

Does housing wealth contribute to wealth inequality?

par Guillaume Allègre and Xavier Timbeau

[In a response to *Capital in the twenty-first century*, Odran Bonnet, Pierre-Henri Bono, Guillaume Chapelle and Etienne Wasmer \(2014\)](#) attempt to show that the conclusion of the book in terms of the explosion of wealth inequality is not plausible. They point out what they see as an inconsistency in the thesis: according to the authors, the capital accumulation model used by Piketty is a model of accumulation of productive capital, which is inconsistent with the choice to use housing market prices to measure housing capital. To correctly measure housing capital, one should use rent and not housing prices. By doing this, the authors conclude that capital/income ratios have remained stable in France, Britain, the United States and Canada, which contradicts the thesis of Piketty.

In [OFCE briefing note n°9 \(“Does housing wealth contribute to wealth inequality? A tale of two New Yorks”\)](#), we show that the authors minimize the contribution of housing to inequality. In particular, we do not believe that trends in housing prices have “second order redistributive effects”. As is often the case, the disagreement is in part due to a lack of consensus on what really matters when discussing inequality: wealth inequality or income inequality or consumption inequality? If we follow the authors, only the consumption from wealth income should matter. We emphasize a theoretical inconsistency in the authors’ main argument. In fact, they value housing capital as the sum of the present values of rents, under the assumption that what matters is the housing service, then they use a dynastic model in which what matters is the transmission of wealth and not the discounted value of the housing service.

In short, our conclusion is that with regard to inequality, wealth matters, housing wealth is in fact wealth, and should be measured in a manner consistent with the measure of other types of wealth. By doing so, one finds that housing wealth does contribute to the growth of wealth and consequently, Piketty's thesis is not refuted.

For more on this, see: [Allègre, G. and X. Timbeau, 2015: "Does housing wealth contribute to wealth inequality? A tale of two New Yorks", OFCE briefing note, n°9, January.](#)

Rental housing: the CAE wants to change the ALUR ...

By Pierre Madec and [Henri Sterdyniak](#)

On October 24th, the French Economic Analysis Council (the CAE) published a paper proposing a new policy on rental housing in France. This paper calls into question a number of government measures in the ALUR bill currently under discussion in Parliament, such as rent control and the universal rent guarantee (the GUL) [\[1\]](#). Are these criticisms justified? The authors acknowledge that the housing market is very specific, that it requires regulation, and that the state needs to build social housing and assist poor families with housing. Their differences with the policy that the current government intends to follow are thus intrinsically limited, and are more related to means than ends. The free market does not work in the area of housing. There is a need for public intervention that should aim, as we shall see, at contradictory objectives, programmes whose structure is by their very nature subject to discussion.

The existing rental housing stock: co-management and moral hazard

With regard to the private rental market, the authors in essence propose the introduction of a system of housing “flexicurity”, akin to what has been recommended for the labour market: diversification and liberalization of leases, new rights for the landlord, more flexible conditions for terminating a lease, and the development of a system of co-management of the private rental market built around a “housing authority” whose powers would extend from setting “benchmark” rents to managing leases. This “authority”, which would be jointly administered by tenants and landlords, would play a mediating role in conflicts between them, much like the *prud’hommes* bodies for labour disputes. The main argument used by the authors to condemn a scheme such as the GUL universal rent guarantee is that it would create significant problems with moral hazard, that is to say, the guarantee would encourage those covered to take “too many risks”. In this case, tenants, who would have a guarantee that any payment defaults would be covered by the fund, would be less concerned about paying their rent; they could therefore choose housing that is more expensive than what they really need. Owners would also be less concerned in their selection of a tenant. The authors also use the argument of moral hazard to defend the establishment of flexible leases: in their opinion, this would help in the fight against the deterioration of housing as well as in disputes with neighbours. The idea of tenants who are systematically “voluntary deadbeats” ready to degrade the housing they have leased seems simplistic and over the top. However, this idea is developed at some length by the authors. They seem to forget that the GUL will in particular cover tenants who are unable to pay their rent because of financial hardship (unemployment, divorce, etc.). This guarantee above all offers new protection for the owner – protection funded equally by landlords and tenants through a pooling system. In case of failure to pay rent, the landlord

will be reimbursed directly from the fund. The latter will then examine the tenant's situation and proceed either with a mandatory collection or personalized support if the tenant is genuinely unable to pay. The GUL should allow landlords to rent to people who are in vulnerable situations (workers in precarious jobs, students from low-income families), without the latter needing to come up with deposits. Owners would have less incentive to seek safe tenants (civil servants, students from better-off families, employees of large companies). The State is fully within its role by covering a social risk that has been aggravated by the crisis and growing job insecurity. Isn't this worth the fantasized risk of an increase in moral hazard? The matter of the lease raises a question of substance. Should encouragement be given to the development of individual landlords, which inevitably generates friction between on the one hand the owner's concern to freely dispose of their property and be as certain as possible that the rent will be paid and on the other hand the tenant's concern to enjoy a secure tenure and their demand for the right to housing? A household with a low or irregular income, which is thus more vulnerable, must also be able to find housing in the private sector. It may also seem preferable either to encourage institutional investors to invest in this sector or for households to make greater use of collective investment in housing and set up mechanisms such as the GUL, which can collectively address the issue of non-payment of rent. Housing is far from being an ordinary good. It is, and the authors do point this out, above all an essential need, a fundamental right. The massive casualization of housing through the establishment of a system of liberalized leases cannot be the solution. On the contrary, authors drawing on the German model, on the introduction of open-ended leases (the standard lease in Germany), constitute a major advance in terms of the tenant's security [\[2\]](#).

