. According to Kim, Korea implemented a progressive property tax system as early as 1973, a response to the rapid increase in land values that outpaced income (GDP) growth during the economic boom of the late 1960s and early 1970s. The progressivity of property taxes was further strengthened during periods of significant land value appreciation, ultimately leading to the introduction of a highly progressive national property tax in 2005. Kim argues that while a high ratio of land value to GDP justifies the implementation of progressive national property taxation to a certain extent, such taxation should be kept at a modest level due to its limitations as a tool for wealth taxation or housing price stabilisation.

**Box 1.1. Key messages: finding good solutions for housing equity across levels of government**

1. *Aligning national and local policies is essential for effective housing equity*

   National policies aim to address housing inequality, but local policies and implementation shape how they play out in practice. Coordination of national and local policies is key for a comprehensive approach.

2. *Subnational governments play a key role in helping to ensure housing affordability and quality*

   Government responsibilities like land use regulation and property taxes significantly influence housing outcomes. Well-designed policies at the subnational level can improve affordability and access.

3. *Reforms in social housing provision, land use regulations and property taxation can promote affordable, equitable housing*

   These reform areas shape housing supply, demand and costs. Well-designed policies can enhance affordability and access for lower-income households.

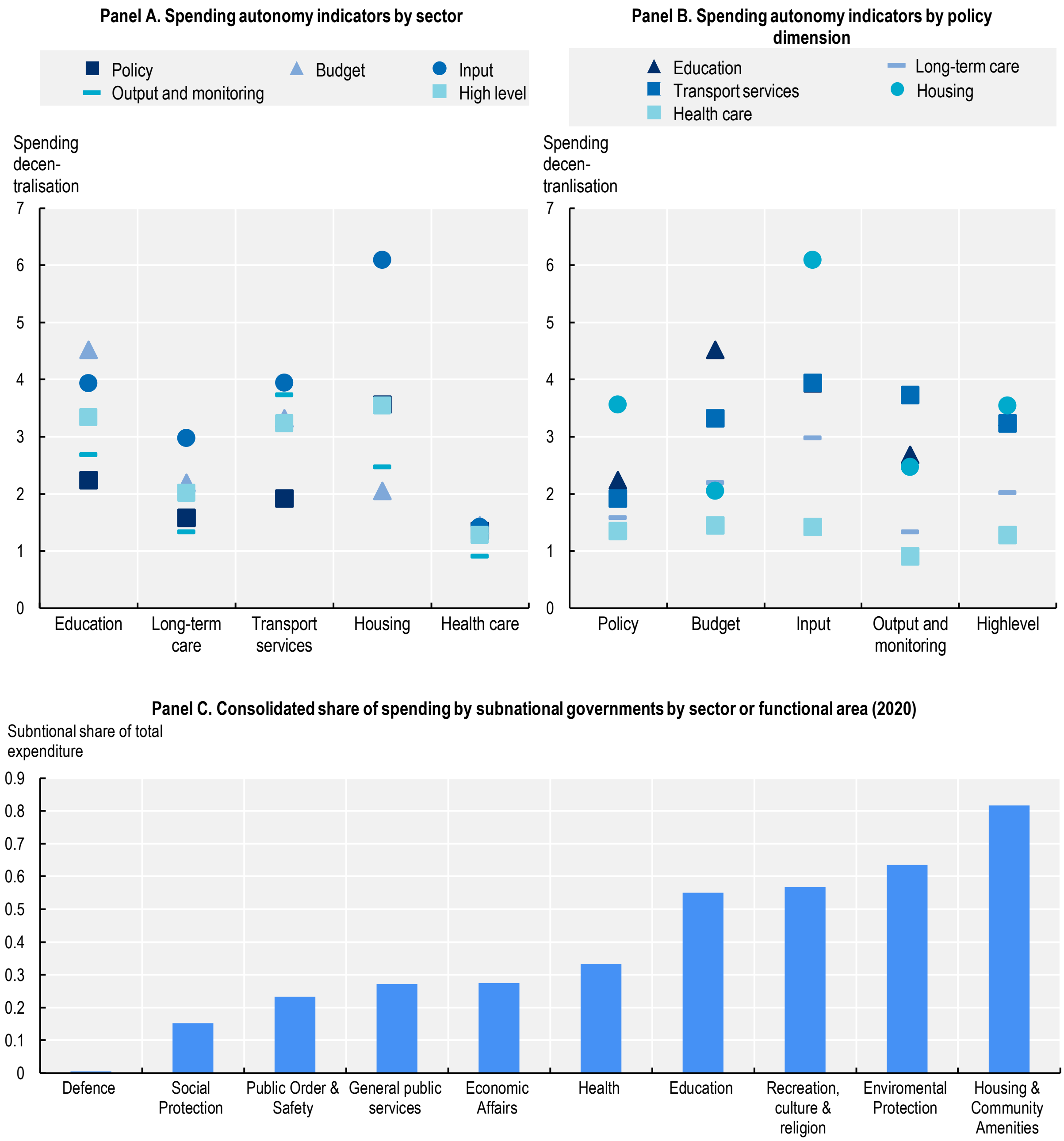
## 1.2. The governance of the housing sector

