

# **AT THE MARGINS OF DEVOLUTION? FISCAL AUTONOMY, HOUSING POLICY AND HOUSING BENEFIT**

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## **1. INTRODUCTION**

At present, there is lively debate surrounding the meaning and consequences of fiscal autonomy for the Scottish economy and polity. This partly reflects a long-term dispute between Scottish economists (reviewed in Heald and McLeod 2002) and party political debate in the run-up to the 2003 Parliamentary elections. Arguably the two key dimensions of this debate involve, first, what one actually means by fiscal autonomy, its depth and breadth. Second, analysts have speculated on whether more economic control from Edinburgh, broadly speaking, would lead to an improved Scottish economic performance.

In this article, this debate and the tensions between devolved and non-devolved fiscal policy levers form the context for a focus on Scottish housing policy and the reform of the UK social security system of Housing Benefit. A theme of this article is that the fiscal autonomy debate can also be usefully considered in terms of specific sectors rather than public finance as a whole. The application here is to housing policy and low-income benefits but it

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might also be in regard to, for instance, resourcing higher education, long term care or transport policy.

The UK Government, through the Department of Work and Pensions (DWP), has been pursuing fundamental design reforms of Housing Benefit (DWP 2002). This is part of a range of reforms that might be considered to represent collectively a project to develop a quasi-market in social housing. However, this project is explicitly aimed at reforming English social housing and key elements to do with the way rents are set and the allocation of social housing operate only in England, although the benefit reforms, initially aimed at the private rented sector, apply equally to Scotland. While the need to reform Housing Benefit is not doubted, the tension between the Scottish housing policy framework and the UK benefits system, which is being directed toward English reforms, raises a number of political and economic questions (Wilcox 2002). In this article, these asymmetries are explored along with the scope for developing a Scottish income-related housing allowance.

The structure of the article is as follows. After the introduction, Section 2 overviews social housing policy and sets out the policy framework in terms of Scottish and UK competencies, focusing particularly on financial matters such as the treatment of Housing Benefit within the 1998 devolved settlement. Section 3 describes the present Housing Benefit system. Section 4 outlines the policy aims that will reform Housing Benefit, restructure rents and widen choice-based allocation of social housing. The specifics of the imminent reforms to Housing Benefits in the private sector, the 'Pathfinder' proposals, are also discussed. This leads on, in Section 5, to an examination of the scope for developing a Scottish alternative either to Housing Benefit as it is currently configured or in terms of the proposed cash allowance that is at the heart of current reforms. Section 6 concludes the discussion, returning to the broader questions of fiscal autonomy and asking what lessons the difficulties emerging from the housing sector may have for further devolution of policy and finances.

## **2. HOUSING POLICY FRAMEWORKS IN SCOTLAND AND ENGLAND**

### ***Background***

Housing is a basic but important concern for households, communities and governments. Typically, families spend 15 to 25% of their disposable income

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on their accommodation needs. Housing investment is the single largest element of the fixed capital stock and housing assets are key components of owner-occupied household wealth. Housing quality is recognised as an important contributor to community regeneration and sustainability, educational attainment, health and economic productivity (DETR/DSS 2000). Despite long term declines in direct public expenditure on housing and the removal of mortgage interest tax relief, Government continues to spend large amounts of public money through capital grants, permission for local authorities to borrow and indirect help through debt write-offs. Most assistance, however, comes in the form of means-tested Housing Benefit, an allowance to meet rental costs (Gibb et al 1999).

Housing policy can, crudely, be categorised according to the different sectors of the housing system. Private housing is a policy concern primarily on two levels. First, it is important in terms of the stability and affordability of the private housing market and this is as much a concern for economic policy as it is, for instance, a question for local land release to ensure that enough new housing can meet demand. Second, there are difficult questions concerned with ensuring private housing sector quality and standards particularly at the bottom end of the rental market and amongst outright owners who are poor financially. Social housing confronts issues of under-investment, poor management and declining demand. Policy responses have increasingly shifted the balance away from councils as providers and more towards councils as enablers of social housing provided by different landlords such as associations, co-operatives and arms-length management. More broadly, local areas also suffer from housing system problems such as generic low demand or rising homelessness; these problems affect all forms of housing but do so in specific ways and require policy responses tailored to local conditions.

Table 1 summarises the differences in tenure structure between England and Scotland (1999). Although the gap is narrowing, Scotland is significantly more 'social' than in England. Approximately a fifth of English housing might be defined as social (council plus voluntary housing associations) but 30% of Scottish housing would fall into that category.

