

**REFORMING HOUSING BENEFIT:
WHAT THE GOVERNMENT OUGHT TO DO, BUT WON'T**

Dr Peter King

Centre for Comparative Housing Research

De Montfort University

Leicester

Adam Smith Institute

London

2000

Contents

Introduction	2
1. The problem of housing benefit	3
2. The current system	10
3. Solving the problem	15
4. The reform agenda	19
5. Conclusions	26

Bibliographical information

Published in the UK in 2000 by
ASI (Research) Ltd, 23 Great Smith Street, London SW1P 3BL
www.adamsmith.org.uk

© Adam Smith Institute

All rights reserved. Apart from fair dealing for the purpose of private study, criticism or review, no part of the publication may be reproduced, stored in a retrieval system or transmitted in any way or any means, without the consent of the publisher.

The views expressed in the publication are those of the author alone and do not necessarily reflect any views held by the publisher. The author has been selected for his intellectual vigour and presented as a contribution to public debate.

ISBN 1-902737-20-2

Set in Palatino 12pt
Printed in the UK by Imediaprint Ltd.

Introduction

Housing benefit is the problem that won't go away, but one that no one, least of all government, can decide how to deal with.

Throughout 1999 government ministers indicated that major reforms to housing benefit were to be proposed in the housing green paper due out in that year. However, as the leaves fell from the trees, the promised green paper failed to appear and ministers became much more guarded about reforming housing benefit. It might, we were told, have to wait until after the next general election. When the green paper was finally published in April 2000 the issue of housing benefit reform had been superseded by other priorities. Minor changes were proposed, but the overhauling of the benefit system was to be put off for a decade. So reform was put off — not until after the next general election, but the one after that!

Nevertheless, the green paper is thoroughgoing in its condemnation of the housing benefit system. The relevant chapter contains a long list of the system's faults. What it doesn't do is offer any positive proposals for dealing with these faults. This is a very strange situation — government identifies a major problem, but then says it is going to ignore it whilst it does other things.

The government can see the problem, but either cannot or will not tackle it. Why is this? Is there something particular about housing benefit that makes it impossible to change, even though everybody knows it is a mess?

In this paper I wish to explore why this situation has come about and how it might be resolved. In the opening sections of this report I shall look briefly at the key elements of the current benefit system and indicate how it operates with regard to the various different tenures. I shall then look at why housing benefit is considered to be a problem ripe for reform. In the later parts of the report I shall look at what the housing green paper proposes, before going on to explore my own set of proposals. The green paper discusses, and dismisses, a flat rate housing allowance. I shall challenge this rejection and offer a case for a flat rate housing allowance incorporated into income support.

1. The problem of housing benefit

Is housing benefit a problem?

The reform of housing benefit has been a key political issue since the mid 1990s. Since then both Conservative and Labour governments have tried to cut back on the growth of housing benefit. The problem can be traced back to major changes in rent policy enacted by the *Housing Act 1988* and the *Local Government and Housing Act 1989*. The Conservative government reduced subsidies to social landlords and put a greater emphasis on rents as a source of income. But this merely shifted social landlords from a reliance on direct subsidy to a dependency on their tenants' entitlement to housing benefit.

Since 1991 housing benefit has grown by 11 per cent a year, compared to an average 4 per cent annual growth in the 1980s. In 1989/90 the total cost of housing benefit was £4.6 billion. By 1996/7, the last year of the Conservative government, it had increased to £12.2 billion (Wilcox, 1999). In subsequent years there has been something of a decline to an estimated £11.2 billion in 1999/00. This decline is due to the restrictions imposed by governments since 1996 (see below) and the fall in unemployment. However, expenditure is forecast to rise to £12.4 billion for the year 2001/02. This, however, is dependent on the state of the economy and the level of unemployment, as well as the effectiveness of the government's continued measures to control housing benefit.

The decline in housing benefit costs after 1997 has led some commentators to suggest that the problem is no longer serious. This may account partly for why the Labour government felt able to delay any serious reform of the benefit system. Indeed, so long as the economy stays buoyant, and the government maintains its strong control over rent levels, then one can state that government might be able to limit the growth of housing benefit, and perhaps even stop real long term growth altogether.

However, the underlying structural problems with housing benefit remain. If unemployment were to rise, so would the cost of housing benefit, regardless of the rent policies enforced on landlords by government.

TABLE 1: Growth of housing benefit 1988-2002 (£billion)



Source: DSS HB factsheet, Wilcox (1999)

In any case, the issue is not entirely a financial one. The areas of concern about housing benefit do not just centre on affordability. Britain already spends proportionately less on welfare than most of Europe (Hills, 1997). The cost of housing benefit is relatively small compared to the amount spent on education and health care. It accounts for only 12 per cent of social security spending and less than 3 per cent of total government spending.

What has really concerned successive governments is the effects that the housing benefit system has on tenants and landlords alike. The Blair government has stated that it considers welfare to be the 'cost of failure', in that individuals are being subsidised for being unproductive (DSS, 1998). They have argued that welfare policy ought to be more about assisting people back into work, rather than paying them to be idle. The government therefore saw an increasing welfare bill as the testament to failure. It would be more effective to use that money to help people find jobs and become independent and responsible for their own affairs. One of the objectives of the 2000 green paper was to promote 'self-dependence' (DETR, 2000, p. 7). The concern then for the government, we were led to believe, was not merely that housing benefit was expensive, but that it was evidence of a failure of social policy.

There are other commentators who would go further and suggest that it is the system itself which actually creates a high and continuing level of demand (Coleman, 1992; Field, 1996; Murray, 1996). Murray, for example, suggests that the

benefit system has perverse incentives built into it which reward anti-social behaviour. Likewise Frank Field, the former minister in charge of welfare reform, argued that a means tested system like housing benefit encourages dishonesty, idleness and a lack of thrift. This is because the payment of benefit is dependent on one's circumstances and thus there is no incentive to improve one's position. There may indeed be incentives to make one's position worse in order to maximise benefit entitlement. According to these critics the issue is not about the cost of welfare benefits as much as being about welfare dependency and the waste of human potential.