In addition to national governments, local and regional governments are essential in the overall governance of the housing sector, with the bulk of spending on housing being carried out by subnational governments. Yet housing spending is often supported by central governments. The provision of social housing together with land-use regulations are two housing-related instruments where subnational governments play critical roles (Phillips, 2020[4]). For social housing in particular, decisions regarding inputs, outputs and monitoring are mainly under the purview of subnational governments and housing providers, while for land-use issues, local governments set regulations and rules that adhere to general national standards.

While the organisation of the housing market varies a lot across the OECD and partner countries, a broadly shared trend has been to allocate more housing responsibilities to the local or regional government level (Figure 1.1, Panels A and B). Over the last 30 years, many national governments have implemented policy reforms that allow local governments to assume a larger role in developing, co-ordinating and implementing housing policies, including those focused on housing equity concerns. Subnational spending on housing and community amenities is the most decentralised area of expenditure (Figure 1.1, Panel C). The trend towards decentralisation experienced by most OECD countries in the last 30 years has resulted in subnational governments being responsible for more than 80% of outlays on housing and community amenities. While current spending on housing has been rising, investment in social housing has been on a declining trend. Chapter 7 examines the effect of housing spending policies on housing supply.

In their cross-country study, Hoenselaar et al. (Chapter 7) find that greater local control over housing spending policies leads to lower housing supply elasticities, whereas increased control of property taxation leads to higher elasticities. This finding is interesting evidence of the incentive effects that local fiscal autonomy has on spending and taxing decisions. As the authors note, new development is often discouraged by local residents because it imposes a fiscal burden on them, particularly in the case of social housing. On the other hand, new development can raise local property tax revenues. This study suggests that, on balance, the fiscal autonomy of local governments may enhance housing affordability.

## Figure 1.1. Government spending on housing is highly decentralised




Note: COFOG classifies government expenditure data from the System of National Accounts by the purpose for which the funds are used.
Source: Dougherty and Phillips (2019[5]); Dougherty and Montes Nebreda (2023[6]); OECD Fiscal Decentralisation and COFOG databases.

Taxes on immovable property are typically levied by local governments. Recurrent taxes on immovable property play a role in attaining an efficient allocation of resources, a less unequal distribution of income and even wealth. Chapters 3, 5 and 7 explore these issues in studies of Norway and the United States, as well as a cross-country study. In the case of Norway, Borge and Krehic (Chapter 3) find that an increase in income inequality does not affect property tax receipts or local public spending on housing. However, they find that housing wealth inequality increases both the property tax revenue from wealthier households and housing spending for poorer households. This finding suggests that the redistributive nature of local property taxation is at play in Norway, albeit at a modest level.

