

An Assessment of the Kuwaiti Governmental Policies Intended to Promote Home-Ownership

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Abstract

This paper investigates the active role played by the Kuwaiti government in promoting home-ownership for the citizens of the wealthy state. The research provides descriptive background information on the current scheme for housing welfare provision in the country. An economic analysis of the scheme is performed so as to identify its flaws and shortcomings, in terms of justice, efficiency and community outcomes. In light of this analysis, the paper proposes an alternative scheme based on direct subsidies that are compatible with market principles.

Keywords: Efficiency, Housing, Justice, Subsidy, Welfare

ملخص

تقوم هذه الورقة بدراسة الدور الفعال التي تلعبه مجموعة من مؤسسات الدولة في الكويت فيما يتعلق بتوفير السكن المناسب للمواطنين. حيث تبدأ الدراسة بتسليط الضوء على نظام الرعاية السكنية الحالي والذي يمثل إحدى أهم مقومات سياسة الرفاه التي تنتهجها الدولة. وتتضمن الدراسة تحليلاً اقتصادياً يهدف إلى التعرف مواطن الخلل والقصور فيما يتعلق بتحقيق العدالة وكفاءة توزيع الموارد والتأثيرات الخارجية على مختلف شرائح المجتمع. وتبين نتائج التحليل أنه على ضوء الطبيعة الشمولية للنظام الحالي للرعاية السكنية، لا يساهم هذا النظام في تحقيق المزيد من العدالة رغم تكلفته المرتفعة. كما تؤكد نتائج التحليل أن تطبيق النظام الحالي ينتج عنه بالضرورة خلل في الكفاءة نظراً لاعتماده بشكل كبير على منظومة دعم غير مباشرة. كما تشير نتائج التحليل إلى إمكانية استفحال بعض التأثيرات السلبية الخارجية في المجتمع نتيجة للتمسك بهذا النظام.

وبناءً على نتائج التحليل تؤكد هذه الدراسة على ضرورة إصلاح النظام الحالي. وفي هذا السياق، تقترح الورقة نظاماً بديلاً يعتمد على منظومة دعم مباشرة تكون أكثر تناسقاً مع آليات السوق من المنظومة الحالية. وتقترح الورقة أن يتم الدعم عن طريق دفع كوبونات "Vouchers" للمستحقين كبديل عن الآليات الحالية والتي تعتمد على إعطائهم قروض بدون سعر فائدة. واستناداً إلى فرضية عدم التساوي في قيمة الكوبونات بين المنتفعين، فإنه من الطبيعي أن تساهم هذه الآلية في المزيد من العدالة في المجتمع الكويتي حيث يمكن تركيز الدعم على الفئات الأقل إمكانية من الناحية الدخلية. كما أن للنظام المعتمد على الكوبونات مزايا أخرى وخاصة ما يتعلق منها بالكفاءة. فيتطلب هذا النظام البديل يمكن تلافي الاختلالات المتواجدة الحالية في عمليات النظم المالية للمؤسسات المعنية بتوفير الرعاية السكنية والناجمة عن عدم كفاءة آلياتها المتعلقة باسترداد القروض. كما يسمح نظام الكوبونات بالقياس الدقيق للحجم الحقيقي للعبء المالي الذي تتحمله المؤسسات المعنية بتوفير الرعاية السكنية. ويمكن ذلك النظام هذه المؤسسات من القيام بتقديرات أكثر مصداقية لأثار الموارد التي يتم توظيفها لهذا الهدف، وفي نفس السياق، يعطي هذا النظام رؤية واضحة للمنتفعين عن الحجم الحقيقي للفائدة التي يحصلون عليها. وبفضل مثل هذه الشفافية في المعلومات والتي تتناسق مع مبادئ اقتصاد السوق، يمكن تحسين منظومة الكفاءة. كما يسمح هذا النظام البديل بآلية الفرصة للقطاع الخاص لزيادة نصيبه من سوق الإسكان حيث أن الكوبونات يمكن أن تستعمل من قبل المنتفعين كوسيلة لتحقيق طلب فعلي على الإسكان يتولى توفيره هذا القطاع في ظل تخلي المؤسسات المسؤولة عن الرعاية السكنية عن عمليات البناء والتشييد كما هو مطلوب في النظام الحالي.

1. Introduction:

One of the principal priorities for the authorities in charge of implementing social policies in the state of Kuwait is to provide housing welfare to its citizens so as to pledge home-ownership for every family. The notion of home-ownership is so highly cherished in the wealthy society to the point that most citizens view it as a constitutional right. In fact, the general consensus in the Kuwaiti society is that one of the principal duties of the state should indeed be guaranteeing home-ownership to all its families. Moreover, the expectations by the public, in terms of the extent of state assistance for this end, are considerable in light of the very high standards of living in the country that are not surprisingly reflected by an evident quest for quality, in particular with respect to housing. To this end, the state of Kuwait has had for a long time a welfare scheme by which very generous home-ownership assistance is channeled to its citizens.