Even before 1999 (the year of the re-opening of the Scottish Parliament) there was a well-established 'Scottishness' to housing policy. While the policies were on the whole recognisably similar in intent and form, there were important differences. Scotland had its own housing legislation, and a powerful national housing agency with funding, regulatory and additional

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powers (Scottish Homes, now Communities Scotland). Distinctive and substantial differences in financial mechanisms that deliver policy objectives could also be readily identified. Many of these differences remain after five years of the Scottish Parliament but have been added to through legislation such as the voluminous 2001 Housing (Scotland) Act, Homelessness legislation and specific policy initiatives, for instance Community Ownership (the transfer of council housing to alternative social landlords).

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**Table 1**  
**Housing Tenure 1999, %, dwellings**

Tenure	Scotland	England
Owner-occupiers	62.3	68.1
Privately rented	6.7	11.4
Housing association	5.6	5.9
Council tenants	25.3	14.6
All dwellings	100	100

*Source: Wilcox, S (2001) Housing Finance Review 2001-2002. Joseph Rowntree Foundation: York. Table 17b, p.89.*

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***Funding Social Housing***

Social housing can be divided into two arms: the voluntary housing association sector and local authority housing. Broadly speaking (see Gibb et al 1999; Garnett 2000), associations are funded through a mixture of up-front capital grants (which might account for around 60% of capital costs) and private loans that have to be repaid out of rental income. Rents are expected to be 'affordable' and provision is made for a sinking fund to meet long-term repairs. Increasingly, associations purchase existing social housing through a stock transfer process. This is wholly privately funded and paid for out of rents. Further loans are often sought in order to fund long-term repairs. Council housing falls wholly under public expenditure classifications. New investment (almost entirely for modernisation or improvement of existing housing stock) is borrowed and counted as public spending in the year of borrowing. Only two Scottish authorities receive any current subsidy to

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reduce their required rental income (they have to balance a well defined housing revenue account each year). Councils operate ring-fenced housing revenue accounts in that there are no transfers between housing and the general fund: that is, there is no subsidy in either direction between council tenants and council taxpayers. For both forms of social tenant, Housing Benefit, a means-tested personal housing subsidy, meets the housing costs of around 60-70% of tenants (in 2001, 63% of housing association tenants were dependent on Housing Benefit).

There are well-established differences in the financial operation of these housing policies when one compares England with Scotland. First of all housing associations in Scotland do not bid competitively for grant as has been the case in England. This has protected average grant levels and, some would argue, the quality of the finished product in Scotland. Second, English local authorities have faced a revenue funding regime since 1989 which in practice has sought to control rent levels and rent increases and has meant that surpluses have had to be used to reduce the Exchequer's cost of providing housing benefit. For several years now the English local authorities have operated as a net contributor to public spending. This system does not apply in Scotland. Third, English local authorities and housing associations are embarking on a 10-15-year process to converge rent levels within areas and develop a national rent structure in order to overcome the chaos of local rent structures which had hitherto been set at the discretion of individual landlords using a host of different rent-setting criteria. Again, in Scotland, where the same problems exist (More et al 2003), there are as yet no plans to restructure rents. Fourth, English councils are moving to a resource accounting and business planning basis for all of their own stock. The Scottish Executive is also examining business accounting for council housing but this may not involve all of the same elements and may not consequently have the same impacts as in England<sup>1</sup>. Fifth, there are other differences

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<sup>1</sup> [Recent consultation by the Scottish Executive has confirmed that Scottish local authorities will be able to develop prudential borrowing principles for all capital borrowing including housing and that restrictions on how they use capital receipts \(currently primarily to repay housing debt\) will be ended. Essentially, this will mean that councils will decide and be accountable for how much they borrow according to central principles to be formalised by CIPFA. They will no longer be subject to Treasury/Executive borrowing controls. This applies throughout the UK. Additional investment will however be constrained by the identification of additional \(affordable\) rental income streams. Further reforms in England, providing](#)

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arising from policy such as the modernised 'Right to Buy', a new framework for council house (and housing association) sales to sitting tenants with less generous discounts. There are also other further differences in the nuances of policies that, though superficially similar, can have markedly different impacts in Scotland or England: Wilcox 2002, for instance, identifies council capital spending opportunities through prudential borrowing and debt repayment at council stock transfer through debt nationalisation.

Why have these differences emerged, and are they likely to persist? There is a tradition of independence in housing policy in Scotland relative to Whitehall though in practice many of the differences in the 1980s and 1990s were of degree and nuance rather than substance. However, local differences in circumstances (e.g tenure or the severity of specific neighbourhood problems) led to 'Scottish' solutions such as the development of community-based co-operatives and housing associations as solutions to peripheral council housing estates. We have already pointed to the distinctive legislative policy platform delivered by the Parliament since 1999. It might also be argued that the Executive's present formation of Community Ownership presents the local dimension as much more central to council stock transfer than is the case in England. The failure in Scotland thus far to grasp the nettle of rent restructuring (and rent levels) reflects both its complexity and the relative lack of enthusiasm in Scotland for more radical reforms to social rented housing. However, there remains evidence of borrowing and imitating policy and strategy between Scotland and England. In both countries, councils are leading the development of comprehensive housing strategies for all housing in local areas nested within wider planning frameworks. England has developed a 10 year rolling programme for English councils and housing associations to conduct option appraisals and then implement strategies to deliver minimum housing standards (the decent homes standard) for all housing. This has widely been seen as a device forcing ownership and management change in councils towards housing stock transfer and other changes in engagements (Gibb, forthcoming). In Spring 2003, the Scottish Executive announced plans for consultation on a Scottish Social Housing Standard to be met to a given timetable. Thus, a combination of convergence and divergence in approaches to housing policy seems likely to continue and,