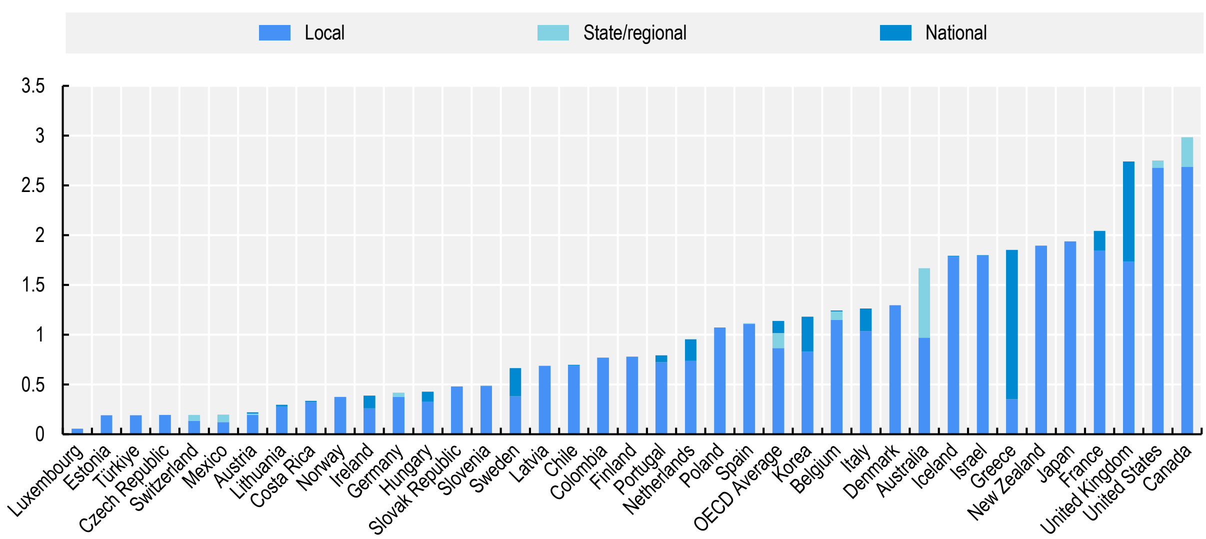
Unlike in the cases of Korea and Norway, Reschovsky (Chapter 5) finds that the property tax levied on homeowners in the United States is regressive. However, the potential impact of the property tax on housing costs varies dramatically across states, as states are responsible for property tax administration, assessment procedures, tax reliefs and limitations. Therefore, he emphasises that high-quality property tax administration and well-designed property tax relief by the states are important fiscal tools for mitigating the regressivity of property taxes.

The overall implication of these studies is as follows. As a result of the relative inelasticity of property taxes – taxpayers usually react little to changes in tax policy because their tax base is immovable – they are relatively efficient and among the taxes that are least detrimental to economic growth (OECD, 2022[3]). In the case of residential property taxation, there is also a close link between taxes paid and public services received, which follows from the benefit principle of taxation in public finance, with expenditure often having a high degree of progressivity.

Many countries raise little revenue from recurring property taxes, a situation that offers scope to make greater use of them (Figure 1.2). Other housing-related taxes, such as transactions taxes tend to be set by central government, while the terms of mortgage interest deductibility are also usually set by central government.

### Figure 1.2. Recurrent taxes on immovable property

% of GDP, 2021 or most recent




Source: OECD Revenue Statistics database.

## 1.3. The policy levers

Policy action in many areas, ranging from housing policies to government spending and taxation, influences housing outcomes. Reforms can aim at multiple objectives: making the housing market more efficient, more sustainable or more inclusive. The latter is the focus of this book. National preferences can vary considerably across these objectives, which will lead to different policy choices. Furthermore, the legacy of past choices strongly shapes today's needs and possibilities because path dependency is very strong due to the slow renewal of the housing stock.