Rent control versus the law of the market

With regard to [rent control](#), the authors rely on a number of studies in order to demonstrate the existence of a correlation between the state of degradation of the rental stock and rent control measures. However, the ALUR law contains provisions for taking into account any renovations undertaken. There is of course a continuing risk that the stock will deteriorate, but once this has been spelled out, we should also mention the equally likely result that the [stock could improve](#) precisely due to this provision for taking renovations into account. The authors also develop the idea that control measures will lead to a significant decrease in residential mobility. While this is a real risk for programmes designed to regulate rents during the lease and not upon re-letting (the main cause of the growing inequality in rents observed in France since the 1989 Act), the rent control provisions in the ALUR law are, on the contrary, designed to lead to a convergence in rents [\[3\]](#). This convergence, although modest, given the large gap still allowed (over 40%), will tend in the direction of greater mobility. In reality, the most important risk raised by the authors is that the number of dwellings available for rent might fall. Although it seems unlikely that landlords already on the market would massively withdraw their rental properties [\[4\]](#), rent control measures could discourage new investors in the rental market because of the resulting decline in yields. This would exacerbate the supply / demand imbalance in high-pressure areas. In practice, this seems unlikely. Even if there were a significant drop in the number of new investors, those already present on the existing market, given the lease conditions (and contrary to the authors' expectations), cannot easily sell their property, except to a new investor who in light of the fall in yields will demand lower prices. The tax incentive schemes ([Duflot type](#)) currently in force on the market for new housing suggest that landlords who invest will be only slightly affected by rent control. Some investors may nevertheless turn their backs on the construction of new housing, which, in the short term, would tend to push down property prices [\[5\]](#), thus encouraging homeownership and a fall

in land prices. The public sector would however have to be ready to take over from private investors. Nearly one in three households in the first income quartile (the poorest 25%) is a tenant in private housing and is subject to a median housing burden, net of housing assistance, of 33%, an increase of nearly 10 percentage points since 1996. Rent control above all offers protection for these low-income households – households that, given the stagnation in social housing and the increasing difficulty in getting on the property ladder, have no choice other than to rent housing in the private sector. As the approach proposed by the [Duflot Act](#) consists of “putting in place a rent control framework to cut down on landlords’ predatory behaviour. Not seeking to try to attract investors based on exorbitant rents and expectations of rising real estate prices” does not seem illegitimate if it is actually accompanied by an effort in favour of social housing. Pressure on the housing market (where supply and demand are rigid) has permitted high rent increases, which is leading to unjustified transfers between landlords and tenants. These transfers hurt the purchasing power of the poorest, the consumer price index, competitiveness, and more. Conversely, these increases can stimulate the construction of new housing by pushing up the value of property, but this effect is low and slow (given the constraints on land). Rent control can help put a stop to rent increases, even if it undermines incentives for private investment in housing to some extent. It cannot be excluded *a priori*.

Social housing mistreated

Even though the authors’ observations seem fair – social housing does not play its [full role](#), and the systems of construction and allocation are complex and inefficient – the solutions that they propose are less so, and are not very consistent. The debate on the role and place of social housing in France is old. Should it be reserved for poor households, thus abandoning the goal of social diversity? If this is done,

should the eligibility ceilings be reduced, even though today more than 60% of the population might be entitled to social housing? Should social housing be profitable? Is there a sufficient supply of it? The idea put forward by the authors, according to which the State, through subsidized loans to housing agencies (HLMs), is to take care of housing only the poorest households, and must leave housing for the working and middle classes to competition (promoters and private investors), is open to criticism, especially in these times of economic crisis. What is needed, on the contrary, is to increase the share of social housing as well as intermediate housing at "moderate" rents that is built with public funds to house the lower classes at reasonable rents and reduce tensions in critical areas. The authors' idea that social housing is not a right to be granted *ad vitam aeternam* seems justified. In 2006, according to the INSEE, more than one out of ten tenants in social housing belonged to the fifth quintile (the richest 20%). Unless one believes that social housing should, in accordance with the principle of social diversity, be open to all, then it is necessary to strengthen measures to encourage these households to leave social housing and direct them to the private sector, or accession needs to be tightened, as the additional rental charges currently applied are not effective enough. But the age of the occupants has to be taken into account, along with the availability of nearby housing at market rents. For housing the lower and middle classes (that is to say, "profitable" operations), the authors also suggest developing competition between private agents (developers, private builders, etc.). Once the amortization period of the loan from the Caisse des Depots et Consignations (CDC) expires, the housing thus built could change status and either switch into the private sector or be sold. This idea gives the impression that the shortage of social housing is the consequence of a lack of available funds. However, thanks to the amounts deposited in Livret A savings accounts, there is no lack of money. The brakes on housing construction are to be found elsewhere (lack of