However, over the years, and because of some serious flaws and deficiencies in the fundamentals of this scheme, enormous pressures on state resources have emerged, causing downgrades in terms of the delivery of the benefits to the public. In particular, in the last few years, and with the continuously growing demands from citizens who qualify to receive these welfare benefits, the state has found it very difficult to keep-up with the consequential arising financial burdens. In fact, the strain on resources has become increasingly severe to the point that the future sustainability of the current scheme is believed to be in serious jeopardy. The expression "housing crisis" is now being commonly used among Kuwaiti policy makers and the general public in reference to the continuous decline in the delivery of housing welfare provision under the current scheme.

While the magnitude of the problem has reached alarming levels, there has not been any significant flow of literature about the different aspects of the issue, as there should be, in particular in light of the unique features of the state of Kuwait and its welfare programs. This paper aims

to fill some of this gap in the literature by shedding some lights on the dimension of the problem and some of its distinctive features. More precisely, its focal aim is to identify the principal reasons for the failure of the current scheme and propose broad ideas for a reform agenda. The paper offers an analysis of this scheme in harmony with economic theory. The main characteristics of the scheme are examined so as to identify its structural deficiencies, and provide viable explanations to the current "crisis". It is hoped that this effort will initiate a scientific debate on the need for this matter to be on the Kuwaiti policy-makers' urgent agenda for welfare reform.

The remainder of the paper is organized as follows: The next section provides brief descriptive background information on the current scheme for housing welfare provision in the state of Kuwait. The third section is devoted to an economic analysis of the scheme so as to identify its flaws and shortcomings. The fourth section outlines the basic prerequisite features that should exist in any reform program intended to turn around the current scheme's failures. More specifically, it proposes an alternative scheme involving a voucher system that is compatible with market principles. The final section summarizes and concludes the paper.

2. The Current Scheme, General Information:

Kuwait is one of the wealthiest countries in the Arab world with an economy heavily dependent on oil. The abundance of oil resources and its relatively small population have been the principal factors behind the materialization of the state of Kuwait into a "welfare state". Indeed, state policies in Kuwait are perhaps some of the more vigorous worldwide, in terms of the extent of generosity of benefits so as to ensure high standards of living to all of its citizens. The range of social services available to Kuwaiti citizens free of charge is impressive by any standard (health care, education, housing allowances, consumer price subsidization, etc...).

However, and as a result of this deep commitment to the ideals of the “welfare-state”, much of the state policies with regard to social services in the country have been severely at odds with market forces. In fact, the state had found itself consistently making efforts to modify the play of market forces so as to ensure all citizens the “best available” standard of living, irrespective of market outcomes. Needless to say that this choice for social policies has, through time, necessitated on a consistent basis an aggressive form of state intervention in all aspects of the economy. This has translated into a relatively large public sector with a huge range of welfare services being provided to Kuwaiti citizens for little or no explicit cost to them.

To put into practice this welfare system, it was necessary for the Kuwaiti government to design strategies and policies, adopt plans, and implement programs intended to help secure benefits to both current and future generations. One of the more important components of social services made available by the state is housing support, or “housing welfare” as commonly referred to in the state of Kuwait. Indeed, the issue of housing policy in general, and that of housing welfare provision in particular, have been some of the priorities for policy-makers in the country during the last few decades. From this perspective, the fact that the state of Kuwait has always had a social housing care policy since its early days should not come as a surprise to anybody. This housing care policy has seen major evolutions in the last forty years, both in terms of the institutional arrangements and the nature of the support delivery. The table below gives an overview of the major governmental decisions taken over the last forty years (arranged in a chronological order), in its continuous effort to ensure housing care to its citizens. More precisely, it records the principal evolutions in the institutional set-up designed to channel housing welfare provision to the public.

Table: Main Decisions Depicting the History of Housing Social Policy

Date	Decision	Mandate
1954	A decree by the government to create a Construction Council”	The council to design an urban and housing policy, and construct 2,000 housing units
1962	A decree by the Emir to the Ministry of Social Affairs and Labor	The Ministry to distribute state housing units
1965	Decree (30) to create the “Bank for Loans and Savings”	The Bank to provide citizens with easy credit for the purposes of real estate finance, finance of state housing unit expansions, and finance of buildings or repairing units on real estate lots allocated by the state.
1974	Decree (15) to create the “Public Authority for Housing”	The Authority to implement the state plans for housing development. The principal responsibility of the Authority is to be in charge of state housing units
1975 1986	Creation of the “Ministry of Housing”	The Ministry, in coordination with the “Public Authority for Housing”, to be in charge of allocating state housing units to citizens based on certain criteria A more coordinated effort in the state’s social housing policy
1993	Merger of the “Ministry of Housing” with the “Public Authority for Housing”	The institution to provide housing welfare to citizens according to a number of criteria
1995	Decree (47) to create the “Public Authority for Housing Welfare” as a replacement to the “Public Authority for Housing”	The private sector can participate in the construction on state land set aside to housing welfare purposes
2005	Amendment of decree (27) of 1995 about private sector involvement	More flexibility for the “Public Authority for Housing Welfare” in regards to the involvement of the private sector