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[\*supplementary resources for councils switching to Arms-Length housing management, have not been extended to Scotland; nor have other wide-ranging reforms to local authority housing finance.\*](#)

as with many areas of devolved policy, this will be most tested when different parties sit in government in either country.

## **HOUSING AND DEVOLVED FINANCES**

Housing questions impinge directly on the Scottish Executive's block grant (the key resource allocation from London to Edinburgh). Apart from allocating funds to housing in order to fund policy programmes such as development funding, supporting stock transfer and discrete initiatives in areas such as homelessness, there is the question of Housing Benefit<sup>2</sup>. Rent allowances, the component of Housing Benefit applied to tenants in the private rented sector and the housing association sector, are met directly by the Department of Work and Pensions. Rent rebates (the local authority part of Housing Benefit) are funded not explicitly by that Department but as part of the block grant. In the first year of operation after devolution, the mechanism worked by assuming the same cost of Scottish rent rebates as the previous year and adjusting for rent increases, assuming that Scottish rents rise each year by the same amount as in England. If rents rise by less, there are therefore additional funds for general use. However, if rents were to rise by more than in England, then other Scottish programmes would have to be cut to meet Scotland's means-tested benefits spending need. Thus far such a concern has not arisen. However, there is no reason to imagine that Scottish rents should increase at the same level as English council rents, particularly as Scotland is not undergoing rent convergence, which, broadly, is bringing council rents in line with higher association rents in England but doing so in a measured and phased manner over several years. Of equal importance, the cost of rent rebates is a function of two variables: average rents and the size of the client group claiming benefit. Changes to the composition and size of

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<sup>2</sup> *One apparent anomaly is the treatment of the Supporting People budget, formerly Transitional Housing Benefit. Since 2000, councils have received funds to provide social care support to vulnerable tenants. While this was funded through the Housing Benefit system it is now fully devolved as the Supporting People budget. The two main reasons for this change are that it first related to social care spending which is clearly a devolved issue. Second, it was convenient to administer through Housing Benefit since councils deliver Housing Benefit and because they also received supplementary income to fund what was a short run solution until the Supporting People system came into play. The transition echoes the introduction of local authority support of care in the community in the 1990s.*

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the stock of Scottish Housing Benefit recipients relative to those in England will also produce financial ramifications for the budget, adversely so if the Scottish client group were to grow in relative terms.

Housing, viewed as a discrete policy area, does appear to represent a fiscal asymmetry because of the tensions between devolved housing policies unfolding over time and the pivotal role of Housing Benefit within the UK income maintenance system. Recent debates about higher education and other social policy experiments have suggested that not all of the consequences of devolution have been thought through (McLean 2003) particularly when Government Departments embark on reforms without sufficient consideration of frictions between reserved and devolved competencies.

### **3. THE HOUSING BENEFIT SYSTEM**

Housing Benefit is an integral part of the UK's means-tested income maintenance system centred on the provision of Income Support but also including various tax credits, council tax benefit and other forms of assistance. The present system is available to all qualifying tenants in private or social rented housing. There is no Housing Benefit for low-income owner-occupiers: they are expected to take out private mortgage protection insurance or wait several months for limited Income Support support. Introduced in its current form in 1988, the underlying principle of income maintenance is that no household's income after housing costs should fall below a certain minimum determined by their household size and any special circumstances. This is why Housing Benefit pays 100% of all eligible housing costs for Income Support claimants (if it were less, then income after housing costs would not be guaranteed). For claimants who have income marginally above the relevant Income Support threshold, Housing Benefit is reduced by 65 pence for every £1 of surplus earnings. This is the taper of benefit withdrawal: it implies a marginal tax rate of 65% on surplus income.