political will, [lack of land](#), etc.). Even tType text or a website address or [translate a document](#). hough it is necessary to fight against urban segregation and the way to do this is by “disseminating poor households throughout the urban fabric”, the proposals of the authors of the CAE note are not realistic. The index of spatial segregation proposed (see Box 10 in the [working paper](#)) would lead to no longer building social housing in areas where it is already significantly concentrated. However, given the land constraints in high-pressure areas, this is not feasible. The objective of the fight against segregation should not take priority over the goal of construction but complement it. Public funding that is rigidly conditioned on the value of one or two indicators, even the most transparent ones, as proposed by the authors, would be extremely complex to implement. The SRU law establishing identical goals for communes with very different characteristics needs to be amended. Social housing needs to be built in accordance with need and demand. Currently, however, there is no match between supply and demand even in the less problematic areas (housing too big or too small, too old, etc.). According to the INSEE, 14% of social housing tenants are thus in a situation of over-occupation (twice the proportion seen in the private sector). Not only is entry into social housing difficult, but so is mobility within the sector. It is thus necessary to build social housing massively not only to accommodate new populations but also to house current social housing tenants in better conditions. Should the housing issue be de-municipalized? It is certainly a mistake to leave urban decision-making (and action) up to the municipalities alone, as some may be encouraged to give preference to selling off the available land to private developers rather than to housing agencies, whether this is directly for financial reasons or in an effort to attract a relatively affluent population without social problems. Housing policy thus requires strong incentives for the construction of social housing, including aid specifically for the municipalities where it is located, along with legal

constraints and compensatory taxation targeted specifically at towns that have no social housing. The SRU Law is necessary. Note that proposals along these lines are difficult to get adopted at the political level. Thus, the measure to provide for inter-communal decision-making power regarding in particular the Local Urbanism Plan (PLU), a provision in the ALUR law, was largely rejected by the Senate, with the support of the Minister of Housing [\[6\]](#). Similarly, the Union sociale pour l'habitat (social housing union), while deploring the lack of social mobility in the sector, regularly opposes any significant changes to the allocation process that could lead to greater mobility, with each organization striving to protect its own criteria.

Rent and housing aid between taxation and imputation

In the CAE note, the way the tax system takes account of housing costs is the subject of questionable proposals. We agree of course with the starting point: it would be desirable to achieve a certain tax neutrality between income from financial capital and implicit rents. This is necessary from the point of view of both economic efficiency (not to overly encourage investment in housing) and social justice (given equal taxable income, a landlord and tenant do not have the same standard of living). But we believe this can be done effectively only by taxing implicit rents. It is difficult to undertake such a reform today, when substantial tax increases have already occurred. It would be difficult to introduce a new tax. This would therefore have to be accompanied by an upward translation of the tax brackets, so that, if owners pay more, tenants pay less. This could, furthermore, divert some households from building housing; the proceeds would be used in part for the construction of housing, which is inconsistent with the previous proposal to use these to reduce tenants' taxes. This would thus have to be introduced only very gradually. First the property tax bases would be re-valued. Then this database (from which landlords accessing it could

deduct borrowing costs) could be used to tax the rental values at the CSG (wealth tax) or IR (income tax) rates (with some deduction). Fearing that this measure would be unpopular, the authors suggest that tenants could deduct their rent from their taxable income (with a relatively high ceiling of around 1000 euros per month). This proposal is not acceptable: – it is arbitrary: why not also deduct, still with ceilings, spending on food (no-one can live without eating) or on clothing, transportation or mobile phones (now indispensable). This could go on forever. The IR tax scales already take into account the need for a minimum income level (for a couple with two children, taxation only kicks in above a wage income of 2200 euros per month). The authors' measure would privilege housing costs over other spending, with little justification; – the tax savings achieved in this way would be zero for non-taxable persons, and low for those near the taxation threshold: a family with two children and an income of 3000 euros per month with 600 euros in rent would pay 700 euros less tax; a wealthy family taxed at the marginal rate of 45% could save 5400 euros in tax, or 450 euros per month, that is to say, more than the housing benefit of most poor families; – the measure would be very costly. The authors do not give us a precise estimate, but lowering the taxable income of 40% of the 18 million taxable households in France (the proportion of tenants) by 10,000 euros could reduce IR tax revenue by 14 billion. In fact, this must necessarily be offset by a downward translation of the tax brackets. At the end, here, too, if the tenants pay less, the landlords pay more. Furthermore, the measure would be less effective economically than the taxation of implicit rents, since it would introduce a bias in favour of housing costs and does not take into account the value of the property occupied. The authors propose integrating the housing allowance into the IR tax and having all this managed by the tax administration, which would be responsible for developing a coherent redistributive policy on behalf of people on low incomes. While the current system of housing assistance [can of course be improved](#), once again

the authors' analysis is one-sided, and does not include all the aid given to the poorest (the "RSA socle" – basic income supplement for the unemployed; the "RSA activité" – income supplement for the working poor; and the "PPE" – in-work negative income tax). They forget that helping low-income people requires personalized support, in real time, on a monthly or quarterly basis, which the tax administration is unable to provide. In fact, they wind up with a system that is hardly simplified: the tax authorities would determine housing assistance for non-taxed households that the CAF Family Allowance fund would pay monthly and which would be adjusted by the tax administration the following year. But it is left unsaid whether the same formula would apply to the RSA income supplement. For taxable persons, the assistance would be managed by the tax authorities. The authors tell us that, "the aid could not be less than the current housing allowance", but their proposal would greatly increase the number of untaxed households for whom it would be necessary to compare the tax savings and the allowance using the old formula. This is not manageable. It would of course be desirable to simplify the calculation of the housing allowance and to better integrate it with the RSA income supplement. This should be included in a reform of the RSA that the government needs to undertake (see the Sirugue report and the criticism of it by [Guillaume Allègre](#)), but the overall arrangement must continue to be managed by those who know how to do this, the CAF family fund, and not the tax authorities.

Readers interested in housing-related issues should see the [Revue de l'OFCE "Ville & Logement", no. 128, 2013.](#)

[\[1\] Trannoy A. and E. Wasmer, « La politique du logement locatif », Note du CAE, n°10, October 2013](#) and the [document de travail associé](#) [both in French].

[\[2\]](#) Note that the German market is very different from the

French market (majority of renters, little demographic pressure, etc.), and that its rules cannot therefore be transposed.