As it stands currently, the two principal channels through which housing assistance is provided by the state are the “Bank for Loans and

Savings” and the “Public Authority for Housing Welfare”, created respectively in 1965 and 1993 as shown in table (1). As mentioned earlier, the objective of the housing policy is to ensure home ownership, as opposed to occupation (rental) as in many welfare systems worldwide. The current scheme, with its two main channels, is designed to help every Kuwaiti family to own either a real estate lot that can be used for housing construction, a house, or an apartment. Under this scheme, the “Public Authority for Housing Welfare” is in charge of financing the construction of houses and apartments, and all pre-construction costs of lots. It also bears all relevant costs of necessary basic services and public utilities. The private sector has a contribution in this process as it is often contracted (through a lowest bidder procedure) by the “Public Authority for Housing Welfare”. The institution also provides long-term interest free loans to purchase a house or an apartment, (in addition to incurring a fraction of rental expenses of people who are entitled to housing care but who are yet to be served). As for the “Bank for Loans and Savings”, its principal duty is to provide long-term interest free loans to build a housing unit on a lot.

The availability of these two channels results in many instances on people receiving housing welfare in more than one form. Typical examples include: i) a citizen receiving a real estate lot from the “Public Authority for Housing Welfare” and a long-term interest free loan from the “Bank for Loans and Savings” for a construction purpose; ii) a person receiving a state housing unit plus a long term interest free loan later on for maintenance purposes; and iii) a family receiving a housing allowance for rental purposes then at a later stage a state housing unit or a lot for construction.

In all cases, tremendous financial burdens are borne by the state. In fact, the pressure on financial resources is being felt more severely in the last few years as it is becoming increasingly clearer that the current scheme is not able to deliver the housing care as stipulated by Kuwaiti laws and regulations pertaining to social policies. Indeed, under the current scheme, the premise of state housing care in Kuwait is of a “distribution of wealth”, rather than “redistribution in favor of the needy”. The fact that every family is entitled to benefit from the current housing care scheme, (through the two principal channels), has resulted into a growing concern that it can not be sustainable in the long-run. Liquidity shortages are a real issue for the two principal institutions for a variety of reasons that will be discussed in the next section. In addition, the demographic factors in Kuwait are

expected to accentuate the crisis in the near future. This is bound to happen as the rate of growth of families entitled to benefit from housing care policies is expected to rise in the next two decades.

But even without this expected increase, as it stands right now, the situation is such that it has reached crisis levels. To illustrate the extent of the problem, it is worth mentioning that the "Public Authority for Housing Welfare" receives more than 5,000 applications every single year. This institution is currently able to barely generate 3,500 housing units. As a result, it has cumulated over the years over 60,000 of unfulfilled applications. There are families who have been on the "waiting list" for as many as twelve years. If all applicants were to receive all the housing care they are applying for right away, it would require the state to spend an amount of around USD 20 billion.¹ An internal study conducted five years ago by the "Public Authority for Housing Welfare" concluded that unless the system is reformed, the situation will evolve gradually over a number of years to the point whereby the state will have to allocate as much as 50% of oil revenues in order to be able to keep financing the current scheme of housing care.² While this prediction may not be held my most as plausible these days, especially in light of budgetary surpluses due to increasing oil prices during the last few years, there is still a general consensus among all that the current system is indeed unsustainable, and that it has to be reformed.³

3. The Current Scheme, Economic Analysis, a Welfare Theory Perspective:

As outlined earlier, the state of Kuwait is committed to providing very generous housing subsidies to its citizens. The fact that housing occupies a major position within the welfare system in Kuwait should not

¹ This figure was given by a former Minister of Housing as reported in the Al-Qabas daily newspaper (Monday June 18, 2001).

² To be noted that it is not clear in this study what was the price level of oil used in the estimation. However, it is safe to assume that whatever price level used in this estimation would most probably reflect that of time when the study was conducted, (well below the current price level).