Table 2 outlines the cost of UK personal housing subsidies and its three main components. Housing Benefit, strictly, is made up of rent rebates to council tenants and rent allowances to other tenants. Low-income mortgagors have limited access to income support payments to help with mortgage interest payments (though this has been severely cut back since 1996). The table is in cash terms and suggests that there has been a shift into expenditure on allowances and away from rebates and that the total exchequer cost is of the order of £12.5 billion in the financial year which ended in 2003. In real terms

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(in 2000 prices), means tested assistance rose from £6.113 billion in 1988-89, to £11,778 billion in 1995-96. The total fell back thereafter to £8.670 billion in 2000-01. The caseload of claimants, representing about one in six British households, has also shifted in favour of the rent allowance element, reflecting housing tenure change and the relative and absolute decline of council housing. Table 3 is a snapshot of the caseload and composition of Housing Benefit in May 2001. It indicates that Scotland had 445,000 claimants; 296,000 were also on Income Support and thus receiving 100% eligible housing costs in Housing Benefit (two-thirds of the total, the same proportion as England). The table also shows the average weekly payment made for Housing Benefit. Scotland has relatively low average payments across all categories of Housing Benefit.

**Table 2**

**Housing Benefit, £m cash 1988-89 to 2002-03**

Year	Rent rebates	Rent Allowances	Income Support Mortgage Costs	Total Housing Benefit and Income Support Mortgage Costs
1988-89	2,718	1,055	286	4,059
1989-90	2,940	1,359	353	4,652
1990-91	3,368	1,779	539	5,686
1991-92	4,068	2,426	925	7,419
1992-93	4,593	3,284	1,141	9,018
1993-94	5,019	4,195	1,210	10,424
1994-95	5,228	4,875	1,040	11,143
1995-96	5,430	5,446	1,016	11,892
1996-97	5,569	5,810	867	12,246
1997-98	5,495	5,682	660	11,837
1998-99	5,405	5,667	648	11,720
1999-2000	5,360	5,809	527	11,696
2000-01*	5,263	5,895	490	11,648
2001-02*	5,303	6,249	484	12,036

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2002-03\*      5,379              6,763              450              12,592

\* *estimates*

*Source: Wilcox, S (2001) Housing Finance Review 2000-2001, Table 111, p.203.*

A claimant may receive less than their rent if the independent rent officer adjudicates that the rent is too high for the household's needs (this rarely applies in social housing but is an issue in the private rented sector where Housing Benefit also operates). There are further wrinkles to the system: savings are treated as a source of imputed income counted in the means test, deductions are made for non-dependents, and small amounts of income are disregarded in the Housing Benefit calculation. Private tenants have their Housing Benefit capped by a ceiling based on the median local rent in an area determined by the rent officer. However, for our purposes, the key facts relate to the way in which Housing Benefit impacts on households at the margin. The steep taper of withdrawal was identified above. It is commonly viewed as a major constraint or labour disincentive to making work pay.

**Table 3**  
**Housing Benefit Caseload by Countries, May 2001**

Category	England	Wales	Scotland	Great Britain
Local authority tenants (000s)	1,690	122	318	2,131
Housing association tenants (000s)	870	37	80	988
Private tenants (000s)	649	24	27	741
All tenants (000s)	3,210	205	445	3,860
IS <sup>1</sup> or JSA <sup>2</sup> claimant (000s)	2,154	144	296	2,594
Not on IS or JSA (000s)	1,055	61	149	1,266
Local authority tenants weekly payment (£)	45.40	40.90	37.50	44.00
Housing association tenants weekly	58.30	49.80	45.00	56.90

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payments (£)				
Private tenants	65.70	53.10	57.60	64.40
weekly payments (£)				
All tenures weekly	53.00	45.20	40.90	51.20
payments (£)				

<sup>1</sup> *Income Support*; <sup>2</sup> *Job Seekers' Allowance*.

Source: Wilcox, S (2001) *Housing Finance Review 2000-2001*, Table 115, p.209.

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Rent increases to eligible claimants are met in full by Housing Benefit whether or not they are in receipt of Income Support. Thus, there is complete insulation for tenants from any price changes. Such an approach blunts price signals and this creates associated problems in terms of reduced mobility and the possibility of tenants trading up at no personal cost. But the policy does make sense in terms of the income maintenance objectives of guaranteeing income levels after housing costs. The income maintenance objective originates in problems recognised as far as back as the Beveridge report of 1942 that housing costs vary widely across the UK and that a single level of housing support would be grossly inequitable. There is thus a fundamental tension between the income maintenance and housing policy objectives of Housing Benefit.