[3] Currently, in the Paris region and more generally in all the so-called high-pressure neighbourhoods, the difference in rent between those who moved during the year and tenants who have been in their homes over 10 years exceeds 30% (38% for Paris) (OLAP, 2013).

[4] Indeed, “old” investors potentially have higher rates of return than do “new” investors.

[5] As the number of new households is tending to fall (Jacquot, 2012, “La demande potentielle de logements à l’horizon 2030”, *Observation et statistiques*, N°135, Commissariat au Développement Durable).

[6] An amendment according a low level for a blocking minority to France’s “communes” during changes to the PLU (25% of communes and 10% of the population) was adopted by the Senate on Friday, 25 October – an amendment thereby reducing in practice inter-communal authority in this area.

Rent control: will the ALUR law be sufficient?

By Sabine Le Bayon, Pierre Madec and Christine Rifflart

On 10 September 2013, Parliament began discussing the [bill on “Access to housing and urban renovation \[“Accès au Logement et un Urbanisme Rénové” – ALUR\]](#). This legislation will result in stepped-up state intervention in the private rental market and

complements the government decree that took effect in summer 2012 on rent control in high-pressure areas. This was an initial step in the government's effort to curb the increase in housing costs being faced by renters. [1]

The government's willingness to regulate the excesses of the private rental market is expected to have a rapid impact on households moving into a new home. For sitting tenants, the process is likely to take longer. In a city like Paris, we can expect that, if the highest rents decline to the ceiling set by law, average rents will fall by 4 to 6%. If through a ripple effect this then affects all rents, the deflationary impact would be greater. On the other hand, the risk of an upward drift for lower rents cannot be discarded, even if the government argues otherwise. Ultimately, the impact of the law will depend in large part on the zoning defined by the rent monitoring "observatories" that are currently being set up.

The regulatory decree: a visible, but minimal, impact

The latest [annual report](#) of the rent observatory for the Paris region [the Observatoire des loyers de l'agglomération parisienne – "OLAP"] [2] sheds some initial light on the decree's impact on rent control. To recap, the decree holds rents upon re-letting to a maximum of the pace of the legal benchmark (the "IRL"), unless substantial work has been performed (in which case, the increase is unrestricted). Between 1 January 2012 and 1 January 2013, 51% of Paris residences offered for re-letting saw their rent increase faster than the IRL, despite the absence of substantial work. This share was lower than in 2011 (58.3%) and 2010 (59.4%), but remains close to the level observed between 2005 and 2009 (50%), prior to the existence of the decree.

The impact derived from monthly data seems a bit more conclusive. Thus, over the period from August to December 2012 when the decree was implemented, the share of rentals offered for re-letting that rose faster than the IRL cap fell by 25%

on average over a year, against only 8% for the months from January to July 2012 compared to the same period in 2011.

The decree therefore does seem to have had an effect, by helping to reduce the share of rents that increased faster than the IRL cap by about 18%. However, given that if there had been full compliance with the decree no rentals would have risen more than the IRL, the impact has still been inadequate. Several factors already identified in a [working document](#) may explain this: the non-existence of benchmark rents, a lack of information about both owners and tenants, a lack of recourse, etc. One year on, it would seem that these shortcomings had a negative impact on the measure's implementation.

A law on a larger scale

The major innovation of the ALUR law concerns the regulation of the *level* of rent in high-pressure areas, whereas previous decrees focused on *changes* in rents. Henceforth, a range of permissible rent levels will be set by law, and the decree will then regulate the maximum permitted changes [3]. To do this, every year the government sets by a prefectural decree a median benchmark rent per sq.m, per geographic area (neighbourhood, district, etc.) and per type of accommodation (one-bedroom flat, two-bedroom, etc.). So:

- For new lets or re-lettings, the rent cannot exceed the cap of 20% over the median benchmark rent, called the upwards adjusted median benchmark rent, except by documenting an exceptional additional rent (for special services, etc.). After that, any increase may not exceed the IRL, in accordance with the regulatory decree for high-pressure areas (except if there is major work);

- Upon renewal of the lease, the rent may be adjusted upwards or downwards depending on the upwards adjusted or downwards adjusted median benchmark rent [4]. Thus, a tenant (or a lessor) may bring an action to decrease (or respectively, to

increase) the rent if the latter is higher (or lower) than the median rent as adjusted upwards (or downwards). In case of an increase in the rent, a mechanism for staggering this increase over time is set up. If there is a disagreement between tenant and landlord, an amicable settlement process may be initiated prior to referral to a judge within a strictly determined timeframe. Within this range, the increase is limited to the IRL;

- During a lease, the annual rent review is currently performed as now, on the basis of the IRL;
- Furnished rentals will now be covered by rent control: the prefect will set a higher benchmark rate and any change will be limited to the IRL.

The introduction of these median benchmark rents represents three major advances. On the one hand, they will be calculated from the information gathered by the rental observatories about the entire rental housing stock, and not simply from vacant housing available for rental, *i.e.* what is called the "market" rent. This so-called market rent is almost 10% above the average of all rents, which itself is above the median rent. This calculation method will therefore inevitably lead to lower rents (both market and average).

Similarly, choosing the median rather than the average as the benchmark rent should make for greater stability in the measure. In the event that all rents more than 20% above the median (*i.e.* above the upwards adjusted benchmark rent) are reduced and all other rents remain unchanged, the median remains the same. In the case of an adjustment of all rents, the median would fall, but in a lesser proportion than the average, which by definition is more sensitive to changes in extreme values.