³ Needless to say that the extent of the problem would have been less severe if it were not for the fact that each Kuwaiti family would like to have a villa as opposed to living jointly with other families in a multi-story building.

be viewed as peculiar or specific to the state of Kuwait. Quite on the contrary, it is consistent with the general trend in other countries adopting inclusive welfare systems as a strategic social preference. In such countries, housing would typically represent one of four main pillars (if not the main pillar) of the welfare state.⁴ In fact many would argue that welfare systems as we know them today had originally been designed in Western countries for the most part after the second world war to address the serious insufficiencies of housing constructions as caused by difficult economic conditions characterizing much of the time period between the two world wars. These circumstances were the basis for heavy government spending on housing welfare during the difficult years in these countries. From this perspective, and given that the state of Kuwait has always been very much identified as a welfare state, both the deep commitment by the state to provision of housing welfare to its citizens and the substantial level of resources allocated for this end should not in reality take anybody by surprise.

In this section, the focus of the analysis is not on the wisdom of the welfare state as a defining guiding principle, as has been to the Kuwaiti society since the discovery of oil. Nor is it on the government commitment to housing as one of the principal cores of welfare state in the Kuwaiti context. Such issues have certainly been extensively debated in the literature on the distribution of income and wealth, (albeit involving contexts different than those relevant to Kuwait), from all angles the more important of which are efficiency of allocation of resources, the notion of justice, and morality. So, this paper could not possibly have any significant added value to this debate, at least with respect to the economic theory of it, beyond what is already available in the literature. Besides, raising a debate about the wisdom of the welfare state as a defining guiding principle in Kuwait would be a totally useless exercise in light of the very deep commitment to this model, which can be tracked-down to the special and indeed unique relationship that has been fostered between the government and the citizens of Kuwait. It is this special relationship to which the abundance in wealth resulting from oil rent inflows had played a major part in fostering, that is at the foundation of the current approach to welfare system in the country and its particular structures. Judging by the

⁴ In most countries, the other main pillars are typically education, healthcare, and social security.

strength of this relationship and its nature, one can safely infer that welfare in general and housing welfare in particular are irreversible as pillars in the country's social policy. So irreversible that in the eyes of Kuwaiti citizens most welfare benefits including those that are aimed at promoting home ownership are among the basic citizen rights.

While it is taken for granted that welfare state spending (aimed at promoting home ownership, or otherwise) in the state of Kuwait is not in question as a uncompromising principle, it would however be reasonable to perform a scientific assessment of the extent of its efficacy in meeting the objectives for which it was designed in the first place. This assessment should in particular evaluate if adjustments in the current spending schemes are needed as a first step towards upgrading the service and ensuring its sustainability for future generations. In other words, what the present paper is proposing is an assessment that should be conducted with the premise to reform the system rather than to abolish it. With this in mind, the remainder of the present section of the paper performs an assessment, within this binding principle, of the current welfare spending for the purpose of promoting home ownership.

At the heart of any assessment of the merits of any welfare policy is the norm relative to the comprehensively debated in the literature theme of "equity vs efficiency". The assessment performed in this paper in no exception; three themes very much connected to this equity vs efficiency subject matter are used as the main criteria for the evaluation of the current scheme of welfare spending for promoting home ownership by the Kuwaiti government. These are: i) justice, ii) efficiency of usage of resources, and iii) community effects. All three of them are appropriate for this type of investigation and indeed consistent with the welfare theory perspective whose objective is simply to maximize the net benefit of welfare assistance to the social utility. In this regard, the principal consideration in assessing whether welfare spending for promoting home ownership in the state of Kuwait is, in its current form, maximizing the net social benefit of state assistance as expected to manifest itself through these three channels (i.e., justice, efficiency and community outcomes). A brief analysis of each of these channels and the extent of the social benefit flowing from it is taken-up below:

3. 1. Justice:

The central question to be addressed here is whether the current scheme is ensuring justice. More precisely, what is being evaluated here is the extent of fairness of this scheme as it is set to assist Kuwaiti citizens secure housing of adequate standards. However, addressing this question is somewhat problematic in light of the deep interdependence between morality and the basic issue of justice. For that reason, it is very difficult to even define what justice is or ought to be. In fact, the basic literature on welfare distinguishes between several broad views of justice. Perhaps the more familiar of these views include those labeled as "distributive justice" and "commutative justice". It is also common for researchers on the topic to portray a course of action as being in harmony with "economic justice" if it allows for transfers of gains to take place from the more advantaged to the less advantaged of the society. In this section, the assessment of the extent of justice associated with the current scheme is performed in accordance with the norms in these three conceptions.

