

Rent of land and housing policies in Brazil

Fabian Scholze Domingues

UFRGS (Universidade Federal do Rio Grande do Sul, Federal University of Rio Grande do Sul)

1. Introduction

The aim of this presentation is to provide a historical context and an overview of the latest housing policies applied in Brazil. Its first part consists of a brief history of housing policies in the country, beginning in the 1950s until approximately 2007. The second part is about policies performed over the last ten years, with special attention to a program called *My House My Life (MHML)* and its pricing dynamics, as well as the growing housing deficit during its execution. The last part is about social outcomes of the housing Program and the unsolved problem of the housing deficit. It refers to some macroeconomic problems related to high levels of rent seeking as well as alternative measures that could be taken to decrease housing deficit.

2. Housing policies and historical context (1950 - 2002)

In Brazil, part of the inequality problem is a result of housing and real estate policies. A brief overview of the housing policies applied in the country can illustrate this fact. Before the 50s there were no public policies for housing, in spite of the increasing number of slums in the biggest Brazilian cities, a consequence of the intense rural-to-urban migration, and increased population density in the cities. During this time Brazil was changing its demographic distribution and it was becoming a country with growing urban areas, but more than half of the population still lived in the countryside.

Housing programs started in Brazil in the 50s, organized by employees' funds that aimed to provide social security to their members. These funds were created by President Getúlio Vargas, organized as Social Security Institutes and related to some specific worker's organizations, such as civil servants, railroad workers, industrial workers and merchants associations. The inflation rates were high and the financial markets were not organized. In order to obtain some protection against the high inflation rates to its members, these Institutes had made the first coordinated and long term investments in the Brazilian

housing market. Basically they built houses for their members. As these were massive organizations, the investments had some impact. However, they had limited success due to its financial and housing goals, which were to obtain financial protection for highly organized employee's associations. The Institutes crashed in the early 1960s and they were unified when the dictatorship began in 1964 in one huge national institute, the National Institute of Social Security.

During the military government changes were made in the labour market. Among them, a big compulsory fund related to the wages to be applied in housing and infrastructure programs was created: the FGTS (Fundo de Garantia por Tempo de Serviço - Guarantee Fund for Employees). This fund is the financial base of the first Brazilian System of Housing, the Housing Finance System. The source of resources was 8% of workers' wages to be deposited by the employer in this compulsory fund. In some cases of dismissals, workers could receive the money deposited in the fund plus a penalty of 40% to be paid by the employer. However, the government gave an end to stability to workers with more than ten years of work in the same place. Thus, this huge compulsory fund was the financial base of the national housing system during the military government and even nowadays it continues to be an important source of real estate policies, *MHML Program* included. Its focus was the housing needs and requirements of the middle-class. Even though 10% of housing deficit is in this segment of society, the FGTS has put 90% of its resources in it. The housing system worked with the monetary indexation and it was sustainable while the wages followed inflation rates. However, in 1986 this system crashed as a consequence of the big debt crisis that hit Brazilian economy. The wages were readjusted below inflation rates used to calculate the household debts with the Housing Finance System. Thus, the loans could not be paid anymore by the households, and the housing system broke.

From that time until 2008 Brazil did not have public policies for housing, and the housing deficit increased a lot. Although the Housing Finance System has provided almost 5 million housing units in 20 years (1967 - 1986), shantytowns have appeared very fast in all big Brazilian cities during this time. In 2007 the total housing deficit was of almost 6 million units, which represents about 24 million people.

3. The last ten years: Housing policies and international crisis

During the two mandates of president Lula (2002 – 2010) housing policies were object of intense public debate. Since the 1988 Constitution, it was the first opportunity to start a broad public housing policy as per its Article 5, according to which housing is considered a citizen's right and a government's duty. Several demands of civil society's organizations were taken into account by the government in order to create and improve housing policies. The main political fact was the creation of the Ministry of Cities to handle urban matters that have become more complex over the last twenty years. A national committee was created and there were great expectations towards an "urban reform" that should take place. However, the international crisis of 2008/2009 hit Brazilian economy and it changed the focus of political economy, as well as the goals of the housing policy.