Finally, the obligation to include in the lease both the median rent and the upwards adjusted median benchmark rent,

the last rent charged and, where relevant, the amount and nature of any work performed since the last contract was signed, provides for greater transparency and a stricter regulatory framework, which should result in greater compliance with the measure.

What changes should be expected?

In 2012, out of the 390,000 residences put up for rent in Paris, 94,000 have a rent higher than the upwards adjusted median rent (3.7 euros / sq.m more on average) and 32,000 have a rent that is more than 30% below the median benchmark rent (2.4 euros / sq.m less on average). Since only rents above the upwards adjusted median rent are to be corrected, the reduction in the average rent would be 4% to 6%, depending on the area and type of housing. This reduction, although not insignificant, would at best permit a return to the rent levels recorded in 2010, before the steep inflation seen in 2011 and 2012 (+7.5% between 2010 and 2012). This adjustment in rents could nevertheless take time. Owners and tenants could easily exercise their rights at the time of a re-letting [5], but revaluations at the time of a lease renewal may take longer to realize. Despite access to information and a regulatory environment that is more favourable to the tenant, the risk of a conflict with the landlord and heightened competition in the rental market in areas where the law applies may still deter some tenants from asserting their rights.

The issue is much more complex for the 32,000 residences with rents below the downwards adjusted benchmark rent. While the quality of some of this housing can justify the difference (insalubrious, location, etc.), it is also clear that the main factor behind the weakness of some rents is the tendency of tenants to be sedentary. Thus, according to the OLAP rent observatory in Paris, the average rent for housing occupied for over 10 years by the same tenant is 20% lower than the average rent for all lets. The question thus arises of re-

valuing these rents. Indeed, during a new let or a lease renewal the law allows owners to reassess up to the level of the downwards adjusted median rent – which is also in contradiction with the decree [6]. Once this level has been reached, future changes shall not exceed the IRL.

Eventually, then, some units with similar characteristics will therefore be on the market at very disparate rents, thus penalizing landlords with sedentary tenants. In contrast, tenants who have lived in their homes for a long time might well see significant revaluations in their rent (over 10%). The housing cost burden [7] on these households could thus rise, pushing those facing excessive budget constraints to migrate to areas experiencing less pressure.

Nevertheless, the possibility of revaluing the rent to the level of the market rent in case of an obvious undervaluation is already provided under existing law, *i.e.* the Act of 6 July 1989 (Article 17c), at the time the lease is renewed. In 2012, in Paris, 3.2% of owners made use of this article. With the new law, while readjustments should be more numerous, the inflationary impact should be weaker as the benchmark (the downwards adjusted median rent) is well below the market rent.

From this point on the issue of zoning is central: the more refined the breakdown, the more the benchmark rents will correspond to the actual characteristics of the local market. In the event of a larger division of the territory, the median benchmark rents may be too high for the less expensive neighbourhoods and too low for the more expensive ones. Meanwhile, low rents will not be re-valued much in the expensive neighbourhoods, and even less so in the others. This could lead to more “inter-neighbourhood” convergence in rents – regardless of local conditions – and less “within-neighbourhood” convergence, which would have adverse consequences for both landlord and tenant.

The impact on rents of the law currently under discussion

could be all the greater given that property prices began to fall in France in 2012 and the current sluggish economy is already slowing rent hikes. But it should not be forgotten that only the construction of housing in high-pressure areas (including via densification [8]) will solve the structural problems of the market. Rent control measures are merely a temporary measure to limit the increase in the housing cost burden, but they are not by themselves sufficient.

[1] For more information, see the blog [“Rent control: what is the expected impact?”](#)

[2] The territory covered by this report is composed of Paris and what are called the “petite couronne” and the “grande couronne” (its near and far suburbs).

[3] As the rent control decree does not cover the same field as the law (38 urban areas versus 28), some areas will be subject to the control only of changes, and not of levels.

[4] While the bill is unclear on the calculation of the downwards adjusted benchmark rent, an amendment adopted in July by the Commission of the Assembly proposed that this should be at least 30% lower than the median benchmark rent. Another amendment clarifies that in case of an upward adjustment, the new rent shall not exceed the downwards adjusted median rent.

[5] In 2012, only 18% of residences on the private rental market were subject to re-letting.

[6] During the renewal of a lease or a re-letting, the rent control decree permits the owner to re-value their rent by half the gap between the last rent and the market rent.

[7] This is the share of household income spent on housing.

[8] On this subject, see the article by [Xavier Timbeau](#).

[“Comment construire \(au moins\) un million de logements en région parisienne” \[How to build \(at least\) one million residences in the Paris region”\], *Revue de l’OFCE* no. 128.](#)

Livret A accounts – drowning in criticism

By Pierre Madec

As the Governor of the Bank of France and the Minister of the Economy and Finance announced a further (probable) reduction in the interest rate on Livret A accounts for August 1st, the rating agency [Standard&Poor’s](#) (S&P) released a study of the French banking system. The U.S. agency argues that Livret A accounts, and regulated savings more generally, “penalize French banks” and are at the root of “distortions in the banking market”. This debate, which is hardly new, has been the subject of a number of reports: [Duquesne](#), 2012; [Camdessus](#), 2007; [Noyer-Nasse](#), 2003, and more. Some ardently defend the peculiar French approach represented by Livret A, while others advocate, on the contrary, a deep-going reform of a system they describe as “lose-lose”.

So what’s the actual situation? Do Livret A accounts really threaten the French banking system? How are the household savings deposited in them used? What has been the impact of the series of increases in the ceilings on deposits? What will be the impact of the (probable) new rate cut proposed by the Minister of Economy and Finance, Pierre Moscovici, both for savers and for the financing of social housing? We provide a few answers below.