A further feature of Housing Benefit that sets it apart is its pivotal role within the housing system. Hills (1991) likens housing finance to a cat's cradle within which attempts to unravel the system to develop a more coherent and rational alternative is highly complex. One of the reasons for this is the interaction between housing finance and the benefits system. We will see below that housing commentators make a strong case for reforming Housing Benefit but they have been hampered by 'path dependency' problems: that is, because of the close relationship between two or more policies or processes, changing or reforming one is less likely to have unambiguous or desired outcomes because of the knock-on and often cumulative effects on the related area. First, the social security system relies on Housing Benefit to keep the absolute levels of Income Support payments to relatively low levels (because there does not need to be any housing component). Second, Government (in England) uses rent surpluses to pay for a large proportion of the cost of local authority rent rebates. Thus, restructuring the business and financial frameworks for local authority housing has been constrained by the need to retain this source of funds. Third, social housing investment depends on rent

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payments repaying private finance. In turn, rental income is largely reliant on Housing Benefit. Lenders and associations therefore have a stake in retaining the present system much as it is. At the same time, Housing Benefit is still a major budget heading for the Department of Work and Pensions and the Government, requiring £12.5 billion per annum. As part of Annual Managed Expenditure, Government obviously remains keen to find way to design out high or increasing budgetary costs.

### **4. REFORMING HOUSING BENEFIT**

The main recurring criticisms of Housing Benefit are:

- As a means-tested benefit it is bureaucratic and cumbersome (it is administered by local authorities acting as agents of the Department of Work and Pensions) and confronts major problems of processing delays, overpayment because of claimant income change and fraud (particularly in the private rented sector). For instance, although precise figures are unavailable, the Government asserts that fraud costs up to one billion pounds per annum (DETR/DSS 2000).
- The Housing Benefit system is not 'horizontally equitable', in the sense that it discriminates according to housing tenure.
- Housing Benefit is a major source of poverty and unemployment trap problems.
- By insulating tenants from marginal changes in housing costs, tenants have no stake in or responsibility for their housing. Many argue that this is made worse because of flat and incoherent rent structures that bear no resemblance to quality differentials and hence market signals. This is worsened, so it is argued, by bureaucratic needs-based allocation of social housing.

To be fair, Government is well aware of these problems and has wrestled with fundamental change in Housing Benefit since at least the first Comprehensive Spending Review undertaken by the Treasury in 1998. But it has been thwarted by concerns over the adverse impact of changes on low-income groups and the path dependency problems alluded to above. For several years, the principal objective has been to move the system from its current ex-post nature (benefit payments depend directly on absolute rent levels and only reduce when relative income levels change) to an ex-ante system based on

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some form of fixed allowance where the amount received is independent of the absolute amount of gross rent charged. The idea is that such a policy will end insulation of the claimant from price changes and allow them to economise on housing and make more active housing choices.

The 2000 Housing Green Paper (jointly published by the UK social security ministry and the English Department of the Environment, Transport and Regions: DETR/DSS 2000) set out the policy chronology that would seek to deliver over time, effectively, a quasi-market in social housing. There were three main elements. First, rents would be restructured so that local rents would be comparable across organisations and local average rents would converge. Second, experiments with allocations systems for social housing would be introduced, allowing for much more choice by tenants in the housing they receive (there are also proposals developing common waiting lists between all social landlords in a given area). Third, and more speculatively, the Green Paper explored ways of moving over a period of years to a fixed or ex-ante allowance, minimising the year on year costs to any groups disadvantaged by the transition to the new personal subsidy. Subsequently, a fourth element has been added in the sense that the Decent Homes Standard will set a minimum quality level for all social housing in England by 2010. However, although the first two elements were implemented (the first only in England), benefit reforms were not. However, recent (and unexpected) proposals from the Department of Work and Pensions have finally initiated long-term reform of the design of Housing Benefit (DWP 2002).

In October 2002, the Department of Work and Pensions announced the proposed introduction of a new housing benefit system for private tenants in 8-10 'Pathfinder' local authorities. The aim is to extend the coverage to rental markets in all UK local authorities within a short period and then work to extend it to all social tenants thereafter. Edinburgh City Council is one of the Pathfinders.

The key idea behind the reform is to develop the use of the median rent ceiling (the so-called local reference rent) and to convert it into a cash allowance set at the appropriate median rent – information that will be widely published. Tenants will know how much benefit they will get and because they receive the benefit in the form of a cash cheque they can keep any savings they make. Up until now more than 90% of tenants sign to let their Housing Benefit be paid directly to their landlord. This will no longer be an

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option for the vast majority of tenants. The Department of Work and Pensions argues that this cash-allowance approach will provide housing choice in the rental market and will give the tenant responsibility to make sure that rent payments are in order. The economic argument is simply that the cash allowance is now independent of rents and that market signals will now be able to work in a way that previously they could not. The Department of Work and Pensions argue that once the rent convergence/restructuring process has taken hold and alongside it choice-based lettings are allocating housing (that is, not relying only on bureaucratic notions of 'need'), then a quasi-market for social housing of a uniform minimum standard will in time allow tenants to exercise choice in non-market housing in a way that they presently cannot.