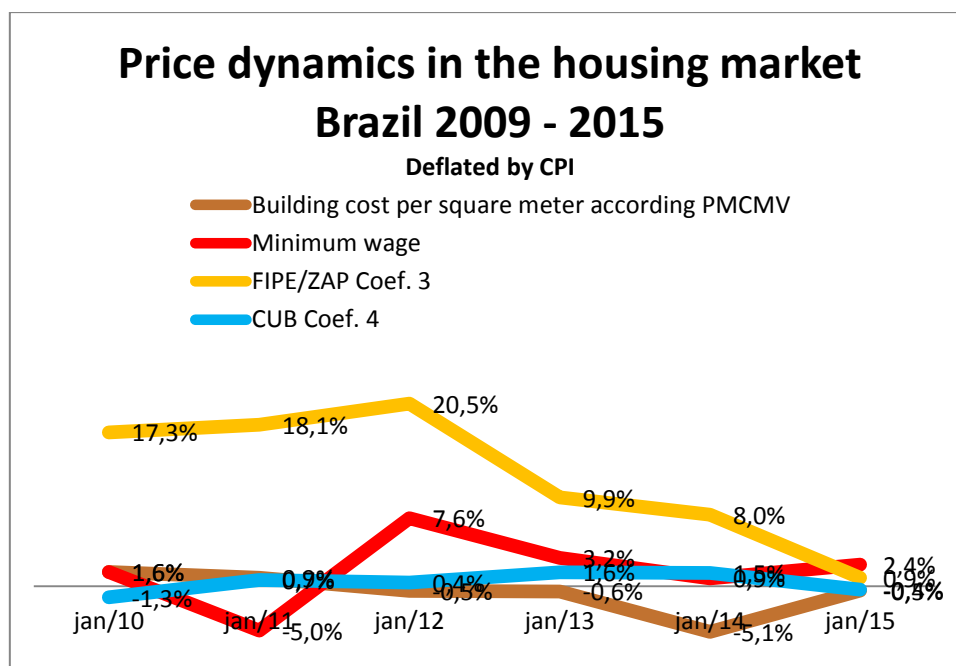
The new goal of nation's government was to promote a Keynesian policy. However, the focus of the counter cyclical policy was not to promote investment, but consumption, mainly for the emergent social segment that was the main beneficiary of the successful government policies against poverty, the lower middle classes. Almost 50 million people improved their living conditions with these policies since 2002. At this point, subsidies were provided to motivate this social segment to buy durable goods. It was called "Inclusion through consumption". However, the debts of the middle class increased sharply during this time and people's financial capacity to sustain economic growth vanished afterwards. As Keynesian theory shows, long term development is sustainable only through investments and not through consumption. The economic expansion caused by increase in consumption and household debts between 2008 and 2013 helps understand the ongoing political and economic crisis.

In 2009, the biggest building and engineering companies in Brazil had an unsaleable stock of housing units for middle classes households, and they started to put pressure on the federal government for help. The international scenario changed for the Brazilian economy and the situation got worse than previously predicted. Thus, the huge housing program originally intended to improve housing conditions to the lower classes and intensely discussed in the public sphere – *MHML Program* – changed its goals to match the new private and for profit perspective. Despite the numbers – almost two million housing units were built with the *Program* budget – the housing deficit to the lower classes increased during its execution, between 2009 and 2014. How was it possible?

4. My House, My Debt: the housing deficit and price dynamics

In order to understand this counter-intuitive fact, let's consider the *MHML Program* in its general features and analyse it from the price dynamics of the real estate industry. The main idea, based on David Ricardo's classic theory of Rent is outlined here. As in Ricardo's theory, the following analysis divides society in three social classes: workers, capitalists and landlords, and its variables are wages, production costs and rent of land.

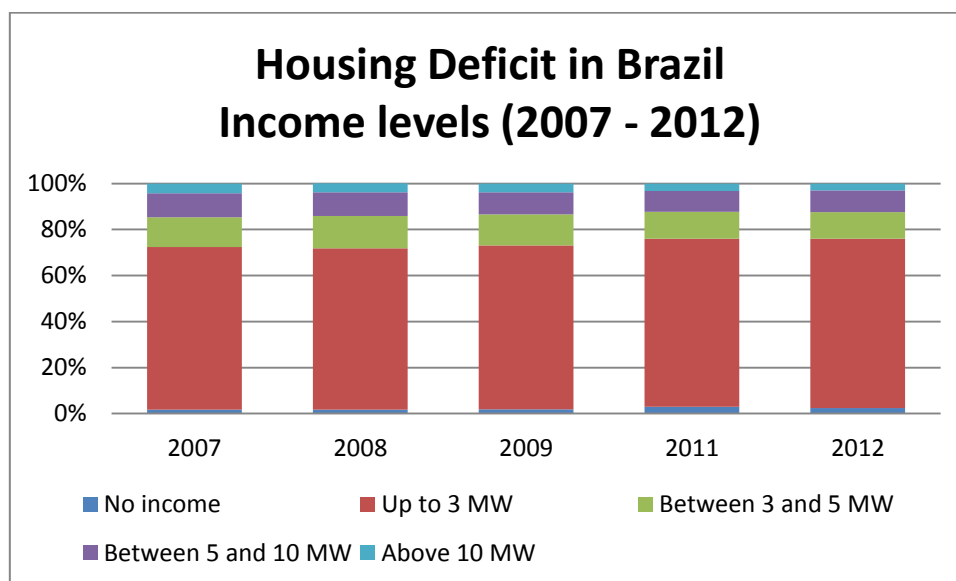
Diagram 1 below shows four lines as the main variables of Ricardo's model. There are two production costs in the analysis concerning capitalists: Building cost per square meter according to *MHML Program* (Brown) and Unitary Built Cost by square meter as an average index for the building industry. (Blue). The cost of labour is measured by the minimum wage, which is a very important index in Brazilian economy and the main reference to wages (Red). The FIPE/ZAP index is an average index about real estate prices and is a proxy to the landlord's rent. All these variables were deflated by the CPI (Consumer Price Index) and they cover the relative variations of the main prices in the real estate markets from 2009 to 2015.