The view of distributive justice in the context of welfare spending for promoting home ownership requires that every person of the society should receive an amount of the subsidy according to his need. On the assumption that Kuwaiti citizens needs in terms of housing standards are much the same, distributive justice in this context would necessitate approximate equality in the distribution of the subsidy among all people entitled by law to receive this form of welfare. Many might argue that this is actually the view adopted in Kuwait. After all, all Kuwaiti citizens entitled to benefit from this welfare scheme do so in accordance with guidelines imposed by the law. That is, all people qualifying by law for this benefit, by virtue of their citizenship, do receive this benefit in an equal fashion irrespective of their income or wealth levels. However, for this to qualify as justice in the distributive sense, the assumption of uniformity of needs must hold. Such an assumption underlies the ideology of socialism characterized by the presence of an approximate equality in income distribution. But the Kuwaiti society is not the least bit a socialist society, nor is it a society with an equal income distribution. It is clearly a society with a certain socio-economic hierarchy allowing certain segments of the society or families to have the upper hand with respect to income and wealth distributions. And to this extent, it would be unrealistic to hold the assumption of uniformity of needs within the Kuwaiti society. Naturally, one should not expect the needs of different people from

different wealth brackets to be much the same. The fact that wealth in Kuwait is not distributed equally would mean that demand for different needs are met differently depending on the wealth bracket. Under such circumstances, it is reasonable to assume that people with more means would typically cultivate more expensive tastes. In particular, with respect of housing needs, this would translate into more expensive tastes in terms of the standards for the wealthier (e.g., closer consideration to latest developments in home construction and internal decoration and so on). Under this setting, an equal amount of welfare subsidy paid by the government aimed at promoting home ownership, (as the case of the current scheme), would inevitably reach beneficiaries revealing unequal needs. From this perspective, it is logical to reach the unequivocal conclusion that the current scheme does not meet the test of justice in the distributive sense.⁵

In regards to the question of whether the current scheme is consistent with the view of justice in the commutative sense, common sense would suggest that the short answer is no. After all, this view of justice as applied to welfare spending with the purpose of promoting home ownership would imply that every citizen entitled to this benefit should receive an amount of it in proportion to the factors of production he has contributed to the productive process. That is, the amount of benefit going to each citizen should not be uniform and would need to be determined in accordance with some sort of a measure of marginal products of their labor, capital and land. Obviously, this is not the case with the current scheme, nor is it the recommendation of this paper that it should be so. After all, nowhere in the moral philosophic literature on the subject or in the conventional social values it is deemed that those with lesser factors of production in the society should only receive rewards to such factors in accordance with the outcome of the competitive general equilibrium. Quite on the contrary, what is recommended in this paper is a system of economic justice by which the less fortunate of the society is allocated a greater portion of the benefit than what is received by the more fortunate. This calls for a "discriminatory" mechanism that allows for an extra focus

⁵ Paradoxically, in order for distributive justice to hold in this case, it is required that the government agencies in charge of distributing welfare to promote home-ownership should respond to the cultivation of expensive tastes by wealthy members of the society by awarding them a greater share of the resources, (which is considered by this paper as both implausible and irrational).

of the welfare policy on the neediest segments of the population. That is, a mechanism of allocation of unequal levels of nominal subsidies inversely proportional to the level of resources available to citizens. In which case, the more disadvantaged of the society would predictably be subsidized in a manner that disseminates relatively greater gains to them and smaller gains to those with more means.

Clearly, justice in this sense is not (and could not be) tenable under the current scheme of the welfare policy on housing in the state of Kuwait, (given that its was designed to reveal an indiscriminate character, i.e., all citizens are entitled to receive the benefit equally). Indeed, under this scheme, the subsidy received by Kuwaiti citizens can not be classified as "progressive". The terminologies "progressive" and "regressive" are generally used in the literature, often in a fairly loose way, to characterize taxes in accordance to the relative degrees to which they impose different burdens on the wealthy and the poor. What is projected by the non-progressive characterization in this context is that the rate structure of the housing subsidy does not take a rising proportion of total wealth as total wealth decreases. This implies that the incidence of the subsidy is bound to be regressive. In this way, the scheme would not allow more resources to be channeled to the neediest segments of the society, forgoing possibly the attainment of significant social benefit. Instead, welfare state resources continue to be allocated to assist segments of the society with no real needs, yielding private benefit but little or no significant social benefit. This is a classic case of crowding-out of state support resources, with social benefit vanishing in the process among the relatively well-off groups of the society. That is, the segments of the society with larger economic resources are effectively crowding-out those with tight resources in regards to accessing housing welfare resources. Obviously, this represents a form of social cooperation implicitly profiting the wealthy at the expense of the poor; which is in contradiction with the concept of economic justice.

It is obvious that irrespective of the conception of justice (distributive, commutative or otherwise), and on the assumption that greater justice raises social utility, the current regime of welfare spending aiming at promoting home ownership does not have in it the basic ingredients that would allow it to do so. In this regard, the heavy burden of this scheme to the society as currently the case is not entirely rationalized.