The Pathfinder proposals have been widely criticised, even by those who generally favour more rational and incentive-compatible personal housing subsidies. The main criticisms are:

- Ending the direct payments to landlords will lead to rent arrears and considerable problems for low-income tenants unused to making rental payments. It is naïve to imagine that tenants will switch effortlessly and take responsibility for making rent payment themselves.
- The local reference rent will act as a floor for landlords. Why should they set rents below the ceiling for the rent allowance? Thus, the system may have a generally inflationary impact and in turn could be institutionalised and ratcheted up. Ironically, considerable strain could well be put on the Housing Benefit budget. Moreover, to the extent that these changes discourage landlords from the bottom end of the rental market, this will reduce supply and put further upward pressure on rents.

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- There is little basis for extending the reforms to social housing where no market or quasi-market exists sufficiently robustly in terms of coherent market signals, or where uniform and sensible rent structures do not generally exist, or where there are no genuine opportunities to respond to such price signals through the social housing allocation mechanism<sup>3</sup>. The proposals to restructure rents and allocations remain in their infancy and cash allowances would be introduced without scope for genuine alternative housing choices to be acted upon. There is also no obvious relationship between social rents and the private rented sector, which is the basis for the local reference rent that determines the housing allowance.
- This is a housing-focused reform but it is likely to undermine a core principle of the income maintenance system. If one is seriously seeking to promote market-like mechanisms for low-income housing, there must be risks that fewer resources will be available for some households and that economising actually means having fewer housing services. In other words, developing a quasi-market approach may well undermine the principle of a minimum income after housing costs. This would be less of a problem if it were not for the fact that basic social protection levels of income maintenance are relatively low in the UK. Thus, at the margin, more choice may be available but it may be at the cost of more absolute poverty, which is in complete contradiction to the UK Government's core social justice policies.

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<sup>3</sup> *It should be noted that English rent convergence brings average rents into line between different providers and operates a common rent structure to differentiate rents. However, this does not necessarily imply that coherent rent or price signals will be generated. For instance, the average rents may be different for a good reason and convergence may not be justified on economic grounds. Thus, the outcome of convergence may be to institute new distortions rather than to replace old ones.*

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- Scotland has not moved to restructure rents or to develop policies to allow average social rents within an area to converge (even though rent-setting is often illogical and incoherent: More et al 2003). A major element of the quasi-market is completely missing from the Scottish housing system even though it will confront the new low-income housing allowance. Figures 1 and 2 in the annex of this article provide a visual summary of the variety in rent schemes and rent differentials in Scotland (one not dissimilar to the starting position found in England).

Noting the asymmetry between housing policy in Scotland and benefit policy and the difficulties illustrated by the Pathfinder proposals, should the Scottish Executive push the issue further by exploring the development of a Scottish housing allowance with which to replace Housing Benefit? It is clear that housing policy instruments and objectives cannot in practice be separated from the benefits system. Should there not therefore be an attempt to bring both elements under the control of the devolved tier of Government – a sector-specific form of fiscal autonomy? The next section of the article looks at this question, its feasibility and the necessary conditions attached to the design of such a policy.

## **5. A SCOTTISH HOUSING ALLOWANCE?**

The situation can be summarised as follows. The case for devolving Housing Benefit rests on the different social housing policy frameworks emerging from England and Scotland. The Housing Benefit Pathfinder reform targeted at the whole of the UK refers specifically to English social housing reforms. Therefore, the Pathfinder reforms are not in a sense appropriate or coherent for the Scottish situation. In turn, this raises three options for the Scottish Executive: to stay with the UK Pathfinder approach, to examine retaining the old Housing Benefit system (which would imply a devolution of Housing Benefit) or, more radically, to use the devolved budget to develop a better working alternative for low income housing subsidy. It is this third option that we consider below on the basis of the problems discussed above with both the present Housing Benefit structure and the Pathfinder proposals.

Thus far we have summarised the position by contrasting devolved housing policy with reserved benefits policy. Indeed, for those opposed to greater fiscal autonomy the benefits system is, like taxes, inviolable. Analysts worry

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about the border-hopping potential of large migrations between the countries in response to a clear benefit incentive on one particular side. However, in actual fact, the Northern Ireland Assembly already has formal devolved powers over housing benefit policy. It just chooses not to use those powers. Likewise, there is a strong a priori case for the Scottish Parliament to seek the same devolved powers. The practical issue is that any successor policy should not cost more relative to England.

Apart from the legal and public finance pre-conditions, such a policy instrument would also need to work within the broader social security framework, although we have seen that arguably the Pathfinder proposals' logic undercuts the traditional income maintenance principle of minimum income levels after housing costs. Any new policy would have to win the support of the housing association sector and its lenders who have well-developed long-term business plans founded on rental cash flow and underpinned by personal housing subsidies (for instance, Glasgow Housing Association has entered into a 25 year loan arrangement for around £800 million which, although there is extensive public subsidy in the project, does need to be met from rental income: Gibb 2003). In other words, any new policy should not unbalance existing financial risks managed by the parties. Inevitably, some form of restructuring of social rents would be required in order to move toward a more coherent uniform rent structure, along with more consumerist allocations systems based on choice if any ex-ante form of allowance were to be proposed. Rent restructuring, like benefit reform, also changes the risks facing providers and lenders since it may impact on rental income cash flows. The English experience of rent restructuring suggests that it has to be carefully and gradually implemented.