Too big a problem to tackle?

In March 1999 the government announced that it would be publishing a green paper on housing policy. One of the three main areas it was intended to look at was the reform of housing benefit. When discussing the possible contents of the green paper, the then housing minister, Hilary Armstrong, indicated strongly that benefit reform was a key area. According to Armstrong, the housing benefit system:

‘gives tenants little interest in their rent. It can also act as a disincentive to work. It is also extremely complex, making it difficult for claimants to understand, difficult for local authorities to administer, and prone to fraud’ (Armstrong, 1999, p. 14)

Indeed when the green paper finally appeared in April 2000 the problems of the current housing benefit system were clearly outlined. However, the only reform proposals which the green paper discusses are a number of minor changes in administration and in the means of tackling fraud.

The government's stated case for inaction was that it needed to restructure rents and introduce choice into allocations. ‘There would be little point in making these types of fundamental policy changes to housing benefit before rent restructuring’, they argue (DETR, 2000, p. 115). But no further reason is given as to why this is the case. However, one would have thought that one way of putting a downward pressure on rents would be to give tenants an ‘interest in their rent’ by reforming the benefit system accordingly. Indeed, if housing benefit does have any incentive effect on rents and the behaviour of landlords and tenants, then reforming the benefit system might have been an effective way of restructuring rents. However, the government disagrees and this choice of priorities effectively puts off the reform of housing benefit for up to ten years.

The real reason for delaying reform may have been that the government wished to duck the issue as being too difficult. Housing benefit is a major problem — and everyone involved with housing knows this — but one with no obvious, cost-free solution. In political terms, the government would find little benefit from tackling it. Any change to housing benefit entitlements would worry the

government's backbenchers and supporters. The government has already faced considerable opposition from its own ranks over cuts in lone parent and invalidity benefits and it might fight shy of tackling a benefit that affects a much wider group of people.

Like all welfare reform, it is not possible to introduce changes to housing benefit without at least some people being worse off as a result. Indeed, if the aim of the reforms is to save money, this is inevitable. There is also a tendency to put up with an existing but seriously flawed system on the grounds that any other proposed system has flaws as well.

Part of the problem might be that the government is not really clear what it is they wish to achieve from welfare reform. Are they intending to save money, or are they trying to change behaviour and thereby reduce dependency on welfare? In their green paper on welfare reform (DSS, 1998) they spoke of the cost of failure and thus seemed to be emphasising the moral dimension. However, they are also fiscally conservative, keen to show that they act responsibly over the public finances.

It may well be possible to achieve positive changes in behaviour and save money at the same time, but this is unlikely. It is more likely that attempts to change behaviour will prove quite expensive initially, but with the promise of savings in the future as fewer people rely on benefits. This is certainly the experience of welfare reform in the United States.

The UK government, however, seems to believe that it can save money and change behaviour straight away. Partly this is due to Treasury orthodoxy, which refuses to transfer spending across financial years. (It was the refusal by the Treasury to countenance extra expenditure in the short term which apparently led Frank Field, the minister for welfare reform, to resign in July 1998 after only just 15 months in office.)

There is also a chronic short termism in political outlook. Housing benefit reform is likely to be a long term reform, spanning several electoral cycles. But why set up hostages to fortune and allow your political opponents (and supposed friends on your left shoulder) to foment unease and insecurity amongst benefit recipients? The reforms that the government is prepared to contemplate are ones which might have an immediate impact and gain everyone's support, such as improved administration and recordable reductions in fraud tied to performance indicators and targets. Changes in behaviour to reduce welfare dependency are much more long term, as well as being political controversial.

Too embedded to disentangle?

Indeed it is the very long term intractable nature of the problem which is the cause for concern. Housing benefit is now so embedded into the structures of housing provision that any reform will be difficult and probably messy. An

understanding of this embeddedness, however, will help to find possible solutions to it.

Since 1989 housing benefit has become increasingly important in housing policy. Since the mid 1970s governments have pursued a policy of shifting financial support away from housing providers and towards individual households. The belief, certainly since the early 1980s, was that there was now enough housing to go round and therefore the emphasis should be on ensuring that households gain access to housing that is both of good quality and affordable.

TABLE 2: Changes in housing subsidies



Source: Wilcox (1999)

Housing policy, the Conservatives argued, should also seek to encourage choice and personal responsibility. As a result housing benefit has had to 'take the strain' as rents have increased to compensate for reductions in public subsidies to local authorities and housing associations. Table 2 shows how the balance of subsidies shifted towards personal subsidies during various years of the Conservative government.

This shift towards personal subsidies has occurred not only in Britain, but in continental Europe, America and Australasia. Kemp (1997) suggests that this has been a general trend as the housing problem changed. The 1970s saw the end of massive housing shortages and thus the end of the need for mass housebuilding programmes. This coincided with the world wide economic slump of the 1970s, which led many politicians and commentators to question whether the welfare state was affordable in its current form. Targeted personal subsidies were now seen as a cheaper and more effective means of helping the poor than the mass public provision of goods and services. The 1970s and 1980s also saw a political sea change which favoured market solutions to social problems and gave a greater emphasis consumers over producers.

In line with these trends some countries, such as Australia, New Zealand and the United States have almost totally got rid of capital subsidies. However, Britain has not gone as far as this and still maintains a hybrid system of capital and personal subsidies. What this means, of course, is that the two forms of subsidy interact. In particular, it has been the withdrawal of capital subsidies such as Social Housing Grant that have led to an increase in housing benefit.

The key issue, and the main stumbling block to reform, is that as a result of this shift in subsidies since the 1970s, the current systems of housing provision *depend upon* housing benefit. Private landlords would find it difficult to survive without it, since over 40 per cent of their tenants claim benefit (see Table 3). But this dependency is even greater on the part of social landlords, with two thirds of both local authority and housing association tenants in receipt of benefit. This means that 58.5 per cent of tenants (private and social combined) are in receipt of housing benefit and therefore presumably would not be able to pay their rents without it.