What are Livret A accounts?

Livret A accounts date from almost 195 years ago. They are a regulated investment that gives the right to a fiscal benefit (exemption from all taxation and social charges), with guaranteed deposits at a rate set by the State [1].

In 2011, the French savings rate was 16% on average, which was 1.1 points higher than in 2006. The increase in the savings rate went largely into regulated savings, and especially into Livret A accounts, which are held by [63.3 million French people](#), with total savings of 230 billion euros in April 2013, twice the level of January 2007. Three successive developments contributed to this massive increase in total holdings: the financial crisis, which redirected a portion of household savings into risk-free investments; the widespread distribution of Livret A passbooks to all banks after 1 January 2009, under the Act to modernize the economy [2]; and finally, the 50% increase in the ceiling on Livret A accounts, which took place in two stages (in October 2012 and January 2013). This growing attraction for Livret A is also due to the full liquidity of the accounts and the deposit guarantee – neither of which is available, for example, for life insurance.

What is the role of Livret A accounts?

One of (many) specific features of the French model for financing housing is (among others) that providers of social housing do not draw on the bond markets ([Levasseur, 2011](#)). Social landlords are therefore financed mainly (73% in 2012) by the Caisse des Depots et Consignations (CDC), where a portion of household's Livret A savings are deposited. The CDC operates a savings fund that centralizes 65% of Livret A holdings, which in April represented more than 150 billion euros (Banque de France). The deposits made available are used primarily for lending for social housing and urban policy [3]. These borrowings are largely used for the construction,

acquisition and rehabilitation of social rental housing by social landlords (*HLM bailleurs*), but they can also be used to finance specific housing operations and urban policy measures such as the National urban renovation plan (“NERP”). In order to secure the deposits and ensure the savings fund has the amounts needed, the amount of deposits centralized under Livret A funds must always be greater than or equal to 125% of the outstanding loans for social housing and urban policy granted by the CDC.

It is obvious that the target of building 150,000 social housing units per year (compared to 105,000 in the year 2012) will give rise to a significant increase in the sector’s financing needs [4]. To meet this goal, 13.7 billion euros in lending for social rental housing will need to be granted for one year in 2013, *i.e.* 4 billion more than in 2012.

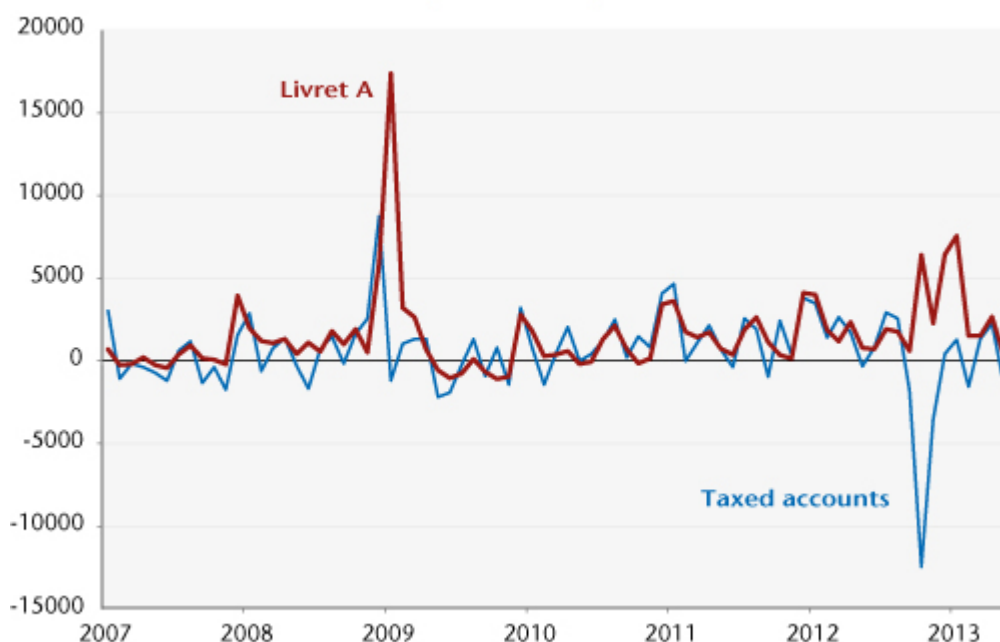
Finally, the Livret A resources that are not centralized by the CDC (80 billion euros) are subject to a “duty of use”. Eighty percent must be used by the banks [for financing SMEs](#) while 10% must be used [to finance energy savings measures in existing buildings](#) [5]. Similarly, a certain number of local government investment programmes (Campus Plan, 2012 Hospital plan, Grenelle Environment programme) have benefited from Livret A funds.

Are Livret A accounts endangering the French banking system?

Given the increasing interest of households in regulated savings (especially Livret A), one might think (like S&P) that this type of investment threatens the banking system by depleting bank liquidity, which has already been undermined by the crisis. The higher ceilings established in recent months have indeed led – in essence – to a transfer of savings to tax-exempt investments, whose share in total household financial savings increased by 0.6 percentage point between 2011 and 2012. In October 2012, there was a significant drop in savings accounts subject to tax (-12 billion euros), a drop

that can be explained in part by the higher ceilings on Livret A accounts (+6 billion euros) [6] (see Figure 1).

Figure 1. Changes in the Livret A balance and in accounts subject to tax (billion euros)



Source : Banque de France.