The difference between the capitalists costs – blue and brown line – shows that the capitalists who worked with *MHML Program* rules received relatively less money for their job than the average prices in the building sector. Thus, the high real estate prices showed in Diagram 1 were not captured by the capitalists in form of higher costs of production and,

therefore, higher profits. Workers (in Red) had a real wage increase as per Minimum Wage Index, but the worker's housing costs rose during this time. The landlords, on the other hand, received the variation of rent, for which the FIPE/ZAP is the variable proxy.

The relative price evolution shows a huge increase of real estate prices, in particular from 2010 to 2012 during the *MHML* scheme execution. Since big residential complexes to lower classes were built in the more distant outskirts – the least urban land – in all big Brazilian cities, real estate prices were readjusted, increasing the rent of land and decreasing the real wages and profits. According to Ricardo's theory, an increase in the rent of land is a symptom of wealth instead of a cause of it. It causes a nominal increase in wages and a decrease in profits. Also, higher land rents cause more housing deficit. The housing deficit in Brazil did not decrease even with the execution of *MHML* because of price dynamics. While almost two million units were built, an equivalent number of people could not afford the high real estate prices. So, the housing deficit had a little positive variation to people who had received up to 3 minimum wages (MW). This fact is illustrated in **Diagram 2** below.



Source: IBGE/PNAD 2007 - 2012. Apud. IPEA, Technical note, nº 5, 2013.

During the *Program* execution, the housing deficit to the lower classes had a small increase, even though almost 50 billion Reais (Brazilian currency) were spent in the Program. Also Brazil nowadays has more empty houses than homeless, just like before the Program was created. In 2010, there were 6.273.000 homeless families, and more than 7

million residential units were vacant. Even if each homeless family occupied one vacant property, there would be still more than 1 million vacant properties in the country.

5. Final remarks

An adequate housing policy must be a comprehensive policy. It should take into account the main characteristics of the real estate market and its general impact on economy and society. Brazilian government created a public policy to build houses for the lower middle classes, which caused inflation in the housing market and, at same time, increased the national housing deficit. Billions of the public budget were used in the *MHML Program*, but the outcomes were disappointing. The least urban areas were the main focus of the Program units, and, according to Ricardo's theory, when people go to the least urban areas, an increase in the rent of land and real estate prices occurs. As a consequence, the price dynamics observed during 2008 – 2015 is not a financial bubble, caused by financial speculation; instead, as Ricardo's theory shows, it has a permanent effect. Millions of householders could not afford the rental agreements anymore and became homeless. It is a real social tragedy.

According to Ricardo's theory, the best way to minimize the rent of land and its unwanted consequences to the economy and society is the creation of a land-tax. It should be levied in relation to the rent of land. Land property is a monopoly, and the landlords – engineering and financial corporations - have market power to control rent prices. In this situation, following Ricardian economic thought, a good way to solve this issue is the creation of a federal tax to vacant properties. In this case, the “social function” of property could be achieved.

6. References

DOMINGUES, Fabian. Renda da Terra e expansão da fronteira imobiliária.

Desenvolvimento em Questão,

BOULOS, Guilherme. *Por que ocupamos?* São Paulo: Scortecci, 2012.

JACOBS, Jane. *Morte e vida das grandes cidades*. São Paulo: Martins Fontes, 2001

IBGE. *Pesquisa Nacional por Amostra em Domicílios*.

IPEA, Nota Técnica nº 5, 2013.

ROLNIK, Raquel. *Guerra dos Lugares*. São Paulo: Boitempo, 2015.