**TABLE 3: Households in receipt of benefit, 1997 (millions),
with housing benefit recipients shown as a percentage)**



Source: Wilcox (1999)

One might imagine that it is just tenants who rely on housing benefit, but these figures suggest that landlords are highly dependent on it too. Social landlords are particularly reliant on housing benefit to be financially viable. The reforms of 1988-9 have not led to any reduction in the dependency of housing organisations on subsidy. What has altered is merely where this subsidy has come from. Moreover, because in the majority of cases the tenant agrees for the benefit to be paid to the landlord, it can effectively be treated as a secure form of subsidy to the landlord. This situation has long pertained with local authorities, where tenants have never been paid directly (since housing benefit is administered by local authorities itself). Thus social landlords have every incentive to maintain benefit dependency, because this insulates them from the risks which the 1988-9 reforms introduced as a spur to efficiency. Therefore, whilst social landlords may squeal over cuts in grant rates and at the reduced level of autonomy they enjoy, are

actually able to ‘milk’ the system to ameliorate somewhat the effects of the 1989 reforms.

What makes the reform of housing benefit so difficult then, even when the government sees it is necessary, is this problem of dependency and just what would happen if it were reformed. To reform housing benefit would be to alter what is now the main source of income for landlords, particularly in the social rented sector. Any reform could have a major destabilising effect on landlords, regardless of any impact that it might have on tenants. Housing benefit, one fears, just might be too difficult to reform.

But is this really the case? Is housing benefit too difficult to reform, or is it just vested interests defending a system that works to their benefit? I believe that housing benefit is not only reformable, but that the current system is not sustainable in its current form. The government does indeed face a major problem and it is an extremely complex one. However, there is no evidence to suggest that the problem will become less complex by avoiding it.

TABLE 4: Housing Benefit: The key facts

Purpose:	<ul style="list-style-type: none"> • To help people with low incomes pay for rented accommodation whether they are in work or out of work
Key facts	<ul style="list-style-type: none"> • Non-contributory, income related, tax free • Administered by local authorities
Qualifying conditions	<ul style="list-style-type: none"> • Claimants must be legally liable to pay rent and occupy his/her home • Income and capital above £3000 taken into account with upper limit of £16000
Rates:	<ul style="list-style-type: none"> • Up to 100% of eligible rent • 65p taken off for each additional £1 of income above income support levels • Restricted if rents are exceptionally high, or above general level for locality • Benefits reduced if there are non-dependants living in dwelling

Method of payment	<ul style="list-style-type: none"> • Rebate against rent for local authority tenants • Private and housing association tenants receive a rent allowance paid to tenant or direct to landlord
--------------------------	--

Source: DSS factsheet

2.The current system

Housing benefit exists to enable people on low income to pay their rent. The amount that each individual claimant receives is determined by the actual rent they are charged. An individual on full income support will receive 100 per cent of their rent, while for those above this level the amount of support is reduced by 65 pence for every additional pound they earn. This situation can be altered by the household structure. Certain members of the household might be deemed to be non-dependants and thus assumed to be making a financial contribution to the household. As a result entitlement to benefit is reduced. Likewise, certain groups such as lone parents and the elderly receive premiums which increase their entitlements.

Housing benefit is administered by local authorities, although the actual administration is split into two, with rent rebates paid to local authority tenants accounted via the housing revenue account (HRA) and rent allowances paid to private and housing association tenants administered through the general fund. Until 1989 a local authority could claim virtually all the cost of housing benefit back from central government. It can now claim 95 per cent of actual costs (including administration of the system), but rent rebate subsidy is offset against any negative subsidy entitlement on the HRA. The government intend to remove rent rebates from the HRA, but have not as yet made legislative time available for this change.

One of the key points in understanding housing benefit is that it is not tenure-neutral in its operation. The different tenures are treated differently for benefit purposes. Some measures apply to one tenure, but not to the others. The effect is to create a complex system with differential incentives aimed at encouraging certain types of behaviour in one tenure but not in another.

Owner occupation

Housing benefit is available only to offset rent payments and therefore owner occupiers are not eligible to receive support. However, owner occupiers in receipt of income support are entitled to receive some help with mortgage interest payments (ISMI). This is limited to the first £100,000 of a mortgage and is only available after the applicant has been claiming income support for nine months. This limitation is aimed at encouraging owner occupiers to take out private insurance to cover their mortgage repayments in case of unemployment. The cost of this support peaked at £1.2 billion in 1992/93 but has fallen to below £600 million as a result of these restrictions and the fall in unemployment since the mid 1990s.

The 2000 green paper announced the intention to increase the waiting period from nine to fourteen months on the premise that private insurance should suffice. The government therefore seems to be placing greater reliance on personal provision through private sector mechanisms and thus one can expect ISMI to fall further.

Private renting

Since 1996 housing benefit payments to private sector tenants have been restricted by the local reference rent (LRR) system. This is where rents are restricted both by local average rent levels set by the rent officer and by household type. The rent officer may determine that housing benefit may be paid only up to a certain level based on what is reasonable for the area. In addition, payments to any particular household can be limited to what would be the rent for a property suitable to that household's needs. This is an attempt to deal with so called 'up marketing', whereby households could choose to live in property too large for their needs. The system aims to encourage households only to reside in suitably sized accommodation by restricting their rent payments accordingly. Prior to 1998 claimants received half the difference between the LRR and actual rent was paid, but since then housing benefit is only payable up to the LRR.

The intention of this policy was to 'encourage' landlords to reduce their rents to what was considered an appropriate level. It would also ensure that tenants did not underoccupy large and expensive dwellings. As Bevan *et al* (1995) suggest, the idea appeared to be that landlord and tenant would renegotiate their contract in the light of these changed circumstances. However, as critics of this measure were quick to point out, this 'renegotiation' depended upon an equal relationship between landlord and tenant. In particular, it implied that there was a ready supply of accommodation so that if a tenant, say, only received £50 per week, yet their landlord wanted to charge £60, there was alternative accommodation at £50 available. If this were not the case it might be that tenants would have to find the difference between their housing benefit payment and the actual rent out of their income support.

