A Comparison of European Housing Finance Systems

Kenneth T. Rosen*

In the late 1970s financing of owner-occupied housing in the United Kingdom, France, and Germany assumed the same high priority that it historically enjoyed in the United States. These three countries have utilized a variety of policies to attempt to create a "privileged circuit of finance" for housing in order to provide an adequate flow of mortgage credit at subsidized interest rates. While the mechanisms vary greatly among countries, they commonly involve: (1) an attempt to segment a portion of the retail savings market from the overall capital market, often with a specialized set of savings for housing institutions, (2) tax deductions for mortgage interest payments and tax exclusion for capital gains on owner-occupied real estate, (3) government subsidies for housing-savings plans and generalized savings plans, and (4) direct provision of government homeownership loans for low and middle income households. Comparing these techniques with the situation in the United States, generally more limitations are put on the tax deductibility of interest payments and a great deal more emphasis put on tax incentives for savings in Europe. Also more stress is placed on voluntary participation of potential homebuyers in contractual savings plans and less emphasis on deposit rate and mortgage instrument regulations. In addition, more of an attempt is made in Europe to target direct and indirect government assistance to low and middle income households. Finally, one should be aware that the three European countries studied have a much lower proportion of owner-occupied dwellings than exist in the United States, which may partly explain the increase in incentives for ownership they have instituted in the past decades.

These differences, however, give way to one overriding similarity—despite the policy goals of the governments, the "special place" of housing finance is being eroded by market conditions. In particular, high and volatile interest and inflation rates, the "sticky" nature of deposit interest rate ceilings, the increased sophistication of the consumer as both a saver and borrower, and the increased borrowing competition from the various federal governments have made it increasingly difficult to preserve the sheltered nature of the housing finance system. As a result, the United Kingdom has

*Kenneth T. Rosen is Professor of Economic Analysis and Policy and Chairman of the Center for Real Estate and Urban Economics at the University of California at Berkeley. The material in this paper was derived from interviews in Europe in the summer of 1981 and from secondary documents available from The British Building Societies Association in the United Kingdom. The author would especially like to thank Eve Icole, Timothy Melville-Ross, and Brian Phillips for their insights into the European Housing Finance Systems and for the published and unpublished materials they provided.

experienced the "mortgage queue," Germany the "loan allotment," and France the "quantitative rationing" of banking credit—all to handle the excess demand for mortgage credit when provided at subsidized rates. Partly as a result of this strong demand for subsidized credit, all these countries have developed systems of cumulative multiple mortgages with an ascending array of yields. Second, third, and "top-up" loans are common in all three countries, as the primary mortgage loan often provides insufficient financing.

This paper provides an analytical comparison of the savings, mortgage, and tax policies of the three countries as they affect the housing finance system.

The Deposit Market

A. France

The French mortgage and deposit market is characterized by a highly complex and elaborate system with substantial government regulation, control, and direct ownership (even prior to the Mitterand regime). The British business community has characterized this high degree of state involvement in the following way: "If there isn't a law in Britain forbidding something it's legal . . . in France it's legal only if there is a law permitting it." [1]

The French deposit market has no equivalent of a savings and loan association. It is dominated by the banking industry, much of which is public or quasi-public. The institutions closest to savings and loans, at least on the deposit side, are the ordinary savings banks (Caisses d'Epargne). These institutions are created by local governments to encourage small savers. They offer primarily passbook accounts and special savings for housing accounts. They and their federal counterparts, Caisses Nationale d'Epargne, offer two types of passbook accounts, known as "A" and "B" accounts. The "A" account has a maximum deposit of FF 49,000 ($8,900), and pays 7.5 percent, all of which is tax free. The "B" account pays the same interest rate but is taxable in full. French commercial banks can only offer the "B" account, which explains the dominance of the passbook market by the savings banks. As Table 1 shows, savings banks hold nearly three-quarters of all passbook savings accounts. The federal government sets the interest rate on all accounts of less than FF 100,000 ($18,200) and of a maturity less than one year. Term accounts and large accounts are free of rate ceilings, though in practice there is little interest rate competition. The commercial banks completely dominate the term account market. However, as is quite clear from Table 1, the passbook market dominates the French deposit market. This is due to a high liquidity preference and the large tax advantage to the "A" accounts.

In July 1965, the French government introduced its first Housing Savings Account (Comptes et Plans d'Epargne Logement). This account pays

[1]Building Society Association, *French Study Group Report*, Volume 1, page 5.