### 1.3.1. Reforms of housing-related local government spending

Investment in social housing – directly or indirectly through non-profit profit associations – increases housing supply. It results in greater affordability for eligible low-income tenants and also for the rest of the housing market because of the increase in housing supply. Eligibility for social housing should be portable across cities and regions to ensure the mobility of low-income workers. Removing obstacles for people to follow jobs is an essential aspect of resource reallocation. Related issues are analysed in Chapter 10.

Causa et al. (Chapter 10) address the issue of inter-regional mobility of workers, an important aspect of labour market dynamism that contributes to the efficient allocation of labour across regions. They find that inter-regional migrants move in search of higher income and better employment opportunities. However, their decisions are influenced by several factors affecting housing costs, such as housing supply elasticities, rental regulations and housing-related social transfers. The study also reveals significant heterogeneity across countries in the patterns of inter-regional migration. An important implication is that structural policies should be complemented by place-based strategies, including the provision of public services, transport and digital infrastructure, as governments need to support both movers and stayers.

Providing social housing that is developed or refurbished in line with high energy efficiency standards contributes to reducing the housing sector's carbon footprint. It can also contribute to reducing energy poverty among social housing tenants. Doing so can have a demonstration effect, encouraging the broader deployment of environmentally ambitious building standards and facilitating the transition of the entire economy towards the attainment of emission reduction objectives. Finally, if social housing investment is well integrated into environmentally and socially ambitious urban strategies, it also contributes to improving the quality of the local environment and to the development of inclusive, socially mixed neighbourhoods. Care should be taken to avoid unforeseen effects, as Chapter 9 shows.

Park (Chapter 9) examines the interplay between national policy initiatives for balanced inter-regional economic development and their consequences on housing inequality at the local level in Korea. In response to over-agglomeration in the Seoul metropolitan region, the central government established planned communities, known as Innovative Cities, across several provinces. Park finds that municipalities hosting Innovative Cities experienced a significant increase in housing price inequality compared to those in more distant control municipalities. This study suggests that it is crucial for national policymakers to understand and mitigate the unintended negative effects of community development projects, demanding close collaboration between national authorities and local stakeholders.

Unlike the provision of social housing with limited benefit portability, housing allowances seldom restrict residential and job mobility. However, a critical difference between the provision of social housing and housing allowances is that the latter supports demand while the former contributes to expanding supply. Where supply is rigid, an increase in housing allowances may have the unintended consequence of putting upward pressure on house prices and rents. This pressure can offset the intended effect of allowances on affordability for beneficiaries while making housing more expensive for households who are not receiving them. Dealing with this trade-off calls for complementary measures to enhance the housing supply responsiveness to changes in demand. Belgium's experience in this area is examined in Chapter 8. Domènech-Arumí (Chapter 8) notes that housing inequality in Belgium is relatively low, but heterogeneity across subnational entities is substantial. An important aspect of housing policies is therefore the local nature of housing, as even national policies have significantly distinct impacts across space. Therefore, he emphasises that enhancing the granularity of housing and income inequality estimates may assist governments in improving their policies' design, targeting and implementation.

### *1.3.2. Reforms of housing-related taxation*

Shifting housing taxation away from transaction-based levies towards recurrent taxes on immovable property would enhance housing market efficiency. They have the advantage of not discouraging residential mobility, which is closely linked to job mobility. Recurrent property taxes have also empirically been found to be supportive of economic growth, by comparison with other taxes, especially transaction-based levies. In countries where the valuation of the property, for tax purposes, lags well behind the market value, there is also scope to align the valuation for tax purposes with the market value, which should reduce inequities that have accumulated over time.