Further changes limiting housing benefit payments for single persons under 25 were introduced in October 1996. The single room rent (SRR) measure limited benefit to the amount equivalent to the rent charged for shared accommodation. This meant that tenants under 25 would have to move to shared accommodation or fund the difference themselves. As with the LRR system, the under-25s rule only applied in the private rented sector. The government also changed the rules for the payment of housing benefit in October 1996, whereby all new claims were paid wholly in arrears on a monthly basis. This meant, of course, that tenants would be permanently in arrears unless they could find a month's rent from other sources.

An area of concern for the incoming Blair administration was the large increases being imposed on secure tenants with fair rents (i.e. where the tenancy predated 15 January 1989 and was thus still covered by statutory rent controls). However, these increases, which impacted disproportionately on the elderly, were

increasingly seen as excessive, since landlords were attempting to ensure that fair rents caught up with assured rents. In addition, as rents could only be increased every second year, the increases were considerable. So in February 1999 the government limited the next fair rent increase to inflation plus 7.5 percent and subsequent increases to five per cent over inflation. Unfortunately, the government gave over six months' warning of this change and consequently some landlords tried to impose huge increases before the regulation came into force. These regulations have been placed into question by a successful legal challenge from a private landlord who argued that the government had no grounds to impose a rent cap.

Research published by the DETR (1999) analysed the effects of the changes made in 1996. It found that the behaviour of some landlords had changed. Some had refused to let to housing benefit claimants at all, others had dropped their standards and others were using tenants' deposits to clear arrears and thus not having to reduce rents. Likewise some landlords operated differential lettings policies when letting to people under 25. Some would not let to that group at all, whilst others would only let certain types of property to this group.

The research found that few tenants had persuaded their landlord to reduce the rent, either before taking the tenancy or during its course. Landlords were reluctant to do so, arguing it was the responsibility of tenants to pay their rent. It found that tenants would meet the shortfall in housing benefit either out of their income or by borrowing. The report, therefore, could offer little evidence that rents had fallen as a result of these measures.

However, Wilcox (1999) suggests that the private rented sector declined for the first time since the deregulation of the sector in 1989. He attributes this decline to 'the restrictions on private rents eligible for housing benefit introduced at the beginning of 1996 (p. 72). Between May 1997 and May 1998 there was a reduction of 100,000 private tenants claiming housing benefit 'and most of that fall can be attributed to the benefit restrictions' (p. 72). However, he does suggest that the 'non-housing benefit' sub-sector of private renting continues to grow.

Despite the phasing out of statutory rent control from 1989 therefore, it is clear that some form of *administrative rent control* has been reintroduced, whereby government again is able to exert some downward pressure on rents. There is no intention on the part of the Labour government to reintroduce statutory controls (DETR, 2000), but it is also certain that this government, like its predecessor, is not prepared to let rents find their own level. This means that competition in the sector is seriously hampered as landlords, in effect, must charge a standard rent.

Housing associations

In some ways housing associations have been in the most advantageous position with regard to housing benefit. However, this is a situation that is likely to change. The LRR system might apply to housing associations, but this at the discretion of the relevant local authority for the area. In practice, most local

authorities do not choose to apply the regulations and this means that they have lower constraints on rent increases than either the private sector or local authorities themselves.

An indirect constraint is the inclusion of a rent formula as part of the bidding and performance review processes, which limits increases to one per cent above the rate of inflation (RPI+1%). The 2000 green paper proposed that from 2002 housing association rents would be limited to the rate of inflation, with no real-terms increase. This will obviously have an impact on the cost of housing benefit, but it is noteworthy that this policy does not affect entitlements of individual tenants in the same way as the LRR system or the SRR.

Whilst housing associations own only about 5 per cent of the housing stock their influence has grown considerably. For example, housing association tenants made up 17 per cent of housing benefit recipients in 1997, but this was a doubling of their representation since 1992. Thus whilst two-thirds of housing association tenants are in receipt of benefit, the proportion of new tenants in benefit is between 80 and 90 per cent. This is largely due to the high rents charged, which are prohibitive to households in low-paid employment. It is this high proportion of benefit recipients as tenants that has allowed associations to expand, but which may prove to be their Achilles heel.

Housing associations have been able to use housing benefit to shield themselves from some of the effects of reducing grants and the introduction of private finance. The ability to increase rents, which for a majority of tenants was covered by housing benefit, has allowed them to expand (and to greatly increase senior staff salaries and the number of people employed in the sector generally). However, this expansion has been predicated on consistent real-terms rent increases. From 2002, with associations unable to impose any real increases, they will face the very stark prospect of bankruptcy. This position shows the sham of the apparent commercialism since 1989. Housing associations, in reality, have merely transferred their dependence on Housing Corporation grants to the housing benefit system. From 2002 onwards, housing associations will genuinely have to manage risk in a way that they have not since 1989, despite appearances to the contrary.

Local authorities

As with housing associations, there is no direct attempt to constrain the housing benefit entitlements of local authority tenants. But indirect controls apply. These take the form of rent capping, whereby rent rebate subsidy is paid only at the rent guideline level. This acts an incentive for local authorities to limit their rent increases as, on average, 66 per cent of their tenants are in receipt of housing benefit (see Table 3). Local authority rent levels are so important because 60 per cent of housing benefit recipients are council tenants (DSS, 1997). Whilst this is a falling percentage, it does mean that changes to council rents have the biggest effect on the national housing benefit bill.

A more long-standing restriction on the cost of housing is the use of notional HRA surpluses to fund local housing benefit payments. Since 1994/5 the amount saved on housing benefit has outweighed the housing element of the HRA subsidy, meaning that government is effectively running council housing at a profit. This is because the government assumes local authorities have notional surpluses due to increasing rent levels and use these surpluses to offset rent rebate subsidy. The accumulated savings in housing benefit costs by government since 1990 are calculated at over £7 billion.