3. 2. Efficiency of Usage of Resources:

The second question to be addressed relates to the extent of efficiency of the current scheme of housing welfare provision. A close examination of the scheme reveals clearly a number of structural deficiencies in it creating the ideal environment for the emergence of significant distortions and efficiency losses. It is clear that in designing the scheme, the basic issue of optimal usage of state resources was not granted significant priority by the authorities in charge. The repercussions of the flaws in the initial design of the scheme are serious inefficiency problems that have been apparent throughout much of its history. For instance, and in reference to long-term loans available to Kuwaiti citizens entitled to receive the benefit from the "Bank for Loans and Savings", one can identify a number of features that exemplify perfectly the nature of the problems. First of all, according to this scheme, loans are interest free. So, the private nominal cost of borrowing to individuals is zero. But in reality, this represents an opportunity cost incurred by the state (i.e., forgone interest payments by the "Bank for Loans and Savings"). In economic policy terms, this practice is the equivalent of granting an indirect subsidy by the "Bank for Loans and Savings" via an interest rate well below the market rate. As consequence to this practice, while nominal installments of the loan are paid-back in principle, the full recovery of the loan by the institution in real terms would not never be possible.⁶

In addition to being interest-free, another feature of these loans is that they are paid-back over an excessively long period, reaching as much as 60 years for the maximum category (KD 70,000). That is, the recovery process is so much protracted. Moreover, given that the interest rate is zero, the system does not effectively breed any rational incentives for early loan pay-backs by the beneficiaries. As a consequence to both the zero-interest condition and the excessive long pay-back period, installments would typically be relatively small (KD 100 a month for the maximum category).

In light of those features specific to this scheme of granting subsidized loans, it should be no surprise that the process results into huge resource waste. This is case as the real cost of the subsidy is significantly

⁶ This would be the case in light of inflation which reduces the real cost of borrowing.

higher than the nominal grant received by the beneficiary. In fact, the opportunity cost of subsidized loans assessed over the duration of the pay-back period would normally add-up to several multiples of the nominal value of the loan.⁷ The simple administrative cost of recovering those loans might even account for a significant share of the recovered values as a result of the over time loan depreciation in real terms.

The inefficiency of this scheme is reflected in the fact that the institution in charge undervalues implicitly the cost of the subsidy. Likewise, the beneficiary does not have an accurate perception of the benefit he is receiving. Misperceptions of this type are known to create economic distortions as they tend to be in conflict with the pattern of a market economy. Combine this with an inadequate loan recovery practice, and the result is some serious adverse effects on the capitalization of the institution in charge of delivering the housing subsidy to the public. As a consequence, the long-term sustainability of resources dedicated to housing welfare is jeopardized. Signs of this are already emerging. In fact, the estimations by the Bank of Loans and Savings that it will face a cumulative deficit of around KD 1,150 million by the 2010/2011 fiscal year.⁸

To remedy this persistent condition of insufficient financial resources, the government has had to intervene in several occasions directly by raising the capital of the institutions in charge to ensure the sustainability of the housing welfare service. In addition to capital increases, the government has had to be resourceful in regards to securing extra financial channels for the system through involving non-welfare Kuwaiti organizations. For example, a scheme has recently been designed by which a fraction of the net profit of the Kuwait Fund for Arab Economic Development will in the future be allocated to the Bank of Loans and Savings. While useful in the short-run, such measures will not solve the issue of capital adequacy decisively as long as the system is not reformed in such a way it would procure the institution of a mechanism allowing it to self-renew its resources and break its dependency on the government. Unfortunately, this would not be possible under the

⁷ The exact size of the opportunity cost depends on the prevailing market interest rate.

⁸ This figure is taken from the Ministry of Plan project of "Five Year Development Plan for the State of Kuwait: 2006/2007-2010/2011"

current arrangements, with the recovery of loans being performed in accordance to nominal term norms as opposed to real term ones.

A lesser important source of inefficiency is related to the heavy administrative burden incurred by the state as a result of the current scheme implementation. The country's long-term commitment to this form of welfare has led to the creation of a complex bureaucracy with a huge number of responsibilities, (e.g., selection of beneficiaries, processing applications, regulation of the scheme, loan-recovery, land acquisition etc...). As the case in most other governmental institutions and authorities in the state of Kuwait, as the bureaucracy gets larger, poor productivity tendencies develop and inefficiencies emerge. In addition, the fact that the scheme is implemented by two institutions is in itself problematic in terms of efficiency as a great deal of cooperation between them is needed. A different conception of this welfare service, one that focuses on targeted direct subsidies (as will be argued in section 4), would certainly entail less administrative burden conducive to a more effective delivery of the welfare service and smaller fiscal resource requirements.