It is important to put S&P's alarmist declarations into perspective – on the one hand, because, except for the month of October 2012, the flow from taxed accounts has been relatively stable, and on the other hand, because in 2012 regulated savings, although up significantly, accounted for only 9.5% (6.2% of which for Livret A) of total household financial savings, which amounted to 3,664 billion euros. In addition, if there were a real and lasting lack of liquidity, technical adjustments exist or can be made. According to the latest [annual report of the Cour des comptes](#) (French Court of Auditors), at the beginning of the year the coverage ratio of savings deposits was 156% of outstanding loans to social housing and urban policy, instead of the regulatory 125%. This over-coverage represents about 50 billion euros, which are allocated neither to the financing of social housing nor to bank liquidity. Now claimed by the banks, these funds are to be quickly allocated. As the savings fund has substantial

liquidity, while leaving unchanged the ratios of coverage and of centralization (the fruit of bitter negotiations), it is clear that a number of temporary transfer mechanisms between the savings fund and the banking sector could quickly deal with any risk of a liquidity crisis. Finally, note that the banks have also benefited from the more widespread distribution of Livret A, notably through the payment by the savings fund of a commission on the amounts centralized. This commission, which is directly drawn on the funds for social housing, took 1 billion euros from the savings fund in 2012. Without drawing any conclusions about what should be done with these counterflows, it is questionable whether a better trade-off could be established between the centralisation rate and the coverage rate, the commission rate and the long-term funding of social housing [7].

What about the “probable” cut in the rates?

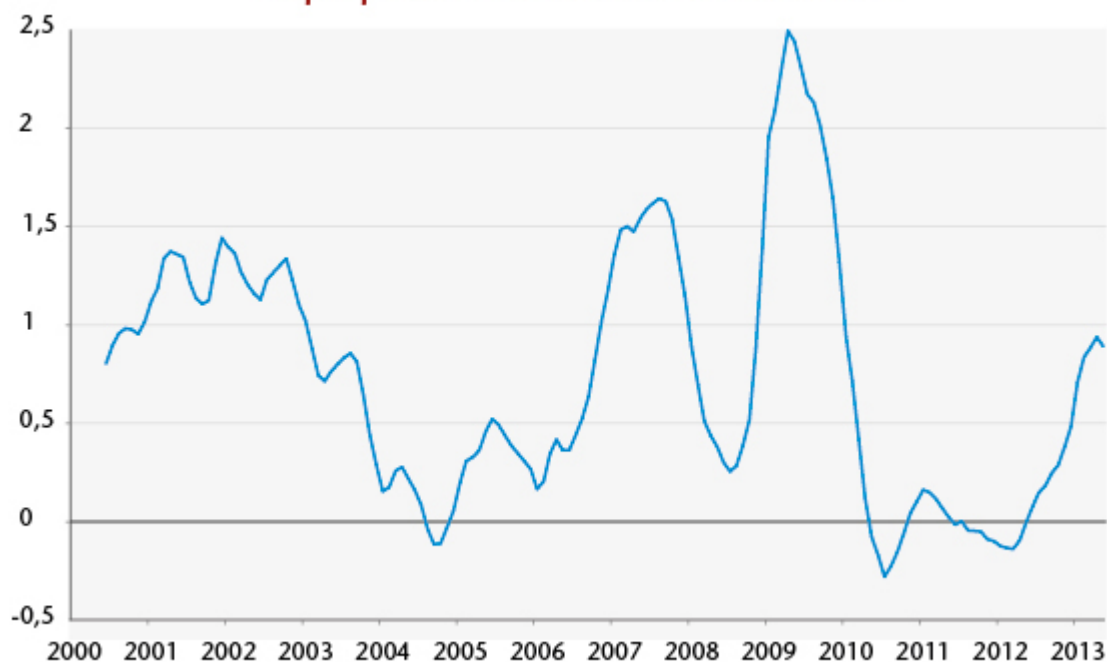
The reduction in Livret A rates, the proposal advanced on June 23 by the Minister of the Economy, Pierre Moscovici, who was echoing the statements made a few days earlier by the Governor of the Bank of France, Christian Noyer, should come into force on August 1, and is the result of a fall in the inflation rate on which it is partly indexed. What effect would this rate cut have on the flow of savings into Livret A accounts, and thus on the financing of social housing?

In May 2013, the interest rate on Livret A was 0.5% in real terms, a relatively low level. Over the period 2011-2012, it even came to an average of zero (see Figure 2). However, the net flow remained stable over the period. This is explained partly by the low rates offered by other investments, in particular taxed savings accounts such as the CEL home savings plan, which have had a negative real net rate since late 2009. Given the trade-offs made by households, in particular the wealthiest ones, in their efforts to obtain the best return on their savings, it is relatively complex to demonstrate a strict correlation between the rate on Livret A accounts (real

or nominal) and changes in the total outstandings. Thus, in the second half of 2009, Livret A suffered outflows even though the real rate on it was high; in 2010 and 2011, however, net deposits were high even though the rate was no longer so high.

Given, on the one hand, the lower real net rates offered by comparable investments and, secondly, current social and economic uncertainties, we can expect some stability in the flows during the second half of 2013, despite the decline in the rate of remuneration. This stability will obviously depend on the size of the rate reduction. As the rate is currently 1.75%, it seems unlikely that the high inflows will continue if the rate is revised below 1.25%. As France's Economic commission expects inflation of 1.2% for 2013, fixing the Livret A rate below this would result in a fall in household purchasing power, which would go against the government's commitments.

Graphique 2. Taux d'intérêt réel sur le Livret A



Source : Banque de France, INSEE, calculs OFCE.