Table 1
Institutional Savings Market in France (Percentage Distribution)

	Passbook Accounts					Term Accounts					Housing Savings Plans and Accounts				
	1970	1972	1974	1976	1978	1970	1972	1974	1976	1978	1970	1972	1974	1976	1978
Banks	21.2	25.1	24.7	27.5	26.9	87.9	92.7	95.5	93.4	94.4	63.4	73.9	76.4	76.0	76.3
Savings Banks	78.8	74.9	75.3	72.5	73.1	—	—	—	—	--	36.6	26.1	23.6	24.0	23.7
Total as % of Total Savings Funds	52.4	50.3	48.1	50.5	50.3	12.1	12.9	15.4	13.5	12.4	3.8	6.9	8.0	10.2	12.9*

*The remaining funds were primarily in Treasury bills, held with the Trésor Publique which accounted for 25 percent of the institutional savings market.

Source: BSA French Study Group, Volume 2, page 9, October 1980.

3.25 percent tax free interest on a maximum deposit account of FF 100,000 ($18,200). A government tax free bonus equal to the interest earned up to a maximum of FF 7,500 ($1,360) is payable on the account. After holding the account for a minimum of 18 months, a subsidized housing loan can be obtained from the institution holding the savings account.

In December 1969, a second Housing Savings Plan was introduced based on a contractual relationship between the depositor and the institution. The Plans d'Epargne Logement required the depositor to save a minimum of FF 1,800 ($325) per year for four years. The tax free interest rate was 4 percent, and a bonus equal to the interest earned up to a maximum of FF 10,000 ($1,820) was also paid. Again a subsidized loan could be obtained with this plan. Also, early withdrawals of deposit money were prohibited.

These savings for housing accounts and plans are distinctive in that they rely on a government bonus and are not restricted to a particular type of institution. In fact as Table 1 shows, three-fourths of these deposits are in commercial banks. As of the end of 1978, these plans accounted for nearly 13 percent of all French institutional savings deposits.

B. United Kingdom

The deposit market in the United Kingdom is dominated by Building Societies which are quite similar to savings and loans in their deposit taking function. Building Societies are all mutual organizations and the large institutions have a nationwide branching network. This nationwide branching network and the absence of government set deposit rate ceilings make them extremely competitive in the retail savings market. As Table 2 illustrates, the Building Societies attract between 30 and 40 percent of all personal sector acquisitions of financial assets in the United Kingdom.

Table 2
Personal Sector Acquisitions of Financial Assets in the United Kingdom
(Percentage Distribution)

	1974	1975	1976	1977	1978
Life Insurance and Pension Funds	40	44	45	43	47
Public Sector	15	12	22	15	9
Bank Deposits and Currency	38	14	14	8	22
Unit Trusts etc.	(14)	(13)	(10)	(13)	(10)
Building Society Deposits	23	41	28	42	29

Source: "Stow Report," p. 24, from *Bank of England Quarterly Bulletin.*

The liability structure of the Building Society looks very similar to that of an American savings and loan in the early 1970s. Over 81 percent of liabilities are held in ordinary shares which are the equivalent of the savings and loan association's passbook accounts. These ordinary shares can

be withdrawn on demand which has created occasional periods of disintermediation similar to those experienced in the United States.

In response to disintermediation in 1974, the Building Societies tried to lengthen their maturity structure by introducing term shares. They offered a 1–1½ percent interest rate differential for two-year term accounts. In March 1977, after a period of rate competition, the term account was modified to offer a uniform ½ percent differential on two-year accounts and 1 percent differential on three-year accounts. In January 1979, a four-year account with a 1½ percent differential was introduced and in July a 2 percent differential for a five-year account was provided. These new account introductions represented a concerted attempt to lengthen the maturity structure at Building Societies.

The impact of these efforts can be seen in Table 3. By 1979, over 12 percent of liabilities at Building Societies were in term accounts.

Table 3
Liability Structure of Building Societies (Percentage Distribution)

	1974	1975	1976	1977	1978	1979
Ordinary Shares	87.2	85.6	84.6	83.2	83.1	81.2
Term Shares	5.6	7.2	8.5	9.4	9.9	12.3
Regular Savings Shares	2.4	2.3	2.5	2.5	2.7	2.8
SAYE	1.4	1.2	1.2	.9	.8	.6
Deposits	3.5	3.5	3.3	3.9	3.5	3.1

Source: The Building Societies Association, *Stow Report*, page 56.

Deposit rates on both share and term accounts are theoretically set on a competitive basis without government intervention. In fact, interest rates on deposits (and on mortgage loans) are set by a recommendation from the Council of the Building Societies Association. These rates tend to lag the market both when interest rates are rising and falling. Since all British mortgages are variable rate, and since rate changes move precisely with deposit rate changes, there has been political pressure and as a result substantial resistance by lenders to raising deposit rates. The political aspect of deposit rate setting, in an environment with variable rate mortgages, is probably unique to the British system. The concentrated nature of the Building Society industry and the discretionary (rather than indexed) nature of mortgage interest rate adjustments make the system especially vulnerable to these pressures.