3. 3. Community Outcomes:

The third evaluation criterion relates to the possibilities of success (or lack of) of the current scheme in generating "external" positive effects on the community. As well known, the concept of "externality" in economics refers to occurrences when economic decisions create benefits or costs to economic agents other than the decision-takers, i.e., the community at large. There is no doubt that historically, the Kuwaiti welfare system in general, and its housing component in particular, have contributed to the success of the country in modernizing the life style of its people, improving its human development, in addition to fostering a very cohesive social solidarity structure. And to this extent, housing welfare policy in particular, and the welfare system in general, have been successful in generating significant positive externalities to the society. Yet, and focusing on the scheme of welfare that concerns housing, certain conditions are now emerging that are likely to weaken its future capacity to generate positive externalities as has been possible in the past. These conditions are molded by the escalating failures of the scheme to provide the welfare assistance to citizens as they are entitled to receive by law. As mentioned earlier in the paper, the system has become inherently unable to keep-up with the number people eligible to receive the benefit, with the

"waiting-list" getting longer every year, now exceeding 60,000 according to data available from the Public Authority for Housing Welfare. The resulting shortfall of benefits to eligible citizens, in particular those who are the less wealthy, might push them towards some undesirable social behaviors, such as marriage delays (due to lack of adequate housing). Some might even be more susceptible to getting involved in morally questionable circumstances, social delinquency, or even worse severe criminal activities. Some psychological problems might also arise as it is possible for disadvantaged citizens in the "wait-list" to develop a feeling of alienation as a result of being cut-off from a benefit they are entitled to by law. Such a feeling is likely to be exceptionally intense in wealthy countries like Kuwait where people would not accept easily the premise that the state can not provide them with the safety net they are entitled to. All are risk factors resulting from the accumulated failures of the current scheme, and all are with potential negative consequences on the fabric of the Kuwaiti society.

If for no other reasons than these potential negative externalities, (in addition to shortcomings in terms of justice and efficiency as outlined earlier), policy-makers in the state of Kuwait have an interest in reforming the system.

4. The Alternative?

Any proposed alternative scheme must encompass the necessary mechanisms that would allow it to address the structural flaws of the current system. In considering reforms, Economists in general have a preference for programs embracing measures which operate in ways that are least likely to distort markets. They are also overwhelmingly for competition. In fact, most economic reform programs (involving housing or otherwise) implemented during much of the last two decades worldwide have been designed accordingly. Kuwait should not be an exception to this trend. The welfare programs in the country, in particular the housing assistance scheme, should be restructured on market principles, (or at least deviate as little as possible from market principles). Under such principles, if certain matters warrant government support (e.g., housing for citizens), then welfare should be arranged through direct methods such as vouchers, as opposed to indirect subsidies via interest rates below market levels.

As well known, a voucher is a given quantity of purchasing power granted to a target person or a family. However, a voucher restricts the

type of goods or services that can be acquired thanks to this extra purchasing power. In the context of housing welfare, vouchers would therefore be issued only to be used as a means towards achieving higher housing standards. A welfare system based on vouchers is effectively one that operates with direct subsidies. In the housing policy context, there are many merits to a welfare scheme based on vouchers, as well elaborated in the literature, (see for example Priemus (2000) and Steuerle et al., (1999)). The more important of these merits to the context of this investigation are those that fundamentally tackle the shortcomings of the current scheme as they pertain to the issues of justice, efficiency, and community outcome.

Starting with the issue of justice, one of the main attributes of vouchers is that they allow for the possibility of targeting the neediest segments of the society. A subsidy of this kind need not be indiscriminate, as the case in the current scheme. In fact, vouchers can be tailored so as to provide the poorest with a proportionately greater housing benefits. That is, they can be used to cope with any insufficiencies in the purchasing powers of the poorest of the society as a means towards transforming their potential demand for housing into an effective demand for it. As well known, simple microeconomic theory suggests that demand for housing, like any other demand, is derived from constrained utility maximization. It is therefore a function of a certain number of variables of the likes of market price of housing and income. From this perspective, the market for housing will meet whatever housing needs as long as they are within the confining budget constraints (which could well be very little especially in lower income group-brackets). However, if the institutions in the country are of the view that those needs as met by the market are not large enough (at least for certain segments of the society) to be consistent with the broad social objectives, then the government would have to intervene to ensure that larger needs for these segments are actually met. This would require taking a course of actions intended to transform potential demand into effective demand for housing. This course of action ought to consist of granting an extra purchasing power (voucher) to the concerned citizens allowing them to exactly access a well defined and transparent target standard for housing.

Naturally, because of wealth endowment differences among citizens, and to ensure justice (in the sense that all are able to achieve the same well defined and transparent target standard for housing), it is necessary for the value of the voucher to be different from one beneficiary

to another. Obviously, in order to implement this system effectively, it is indispensable to have in place a well designed mechanism by which wealth endowment reporting by the applicants is accurate. The approaches that should be adopted in deciding the value of the voucher should be transparent, objective, and taking into consideration all personal wealth related variables and factors that can be measured. It is also necessary to continuously review the objectivity of the criteria and the transparency of the procedures so as to improve upon the credibility of the scheme and its effectiveness in providing the subsidy to the neediest segments of the society.