From an economic perspective, however, the most interesting questions relate to the design of the hypothetical new housing allowance. Can it be designed, within the constraints set out above, in such a way that it overcomes the problems identified with the present system and the Pathfinder proposals? There are several dimensions to consider.

Should it be regionally varied? The reason for regional variation in absolute benefit levels is to reflect local variations in housing costs. This is clear when one compares, for example, London and the North East of England. It is arguably less apparent within Scotland, though housing costs in Edinburgh are generally higher than in other parts of the country. It could of course be argued that providing compensating regional variations simply

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institutionalises these variations. A flat allowance could act to close the gap between regions. However, this is to place a lot of faith in the self-corrective and efficient workings of housing markets.

What structure should the allowance operate within? Starting from the principle that the allowance should be broadly ex ante in form and thus not fully insulate the recipient from rent increases, there are several options. A simple alternative would be, as with the Pathfinders, to convert the ex-post rent component into an ex-ante fixed allowance related in some way to average housing costs for low income households. Alternatively, a variant of the housing gap scheme could be employed, where recipients are expected to meet a proportion of their housing costs themselves (e.g. no more than 25% of their income) beyond which help is provided but normally only for a proportion of the remaining housing costs up to a ceiling. There would also be means-tested income eligibility ceilings with such an allowance. The pitfall with these types of approaches, common in many other countries, is that they are designed for systems with higher levels of basic income maintenance. Without that additional support, as is the case in the UK, such a scheme seems to be a non-starter. A scheme along the lines of the Pathfinder structure would appear to be more feasible.

Should it be delivered in the form of cash, voucher or tax credit? A fixed allowance could be paid to the recipient in a number of ways – in cash, as a marketable voucher or through tax credits. Although there is considerable political resistance to vouchers in the UK and in Scotland, Government is of course moving forward with tax credits, some of which are replacing Department of Work and Pensions benefits. A housing tax credit could perform exactly the same role as an allowance and would have alleged positive effects on labour market incentives (depending on precise design). However, a Scottish allowance would have to overcome the administrative problems associated with the recent introduction of child tax credits. Moreover, devolved tax credits would cause additional political problems of fiscal autonomy because it would undermine the UK integrity of the tax system.

How can the negative consequences of the taper be reduced? Such an allowance would have to be means-tested but poverty trap elements could be addressed in different ways. One suggestion would be to time-limit personal housing subsidies so that benefits are received for say 6 months and are not affected by any change in circumstances. Policies to reduce the taper of

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benefit withdrawal run into the twin problems of costing the Exchequer more and widening the reach of the poverty trap. There are also several small but important administrative changes to the way benefit is calculated and administered that could protect low-income households considering returning to work. Hills (1991) proposed adding a second, lower taper to the existing Housing Benefit system. This lower taper would only cover a given proportion of total housing costs (e.g. 75%) and would apply slightly higher up the income scale, producing a small reduction in marginal tax rates and imposing a marginal cost on recipients when rents increase. Such a scheme could be applied to an ex-ante allowance to counter high marginal tax rates.

A new allowance would have to fit within social security constraints and would have to be phased in to avoid transitional problems for recipients and landlords alike. Clearly, some of the features of the Pathfinder proposals could be replicated but several differences would be required. In terms of fiscal autonomy it would be a significant further step but it could be managed and maintained within the existing wider UK tax and benefit structure.

## **6. CONCLUSIONS**

Within Scottish housing policy we have identified an asymmetry between reserved and devolved powers, largely though not entirely as a result of UK Housing Benefit combining with substantively different devolved social housing policy frameworks. Arguably, the proposed 'Pathfinder' reforms to Housing Benefit, particularly their extension to all rental housing, will worsen the tensions between Scotland and Whitehall over housing policy. However, this will create an opportunity for the Scottish Parliament to explore developing its own housing allowance. This is an opportunity to design a more efficient and rational personal housing subsidy as part of wider reforms to social housing.