Controlling the complexity

As we have seen, then, the manner in which housing benefit operates and the means by government has set about trying to control housing benefit differs according to sector. In the private rented sector it has tried to set rent ceilings. In the social rented sector it has attached controls to the capital subsidy system, rather than limiting entitlements.

The reason for this is that capital subsidies are easier for government to control as that they involve direct payments to specific bodies according to definite criteria. The government is able to change the criteria to suit its purposes and it has a reasonable hope of successfully achieving its aims. Thus it can reduce its liabilities by limiting rent rebate subsidy to a known increase rather than having to pay out according to locally determined rent increases. It is not possible to do this in the private rented sector simply because it does not provide any demand-side subsidies.

The problem for government is that the most controllable form of subsidy are those on the supply side, but since the mid 1970s there has been a concerted shift towards demand-side housing subsidies. But this policy ran counter to general government policy under the Conservatives, which cut back on other demand-led subsidies such as student grants and free eye tests.

3. Solving the problem

What needs doing?

Despite the government's refusal to undertake any reform of housing benefit, they are quite clear what is wrong with the system. The housing green paper (DETR, 2000) offers what appears to be a damningly comprehensive list of faults:

- housing benefit is complex to deliver and to administer;
- tenants don't understand the system and what they might be entitled to;
- the performance of local authorities in administering the system is inconsistent and inefficient;
- administrative delay causes worry for tenants and might lead to eviction, as well as causing cash flow problems for landlords;
- fraud is estimated as £840 million per annum;
- housing benefit deters people from taking jobs;
- landlords exploit the system by charging high rents for poor quality accommodation;
- housing benefit takes responsibility away from tenants as they have little interest in their rent.

But this list, comprehensive as it appears, still seriously understates the nature of some of the problems of the housing benefit system. The government is being rather selective in those problems it highlights, on the basis of what it considers easier to tackle. Everyone is against bureaucracy and fraud, whereas dealing with entitlements is more controversial. Likewise, many of the specific measures contemplated in the green paper are targeted against the private rented sector, which is less organised and politically sensitive than the social rented sector.

Fraud, of course, is indeed a serious issue, but much of it is possible because of the complexity of the system, allowing both landlords and tenants to take advantage of the system. Administrative reforms would help in this regard, as well as being necessary to speed up the assessment of claims. But these problems are not by any means the only, or even the main, problems with the housing benefit system. One can point to other issues which need attention in addition to those identified by the government. These are both more controversial to deal with and involve a more fundamental approach than is apparently contemplated. Therefore,

before discussing possible reforms, I want to clearly state what I consider to be the two main problems of the housing benefit system.

Different Treatment

Firstly, tenants are treated differently in terms of age and tenure. This means that system is not properly based on needs, but already makes value judgements on particular groups. One can question the validity of these assumptions and the equity of treating a 24 year old differently from a 26 year old. Age restrictions are arbitrary and do not have any logical basis to them.

Similarly, claimants receive premiums or have certain parts of their income disregarded depending on their circumstances, e.g., the elderly, carers, lone parents. This is a controversial issue as some commentators, such as Murray (1996), have argued that the effect of these premiums is to encourage what they are designed to alleviate — *moral hazard* problem. The government appeared to appreciate this point when it restricted lone parent premium to new claimants in 1997.

Nor are the various tenures treated consistently, with eligibility restrictions applying to the private sector, but not to the social rented sector. Even within social housing there is no consistency, particularly in the fact that local authorities make a considerable contribution to the cost of rent rebates, whilst housing associations do not.

I would argue, therefore, that a key aim of any reform should be to create greater neutrality between both households and tenures. The green paper makes no such proposals. Indeed it sees no reason to alter current tenancy regulations or change the administrative basis of the system.

Producer capture

The second, and even bigger problem, is producer capture. The current system gives landlords the ability to control housing benefit by having payments made directly to them. Housing benefit for all local authority tenants (i.e. 60 per cent of claimants) is paid directly to their landlord as part of HRA subsidy. Housing associations and private landlords have the right to direct payments if arrears are over 8 weeks. Furthermore, many landlords insist on tenants signing payments over, or make it appear a condition of tenancy. The green paper states that 70 per cent of private sector landlords have direct payments. Therefore a large majority of tenants do not receive a housing benefit cheque. Instead it is sent directly to the landlord.

The ability of landlords to have payments made direct to them gives them considerable control over the benefit system, because of their ability to set rents. This is why governments since 1996 have tried to limit this power through measures such as local authority rent capping and local reference rents. The 2000 green paper partially recognises this problem and makes tentative proposals to make direct payments to private sector tenants. However, it does not seem to

consider the issue of irresponsibility a problem in the social housing sector, even though this is where the majority of housing benefit recipients reside.

The problem of direct payment is that it removes a sense of personal responsibility from tenants for their rent payments. The current housing benefit system is such that landlords, in both the social and private sectors, have been able to 'milk' the system by their ability to control their rent levels. This does not amount to fraud, but it means that landlords are exploiting the open-ended nature of the housing benefit system. *An important area for reform is therefore to develop the responsibility of tenants for their rent payments, and break the hold that landlords have by being able to create a link between rent levels and housing benefit.*

Any effective reform of housing benefit should therefore be concerned with the problems of differential treatment and producer capture, in addition to the list offered by the green paper. Indeed, much of the complexity is created by differential treatment according to household type and tenure. Likewise the exploitation of tenants and the creation of irresponsibility is a direct result of producer capture.

What the government intends to do

The green paper, whilst writing off major reforms for a decade, does state a range of possible options for improving the administration of the system and reducing fraud. These changes include:

- information sharing between DSS and local authorities to deal with fraud and administrative delays;
- fixing benefit awards for a set period regardless of changed circumstances to reduce administration;
- introducing performance targets to cut fraud and error;
- establishing a national fraud hotline;
- the possibility of minor changes to earnings disregards to create incentives to work;
- possible restrictions on payments to private landlords of substandard dwellings by either reducing payments or refusing to make direct payments to landlords.