In addition, a move of the recurring property tax basis towards land, rather than structures, would have the benefit of encouraging more efficient uses of land and therefore greater environmental quality. A proposal for a new split-rate property tax which also supports environmental objectives is developed in Chapter 6. Muellbauer (Chapter 6) addresses several fundamental challenges, including the climate crisis, equity, housing affordability and intergenerational injustice. As a solution, he proposes a green land value tax, an innovative approach to property taxation. While a land tax has long been advocated for its positive effects on efficiency and equity, it often encounters political resistance in practice. Importantly, Muellbauer suggests several measures to enhance public acceptability. These include methods for accurately measuring land values, offering green property tax discounts, allowing property tax deferral for cash-poor households owning expensive properties, as well as sharing property tax revenue across government levels to enable redistribution among local authorities. By reducing the extent to which recurring housing taxes discourage investment in dwellings, a shift towards the taxation of land should also make the supply of housing more responsive to changes in demand and thus improve affordability in the long run. Whether the recurring property tax is progressive or regressive, depends on the design of the tax: tax rates can be flat rate or progressive, the tax rate can be split between land and housing structures, tax relief can be granted and valuation plays a role.

Phasing out mortgage interest relief can reduce house prices by substantial amounts in countries, where supply lacks flexibility, because much of the value of mortgage interest relief gets capitalised into land prices in areas where supply is rigid. In the long term, lower house prices make housing markets more inclusive by facilitating homeownership of a larger share of the population and by driving down rents. Providing mortgage interest relief also raises pressing distributional issues, because mortgage interest relief primarily benefits higher-income groups. Furthermore, because mortgage interest relief does not remove primary barriers to first buyers such as downpayments and credit scores, its reform is also likely to have limited effects on homeownership even over the medium term. Increasing the effective taxation of residential property through the removal of mortgage interest relief or other advantages offers the additional benefit of contributing to smooth housing cycles.

### *1.3.3. Other policy areas*

Reforms of housing-related spending and taxation, which are typically enacted at the local level, are the primary focus of most chapters in this book. Two other policy areas are usually at least partly the purview of lower levels of government: land use and rental market regulation.

Reforms of strict land use regulations can raise the supply responsiveness of the housing market, which reduces upward pressure on prices, thus improving affordability. Furthermore, reforming land-use regulations can have broader positive consequences for the economy. Flexible land-use regulation within integrated planning frameworks can facilitate the efficient reallocation of labour and capital by allowing housing supply to adjust to the demand for relocation to high-productivity areas: such flexibility boosts investment, productivity and thus economic growth.

One way of doing so is to regularly revisit the geographic boundaries for urban development to accommodate city growth while ensuring forms of expansion compatible with environmental objectives. Moreover, land-use governance arrangements that avoid overlap in the allocation of housing policy functions across the different levels of administration and favour planning at the metropolitan level rather than lower levels of government can facilitate the matching of supply and demand within broader catchment areas. This can increase the responsiveness of supply to evolving demand, mitigating upward pressure on prices and making housing more affordable.

Making rental market regulation such as rent control and tenure security more flexible, in combination with reforms to allow more responsive supply, have the potential to make housing markets more efficient and affordable in the long term. Still, they could undermine affordability for some households in the short term, especially for incumbents. But stringent rent controls also reduce the rates of return on real estate investment. The related uncertainty discourages developers and lenders from investing in real estate, making the supply of housing considerably less responsive to changes in demand. At the same time, tight rental contract restrictions could also affect vulnerable renters adversely, which poses obstacles for residential and labour mobility. Indeed, excessive protection of tenants often implies that renters with uncertain labour market prospects, such as low-wage or non-standard workers, find it difficult to sign a lease, because landlords, who anticipate a difficult eviction in case of non-payment, require evidence about the stability of tenants' income. There nonetheless remains a case for providing tenants with reasonable security over tenure and rent levels: a compromise can be a system of rent stabilisation, whereby rents can be varied for new contracts and renewals but regulated in line with market developments during the duration of the contract.

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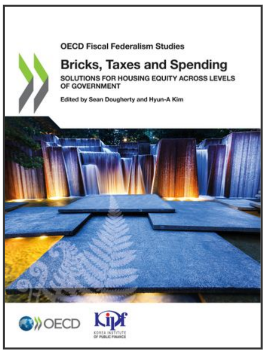


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