In terms of the fiscal autonomy debate, the article raises two types of issue. First, can one expand the Parliament's fiscal powers on a sector-by-sector basis rather than through general measures to increase fiscal controls? Second, it raises the 'spectre' of dismantling the UK benefits system. The real stumbling block, of course, is not Housing Benefit per se but the low levels of income maintenance more generally. This reduces the scope for the type of housing allowance reforms that are feasible. On the basis that the Income Support system is fixed for the foreseeable future (and will not be devolved), would Whitehall countenance a personal housing subsidy designed and run

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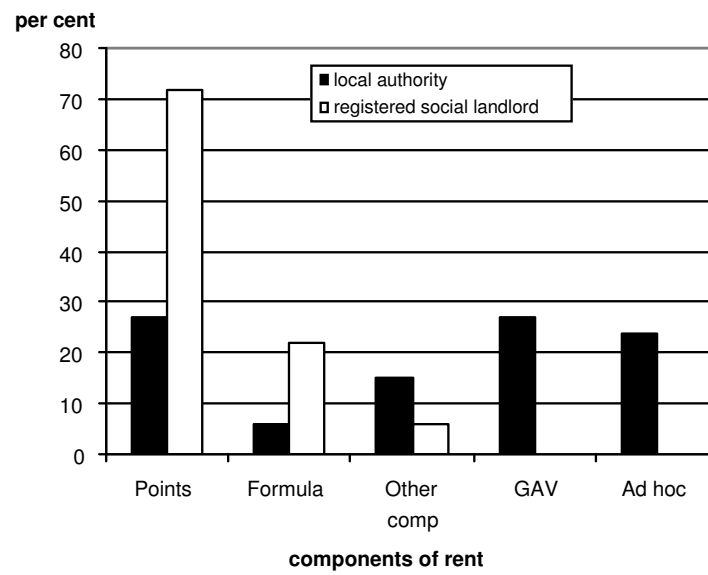
from Edinburgh? If the financing of the allowance operated on the same basis as currently for rent rebates, with the opportunity cost of higher bills falling solely on the block grant, it may not be unfeasible. Modest phased reforms that protect tenants, providers and funders aiming to arrive over a period of years at a fixed cash allowance, varying according to housing market area and household size: this would essentially replace reliance on actual rents with an ex-ante, fixed allowance alternative. Such a policy would also offer an opportunity to redesign the means-tested element of the allowance by looking again at the rules for encouraging benefit recipients to work (for example, by introducing fixed benefit periods and considering altering the taper).

In conclusion, the primary stumbling block to rational reform of personal housing subsidies may not in fact be the fiscal autonomy debate or income maintenance but the scope to deliver the required wider reforms to social housing. Housing policy in Scotland and in England is seeking to increase the level of investment in the existing social housing stock (largely through private finance initiatives such as stock transfer but also through prudential borrowing). This is also about improving management effectiveness, and services to tenants, and decentralising management and ownership to local communities. At the same time, the reform of benefits is couched in terms of wider quasi-market reforms to provide tenants with choice and the capacity to exercise that choice – but these will be difficult to implement and design. How should rents be restructured and how can choice-based housing allocations be introduced on a wide scale while retaining the capacity to prioritise housing need? These are difficult problems that need to be adequately addressed before diving into benefit reform. Earlier in the article, the path dependency problems constraining benefit reform were identified. Even if the devolution finance, housing policy and income maintenance problems are overcome, it may still prove inherently difficult to address what remains a poorly-designed and illogical benefit system.

ANNEX

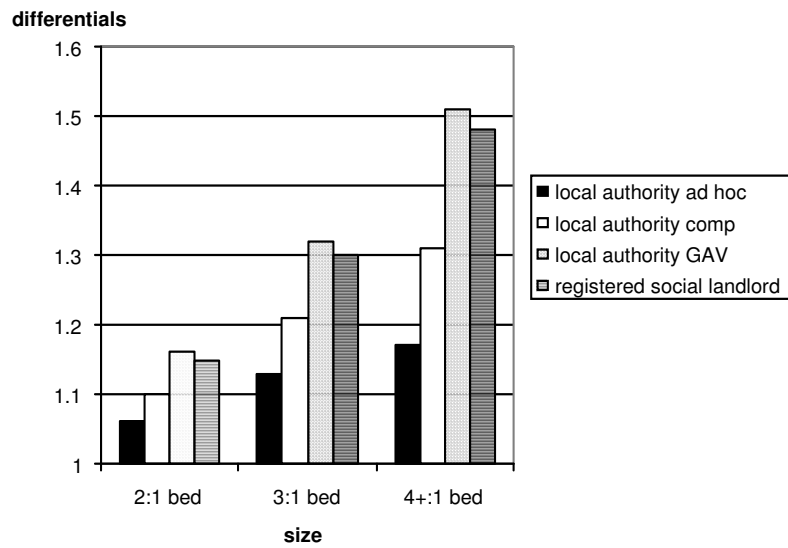
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**Figure 1**  
**Rent setting systems in Scotland**



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**Figure 2**  
**Rent differential ratios by property size, Scotland**



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Both Figures are from More, et al (2003). Note that GAV is the old Gross Annual Value domestic rating system. Points systems and other comparability approaches assign scores to housing attributes which are then summed to work out rent required per point. 'Comp' means 'comparability'.

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