Nevertheless, it should not be forgotten that this re-valuation in the rate is not automatic and in fact depends on a political decision. In the second half of 2009, while the

collapse of inflation would have justified a decrease of 1.5 points to reduce the rate to 0.25%, the rate reduction ultimately applied was only 0.5 point, leaving the rate at 1.25%. An additional 2 billion euros was thus distributed to households. Conversely, in February 2012, given the return of higher inflation (even temporarily), the rate should have been lifted to 2.75%. The savings shortfall for households due to not changing the rate is estimated at 1 billion euros.

As with households' choice between safety, liquidity and yields, the public trade-off between household purchasing power and the lending terms for social landlords can prove to be complicated. So while undervaluing the rate significantly benefits beneficiaries of the allocation of funds from Livret A (mainly social landlords) whose loan rates are "indexed" on the Livret A rate, it is disadvantageous for the saver.

While "small" savers are not very sensitive to changes in interest rates, "big" investors, that is to say, those approaching the deposit ceiling, can make rapid trade-offs out of Livret A. However, these 10% of the depositors, with the largest accounts, represent 51% of Livret A deposits. A massive reduction in rates could therefore lead to a significant outflow and subsequently substantially reduce the CDC's capacity to lend to the social housing sector, a sector with ambitious building targets and mounting financing needs. On the contrary, it seems clear that maintaining higher rates during a period of low inflation would push up the cost of lending to social housing, at a time when the State and the housing agencies have committed to the construction of [120 000 social housing units](#) per year between 2013 and 2015.

[1] For greater detail on the method of determining the interest rates, see [Péléraux \(2012\)](#).

[2] In January 2009, the total balance experienced a historic

increase of 12.5%. For comparison, the successive increases in the ceiling in last October and January resulted in increases of 3.1% and 3.5%.

[3] In 2012, [total lending of 9.7 billion euros was granted by the savings fund](#) simply for financing the 105,000 social housing units.

[4] This objective corresponds to a campaign promise of the candidate Francois Hollande. It was recently downgraded: 120 000 housing financed per year until 2015 and 150,000 from 2016.

[5] For example, in 2012 Oséo and the FSI Strategic investment fund (*Fonds stratégique d'investissement, FSI*) received, respectively, 5.2 billion and 0.5 billion euros of resources from Livret A.

[6] The transfer was made primarily to the LDD Sustainable development account (*Livret de développement durable*), whose outstandings grew by nearly 14 billion euros in October 2012 following the doubling of the ceiling.

[7] While the commission rate should converge by 2022 to 0.50% for all the distributing institutions, in 2011 it was 0.37% for new distributors and 0.53% for traditional distributors ([CDC, 2012](#)).

Roofs or ceilings?

by [Philippe Weil](#)

The [bill to promote access to housing and urban renovation](#) provides for regulating rents “mainly in urban areas where there is a strong imbalance between housing supply and demand

and where rents have experienced the steepest increase in recent years". Rents that exceed the median rent, set by neighbourhood and housing type, by more than 20% "will be targeted for a reduction". The purpose of the cap is of course laudable, as it is "designed to combat the housing crisis, which for many years has been characterized by a sharp increase in prices, housing shortages and a decline in consumer purchasing power". The road to hell is, alas, paved with good intentions, as today's ceilings often destroy tomorrow's roofs :

- "Rent ceilings [...] cause haphazard and arbitrary allocation of space, inefficient use of space, retardation of new construction and indefinite continuance of rent ceilings, or subsidization of new construction and a future depression in residential building. Formal rationing by public authority would probably make matters still worse."

Opposing rent ceilings does not mean, however, resolving the inequalities that arise with respect to housing:

- "The fact that, under free market conditions, better quarters go to those who have larger incomes or more wealth is, if anything, simply a reason for taking long-term measures to reduce the inequality of income and wealth. For those, like us, who would like even more equality than there is at present, not alone for housing but for all products, it is surely better to attack directly existing inequalities in income and wealth at their source than to ration each of the hundreds of commodities and services that compose our standard of living. It is the height of folly to permit individuals to receive unequal money incomes and then to take elaborate and costly measures to prevent them from using their incomes."

The authors of these two quotes, which enjoin us to allow the

free market system to allocate the available housing to tenants and which advocate attacking inequality of income and wealth directly at the source, are none other than Milton Friedman and George Stigler – the two founders of the Chicago School. The title of this post is borrowed – I hope they forgive me – from their 1946 article [“Roofs or Ceilings: the Current Housing Problem”](#) [1].

The Duflot bill envisages a rent control mechanism that is far more sophisticated than the one denounced by Friedman and Stigler nearly seventy years ago. Its impact on the French real estate market can of course be evaluated in a few years, but the recent economic literature warns that so-called “second generation” rent control mechanisms often have ambiguous effects [2] – not always negative but not necessarily positive [3]. In these circumstances, it is regrettable that a preliminary experiment of the sort that prudence demands is not being considered for some randomly selected cities. While political urgency undoubtedly argues against delay, nevertheless in economics as in medicine it is crucial to ensure that efforts to cure the patient do not wind up killing him.

To conclude, the warning of Friedman and Stigler still holds: inequalities in income and wealth need to be attacked directly at the source, and not later down the line.

[1] Foundation for Economic Education, Irvington-on-Hudson, NY.

[2] Cf., for example, *The Economics and Law of Rent Control*, by Kaushik Basu and Patrick Emerson, World Bank, 1998.

[3] Please see [Le Bayon, Madec and Rifflart \(2013\)](#) [in French] for an evaluation of the regulation of the French rental market.