On this latter point, the government is conscious of the need not to harm tenants' interests, and therefore the green paper appears to favour the banning of direct payments rather than reducing the level of payments. The latter appears to be an option only in areas of low demand, which would imply tenants would have an

alternative. The green paper does discuss briefly the possibility of ending direct payments to landlords more generally, on the grounds that tenants might be ignorant of the actual rent charged and feel they have limited control over rent levels. However, whilst the government sees this might have a limited role in the private rented sector, it dismisses a more general policy on the grounds it would increase rent arrears and adversely affect landlords. It argues that 'the payment arrangements are administratively efficient for both local authorities and landlords' (DETR, 2000, p. 120) and this appears to override any consideration of choice, despite that being one of the main themes of the green paper.

One reform that has been advocated by many is the reduction in the tapers by which housing benefit is reduced as income increases. The argument against the current 65 per cent taper is that it acts as disincentive to work, particularly as it interacts with the tax and benefit system to create an even higher marginal tax rate than 65 per cent. The green paper seems to reject this proposal by arguing that it would be expensive and have only a marginal impact on work incentives. They appear to be placing greater store on measures such as the working families tax credit which give low income families a guaranteed minimum income.

The green paper discusses in some detail the advantages and disadvantages of a flat rate level of benefit. This would be where housing benefit is abolished and replaced entirely by a notional increase in income support to cover housing costs. The advantages of such a system include its simplicity to administer and ease of understanding. However, it has the disadvantage of not taking into account variations in individual circumstances. Accordingly the green paper concludes that a fully flat rate scheme 'does not look an attractive option' (DETR, 2000, p. 118).

The preferred option appears to be an amended form of flat rate payment, which incorporates a so called 'shopping incentive'. Such a system, as proposed by Kemp (1998, 2000) would involve 80 per cent of the rent being met by housing benefit, with the remaining 20 per cent being made up by the tenant from their income support. Income support would be increased to allow this, but through a flat rate increase worth 20 per cent of average housing costs for the area and household size. This would give the tenants some incentive to 'shop around' as they would keep any portion of the difference between the actual rent and their increased income support payment. The green paper suggests that income support could be uprated by 25 per cent of average housing costs to provide an extra margin of affordability.

This latter point, however, is only tentative and it is instructive that more space is given to the apparent problems of reform than on any specific proposals. In any case, fundamental reform is to be shelved until social housing rents have been restructured and greater choice has been introduced into allocations. The clear intention is to put off any reform of benefit, hiding behind the decline in spending in the late 1990s. More fundamentally, the belief appears to be that housing benefit can be controlled through indirect rent controls such as rent capping in the local authority and housing association sectors and local reference rents in the private sector.

One can speculate whether the government is playing the long game, seeing welfare reform as a long term aim and therefore taking an incremental approach. On this basis, the government might still be as committed to fundamental reform, but sees that this can only be achieved in stages. This would be similar to the Thatcherite welfare reforms of the 1980s.

The difference though is that the Blair government does not appear to have a clear agenda for reform. The housing green paper is described by John Prescott as 'the first comprehensive review of housing for 23 years' (DETR, 2000). Yet its conclusions, on housing benefit and much else, are cautious and managerial. What is lacking, as distinct from the Thatcherite housing reforms in the early and late 1980s, is any clear vision. One gets the firm impression that the Blair government just does not know what to do about housing benefit and housing policy more generally.

4. The reform agenda

Fundamental reforms

In this section I want to outline some proposals for the radical overhaul of housing benefit. These changes are aimed at radically altering the incentives which currently operate on both landlords and tenants. They are aimed to be broadly neutral in terms of the cost of benefit system itself, but would involve significant savings in other areas.

In essence my proposals are in two stages and, like the green paper's aim of dealing with rents and then reforming benefits, I too wish to deal with rents in all sectors and then to introduce a fundamental change in the structure of housing benefit. Therefore, like the government, I believe that housing benefit reform must be part of wider changes to housing structures. But, unlike the government, I believe that one the fundamental problems of the current system can be tackled immediately and that this would have a considerable impact on rents.

Stage one reforms

The aim of these initial reforms are to deal with some of the institutional differentials which plague current housing policy and to deal with the producer capture of housing benefit. There are four essential changes at this first stage.

1. The removal of all supply-side subsidies to local authorities and housing associations

Removing the supply side subsidies would make a saving of £4 billion per annum. To compensate, the restrictions against local authorities borrowing from the private sector should be removed. Or an alternative would be to speed up further the transfer of up to 200,000 local authority dwellings as discussed in the housing green paper, alongside the withdrawal of supply-side subsidies.

The aim of this change is to allow the various tenures to compete equally — unlike the current arrangements, which allow for considerably lower rents in the local authority sector. In 1998 average weekly housing benefit for each local authority was £37, as against £50.70 for housing association tenants and £58.90 for private tenants; much of this disparity is due to the differential treatment between the tenures. Abolishing the supply side subsidies would help the situation. The effective transfer of the local authority stock would also help to

equalise the tax treatment between the tenures, which currently benefits the local authority sector.

But for this change to be properly effective, a further general change is needed.

2. The creation of a single market

Local authority tenants currently enjoy statutory security of tenure, whilst private sector and housing association tenants have contractual assured tenancies. Local authority tenants enjoy the right to buy and have greater rights of succession and consultation than other tenants these rights do not apply to assured tenancies. So not only are local authority tenants receiving subsidised rents; they also enjoy greater rights.

Moreover, there are further distinctions between the tenures in terms of eligibility. Social housing is allocated on the basis of need, whilst the private rented sector is said to be driven by the profit motive. This presumes that tenants in the private rented sector are not in housing need, whilst social housing tenants are. But such a distinction is more due to the need to ration access to local authority housing on the basis of available supply. Certain categories of households, such as childless couples and single people, have historically been excluded as low priorities compared to families with children.

The differences in tenure rights and restrictions on access, allied to the existence of supply side subsidies, create an unequal position between the tenures. It is necessary to level out this situation to allow proper competition in rented housing on the basis of price and quality.