It is normal that such a course of action will in all likelihood result in some significant financial burden on the government, (although arguably less costly than the current regime). While this proposed alternative system will remain significantly costly, it will at least introduce a progressive character into the housing welfare values. Indeed, it will bring to an end the highly regressive character of the current housing welfare policy provoked by the zero interest loans scheme. In such a manner, more of the costly resources would be directed to the more deprived segments of the population, ultimately altering society status differentials and achieving more economic justice. This represents effectively a welfare perspective that maximizes the effect of the costly assistance.

Another argument in favor of a housing welfare scheme based on vouchers is that it is more efficient. Indeed, in addition to allowing for the subsidy to be directed to lower income households, the voucher system should entail less real cost to the society than a system of indirect subsidies via zero interest loans. With such a system, there would not be any of the distortions tied to the operations of the country's housing welfare institution finance systems that are caused fundamentally by inadequacies in loan recovery procedures. Arguably, its implementation would result into significant economies of resources in the long-run, in addition to being more effective in terms of reaching those who need it most. Moreover, the voucher system would allow for a more accurate measurement of the magnitude of the involved fiscal expenditure in real terms by the institutions in charge of granting housing welfare. That is, these institutions would be in a better position to assess the extent of the effect of the resources they are granting. Equally important, under this system, each of the beneficiaries would have a clear perception of the extent of the real benefit he is receiving. It is this type of transparency in information that is

compatible with market economy patterns. In fact, with the persistent call by a large segment of the Kuwaiti civil society for a comprehensive economic reform program with market economy features being at its core, an approach to welfare based on vouchers to support housing demand should in principle be regarded as more suitable than an system based on indirect subsidies as the current scheme. As such, and in light of their restrictive nature, vouchers would allow the beneficiaries to choose among various private sector suppliers of housing. This would create an opportunity for the private sector to take a major share in the process of transforming the potential demand into effective demand for housing, together with a disengagement of the government institutions currently in charge of housing welfare from the costly activity of housing construction. That is, a welfare provision consistent with market principles, achieving market efficiency as beneficiaries are allowed to make optimal choices in regards to effective demand for housing.

Another potential source of efficiency improvement of a system based on vouchers is the reduced administrative burden as compared to that incurred under the current scheme. Under the proposed system, tremendous administrative costs will be slashed as the institutions in charge of housing welfare provision will find their responsibilities limited to processing applications and selecting beneficiaries, deciding the value of the voucher for each beneficiary based on transparent objective criteria, making a one single-time payment of the subsidy, in addition to regulating the whole scheme. All long-term administrative commitments as in the current regime will disappear, (such as those commitment related to recovering loans or construction activities etc...).

It is clear that the advantages of a housing welfare system based on vouchers over the current system are substantial, at least on a conceptual level. Common sense suggests that these advantages would be confirmed in reality if the proposed system is adopted and implemented. Indeed, with its potentially progressive character and its close compatibility with market principles, the voucher system can ensure a greater justice within the Kuwaiti society, and more efficient usage of resources, both of which contribute to raising the net social benefit of the subsidy. In particular, the issue of potential improvement in efficiency is intensely critical as it has crucial implications on the sustainability of the scheme for future generation in the long-run, a process that is clearly untenable under the current scheme. Not to overlook that, by virtue of improving the efficiency

of the system and ensuring its sustainability, the concerns tied with the failures of the current scheme (referred to as "community outcomes" in the previous section), will all dissipate.

5. Conclusions:

The central issue addressed in this paper relates to the current generous housing welfare scheme applied in the state of Kuwait and its effectiveness in generating adequate social benefit to the society. The analysis performed in this paper revealed that the current scheme has some structural flaws. It was clear that Kuwait has not been accomplishing economic justice as a result of implementing this scheme, nor has it been achieving efficiency in regards to the resources allocated to this end. Moreover, potential negative externalities to the society have been emerging as a result of the clear failures of the current scheme. In light of this analysis, and to address the consequent problems, the paper proposes an alternative scheme based on vouchers which are more compatible with market principles than the current indiscriminate subsidies system. The paper argues that the merits of direct subsidies involving the likes of vouchers are sizeable at least at the conceptual level, and most likely at the practical level as well. However, in light of the unique features of the Kuwaiti society, more focused research on the prerequisites for the success of the proposed scheme is needed (e.g., change in attitudes of people to accept the notion of indiscriminate subsidies, as well as other qualifying criteria). These issues are left for future research.

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