The first step would be to implement a standard form of tenancy for rented housing, presumably along the lines of the current assured shorthold tenancy. This would ensure that all tenants enjoy the same rights and have the same responsibilities.

Secondly, it would be necessary to remove all eligibility criteria from social housing and base allocation on the principles of choice and demand. The demand for social rented housing is skewed by virtue of enhanced rights and cheaper rents. The green paper appears to favour the extension of choice-based lettings systems, although the current models under consideration involve merely changes in administration rather than in eligibility.

Removing eligibility criteria, along with the changes to subsidies, would force social landlords to compete on the same basis as private landlords, namely on price and quality. The effect of these changes would be towards an equalisation of rent levels across the rented sectors, with demand being the primary determinant. It would also make all landlords equally responsive to the market, rather than setting up artificial divisions.

The main argument against the removal of need as the main criteria of access is that the most vulnerable people would suffer if they were not automatically preferred by some bureaucratic means of allocation. But this should be seen in terms of an issue of advocacy on behalf of the vulnerable to assist their access, rather than one of principle. One ought not to reject essential change of the basis of its effects on a minority, when mechanisms to protect that minority can be built into the changed system.

None of the changes discussed so far directly impact on housing benefit. However, taken together, these changes will create a single market in rented housing, where price and quality will be the determining factor. This would lead to an equalisation of rents across all rented housing and allow for fundamental changes to housing benefit in the second stage of reform. But there are two changes to housing benefit which ought to be introduced at this first stage.

3. Removing single room rent regulation

Not only is it necessary to deal with differentials between tenures, but also those between households. I would therefore propose the withdrawal of the single room rent regulations whereby single persons under 25 receive a reduced level of benefit if they rent in the private sector. This is an arbitrary rule, which also causes some hardship for recipients, as there is little evidence that landlords have reduced rents (DETR, 1999). I advocate further, and more fundamental, changes in eligibility as stage two reforms (see below).

4. Direct payments to tenants

As we have seen, the majority of tenants do not receive a monthly housing benefit. Instead, payments are sent directly to their landlords. Thus for tenants receiving full housing benefit, rent levels are a matter of indifference. They need not be aware of the rent they are charged and need not develop a close relationship with their landlord.

The key issue though is that by-passing the tenant gives landlords some control over housing benefit, through their ability to set rent levels. They may also have an incentive to allocate dwellings to housing benefit recipients, since this guarantees their income. They are therefore able to 'milk' the system and, certainly in the case of local authorities before 1996 and housing associations, use housing benefit as *de facto* supply side subsidy.

A reformed benefit system should attempt to break this producer capture. This can be done by making all payments to applicants and not to their landlords. Landlords should not be able to receive benefit payments direct, but only from their tenants.

This would re-establish personal responsibility on the part of the tenant and dramatically reshape the power relations between landlords and tenants. Landlords would have to deal directly with tenants based on their contractual obligation. It would also make rent levels a significant part of that relationship again, in that landlords would have to consider the response of tenants to rent increases (this, of course, would depend on the further reform of basing payments on notional rather than actual housing costs which I discuss below). And if there is competition between all landlords, they are likely to be more sensitive to changes in rent levels.

There is also the important point that households would become more aware of the real cost of their housing. This, of course, is an important prerequisite if rational choices between available dwellings are to be made. Payments direct to the landlord ensure that rent levels are a matter of indifference to benefit recipients. Prohibiting the landlord from receiving payments direct would ensure that rent levels are relevant to households. This awareness of cost should serve to prevent 'up-marketing' and allow a more genuine market to develop.

Furthermore, payments direct to households makes it clear that they are responsible for their contractual obligations. They would be directly responsible for making payments to their landlord and would not be able to pass this responsibility onto an impersonal bureaucracy.

The main objection to this proposal — and one stated in the green paper — is that there is no guarantee that tenants will pay their rent if benefit is paid to them rather than to the landlord. By making direct payments the subsidy is assured of being used for its intended purpose, which is not necessarily the case if tenants are given control over their benefit. But I see this argument as an essentially paternalistic one. It assumes that tenants are not competent to manage their own affairs and thus should not be trusted to use their income responsibly. However, the outcome of such an approach, which has held in housing policy for many years, is precisely to remove responsibility from individuals and to create the shortcoming which is assumed. An essential element of a reformed system of housing supports should be to reinduct a sense of personal responsibility. Tenants, like owner occupiers, ought to be fully responsible for the consequences of their actions. Landlords have the sanction of eviction for those that do not pay their rent and the certainty of the application of this sanction ought to be sufficient to ensure payment owner occupiers in dealing with their mortgage providers.

No doubt there will be some individuals who are not capable of managing their own affairs those already in need of specialist support or are in a transitional stage between this support and independent living but these cases are clearly exceptional and identifiable. But the necessary and proper care of these individuals should not be used as an argument to preserve the general presumption that social housing tenants are incapable of running their own lives.

The aims of these first stage reforms are to develop a proper market in rented housing. This will have the effect of equalising rents across the currently distinct rented sectors, with differentials based on the more rational criteria of quality and price. The legal and financial arrangements would become more equal, and ending direct payments to landlords would break the control which the supply side currently enjoys over housing benefit. However, these changes should be seen as prerequisites to a more fundamental reform of housing benefit.

TABLE 5: Reforming housing benefit

<p>Stage One</p> <ul style="list-style-type: none">• End supply side subsidies, saving £4 billion per annum• Create a single rental market with uniform tenancy• End the single room rent restrictions for under 25's• End direct payments to landlords
<p>Stage Two</p> <ul style="list-style-type: none">• Flat rate benefit at 105% of local benchmark rent• Ending differential entitlements on the basis of household types• Shifting housing benefit administration to Department of Social Security

Stage two reforms

The first stage reforms discussed above would change housing benefit and, of course, transform the housing organisations and markets more generally. However, the basic structure of housing benefit would remain the same. The second stage of reforms would be aimed at changing the structure of housing benefit, and makes its operation less arbitrary.

1. Flat rate benefit

Once rents have been equalised across all rented housing it will be possible to operate a fully unified system, which does not distinguish on the basis of the

landlord. This will allow for a proper flat rate benefit to be implemented based on a local benchmark rent.

The flat rate model discussed by Kemp (1998, 2000) would operate properly only in the private rented sector, with a notional contribution being envisaged for social housing. This would effectively let social landlords off the hook on the spurious basis that they have a social function rather than a profit making one.

The rate of benefit allowed is important for the incentive effect it might have. Kemp argues for a 20 or 25 per cent flat rate contribution as part of income support, with housing benefit still covering 80 per cent of actual rents. Recipients would be able to keep the difference between total benefit and actual rent and would thus have some incentive to shop a round to find cheaper accommodation. But this would have little effect because 60 per cent of tenants would not be fully part of the system and landlords would still control much of the benefit and have some control over rents.

I would therefore argue for a flat rate of 105 per cent of local benchmark rents. This would allow certain households to afford more expensive property. But it would also offer tenants much greater choice in terms of the rents they wish to pay by allowing them to keep the difference between the benefit rate and the actual rent. This choice would be limited by supply, but the stage one reforms would have massively increased competition amongst landlords and thus have increased the range of possibilities for tenants.

But this should properly be a flat rate and not be dependent on household type. Eligibility should be on the basis of income and not on the specifics of the household. Benefits should not encourage lifestyle choices, any more than mortgage repayments or salaries are altered because of the composition of the household. I would suggest that this should even apply to the elderly. The rationale for this restriction is not merely to remove differentials, but also to shift the relationship between landlord and tenant to a purely contractual one.

2. Administration of housing benefit

Housing benefit is currently administered by local authorities, whilst other benefits are administered by the Department of Social Security. The result is a duplication of administration, particularly as eligibility for housing benefit is based on the level of income support. Removing the administration of housing benefit from local authorities would save £350 million per annum and remove the peculiarity of local authorities acting as landlord and administrator of benefits for its own tenants. The aim should be the integration of housing benefit into the income support system. For working households on low income housing benefit could be integrated into the working families tax credit and the minimum income guarantee.

A third stage?

The reforms discussed above are achievable, but would involve a considerable change in direction. Indeed they would involve government taking a direction rather than the drift in policy that is the current state. However, should the model discussed above be seen as the end result?

One further stage of reform, which I have discussed elsewhere (King, 1999), could be the eventual abolition of a separate housing allowance altogether. This would involve the integration of a notional housing element into income support. This, indeed, would be the logical next step in creating a neutral and universal system. In addition, by ending a distinct housing allowance, the link with rent levels is completely eroded. Thus housing benefit would cease entirely to influence rent levels. The main influence would be demand as determined by household income, and this is entirely as it should be.

With this reform one would truly have achieved a situation where all households make the same choices and have the same responsibilities, regardless of income or whether they are working or not. I would suggest that this final stage could be readily attained after the second stage of reforms are bedded in. Instead of uprating benchmark rents and income support separately, it would be merely be a case of uprating the level of benefit.

5. Conclusions

This paper has discussed the main problems of the housing benefit system and made proposals about dealing with them. My belief is that these changes would lead to considerable cost savings, particularly through the removal of supply side subsidies. The greater leverage given to tenants would also exert a downward pressure on rents and on total spending.

But the proposals would also have an impact on behaviour. By insisting that tenants receive benefit payments, they become responsible for rent payments and must engage in a direct relationship with their landlord. Likewise, through the creation of competition in the rented sector, landlords will no longer be able to take their tenants for granted, but must be more aware of what choices tenants have. In particular, social landlords will have to change their attitude to housing benefit and no longer be able to see it as a *de facto* supply side subsidy. In short, these proposals would properly introduce the risk that the 1989 reforms were intended to do. This again will benefit tenants, by forcing landlords to operate in a cost conscious manner concentrating on their core contractual obligations rather than on the manner extraneous activities they currently involve themselves in.

The housing green paper has started a debate about the future of housing policy. It claims it is a comprehensive review of policy, but, as I have argued with regard to housing benefit at least, its is rather weak on actual proposals. Most housing experts would argue that housing benefit is in need of immediate attention. The terms 'crisis' and 'unsustainable' are frequently used, even if commentators cannot agree on the changes that are needed. What is clear though is that a ten year delay before reforming housing benefit is just not tenable. The government appears to want to avoid a fundamental review of housing benefit, but one fears that delay will merely make the problem harder to solve in the long term.

References

Armstrong, H (1999): 'Let's Go Green', *Inside Housing*, 19 March 1999.

Bevan, M, Kemp, P and Rhodes, D (1995): *Private Landlords and Housing Benefit*, York, Centre for Housing Policy.

Coleman, D (1992): 'The 1987 Housing Policy: An Enduring Reform?', in Birchall, J (Ed): *Housing Policy in the 1990s*, London, Routledge.

DETR (1999): *Housing Benefit and Private Landlords*, London, DETR

DETR (2000): *Quality and Choice: A Decent Home for All - The Housing Green Paper*, London, DETR/DSS.

DSS (1997): *Social Security Support for Housing Costs*, Welfare reform focus file 5, London, DSS.

DSS (1998): *New Ambitions for our Country: A New Contract for Welfare*, London, The Stationery Office.

Field, F (1996): *Stakeholder Welfare*, London, Institute of Economic Affairs.

Kemp, P (1997): *A Comparative Study of Housing Allowances*, London, The Stationery Office.

Kemp, P (1998): *Housing Benefit: Time for Reform*, York, Joseph Rowntree Foundation.

Kemp, P (2000): 'Shopping Incentives' and Housing Benefit Reform, York, Joseph Rowntree Foundation/Chartered Institute of Housing.

King, P (1999): 'The Reform of Housing Benefit', *Economic Affairs*, Vol. 19, no. 3, pp. 9-13.

Murray, C (1996): *Charles Murray and the Underclass: The Developing Debate*, London, Institute of Economic Affairs.

Wilcox, (1999): *Housing Finance Review, 1999/2000*, York, Joseph Rowntree Foundation.