The problems induced by the "sticky" movement of Building Society deposit rates are illustrated by the instability of deposit growth shown in Table 4. As in the United States, the differential between market rates and deposit rates paid by the Building Society crucially influences deposit flows. In calculating interest rates on Building Society shares, it must be remembered that interest paid to shareholders is net of personal income

taxes. As a result, the effective before tax rate of return is often calculated by "grossing up" the net rate by the basic tax rates.

Table 4
Building Society Share Growth and Interest Rate Differential

	(1) Net New Share Growth (millions £)	(2) Gross-Up* Building Society Share Rate	(3) MLR (Bank Rate)	(4) Spread (2)—(3)
1974	1165	10.94	11.94	−1.00
1975	3191	11.09	10.79	+ .30
1976	2278	10.80	11.77	− .97
1977	4722	10.58	8.45	+2.13
1978	3367	9.64	9.12	+ .52
1979	3000	12.08	13.75	−1.67

*Effective rate after adjusting for basic tax rate.
Source: *Stow Report*

As shown in Table 4 when the interest rate spread is negative, deposit inflows to Building Societies are weak. Thus in 1974, 1976, and 1979 when Building Society rates were not adjusted up to market, deposit inflows tapered off. This created a credit rationing phenomenon known in the United Kingdom as the "mortgage queue." Evidently there is always a queue in the United Kingdom, but in periods of weak deposit flows the problem becomes more severe.

The periodic disintermediation of funds from Building Societies has recently threatened to become a secular problem. Large government deficits have forced the federal government to begin competing aggressively for retail savings. In the past several years "index linked" government obligations have been introduced. "Granny Bonds," available for anyone over the age of 50, pay the inflation rate plus 2 percent. A five- to seven-year National Regular Savings Account, available to all households, also offers an index linked return, though deposits are limited to £100 per month. These new accounts have forced the Building Societies to become rate competitive for the retail savings dollar. They have begun to offer short-term notice accounts (one-month notice) which pay between ¾ percent and 1 percent over the basic share rate. They have also introduced term accounts which can be redeemed on three months notice.

At present, Building Societies face some critical decisions on the competitiveness of their rate setting. As the retail deposit market becomes more rate sensitive, their ability to subsidize mortgage rates by holding down depositor rates will become more limited. Fortunately this just means that rates will be somewhat higher, which will not adversely affect the viability of the Building Society system. Moving to market rate liabilities and assets may be unpleasant for some borrowers but will not produce the crisis it has in the United States.

In addition to term and ordinary share accounts, the Building Societies have been participating in a government inspired "save-as-you-earn" scheme (SAYE) since 1969. Savers who add a stipulated amount, ranging from £2.50 to £50.00, to their savings account each month for a period of five years receive a tax free state-paid bonus at the end of the five years, equal to 14 months of savings. If the saver maintains the account with the Building Society and continues making the regular deposits for an additional two years, the tax free bonus is doubled. The five-year bonus amounts to 23⅓ percent of the amount saved; the seven-year bonus amounts to 33⅓ percent.

A final plan to stimulate savings for housing is the Homeloan Plan for first time buyers set up in 1978. It allows a special account to be set up at any financial institution. The household must save for at least two years under the plan. The government then provides a bonus depending on the amount of the savings balance. The bonus amounts to 11 percent of the amount in the account up to a maximum of £110. The householder can also receive a £600 loan to meet downpayment requirements if he is in the savings plan. There is no interest or repayment for five years on the mortgage loan.

C. Germany

The German deposit market is also heavily influenced by savings incentive plans. A general savings incentive scheme is used in Germany known as the "624 Mark Act." If a householder saves up to 624 DM ($277) per year, he will receive a government bonus of 30–40 percent depending on family size. This plan is only available to those with income less than 48,000 DM ($21,000). Those savings also qualify for a 14 percent Savings Premium if they are held in a special seven-year contract account.

This general savings incentive is complemented by a specialized savings-for-housing plan at building-savings institutions (Bausparkassen). The Bausparkassen attracts money primarily through a contract savings scheme. The saver contracts to put aside a certain amount with the institution. Once 40 percent of the contracted amount has been saved over a minimum of 18 months, the saver then can receive a loan for the remaining amount of the contract. Typically, the interest rate on the savings contract has been below market (2½–3 percent) as is the interest rate on the mortgage loan (4½–5 percent).

The Bausparkassen is especially attractive because of the federal subsidy paid in the form of a Building Savings Premium. Married couples with an income of less than 48,000 DM receive an annual premium of 18 percent up to a maximum of 1,600 DM ($700). The savings period required for the premium to be paid is seven years. Thus savings in this plan receive an additional 4 percent premium over the general savings incentive plan. To receive the benefits of either of these contractual savings plans the household must just save and wait.

The importance of the Bausparkassen savings incentives can be seen in Table 5. Over 20 percent of German institutional savings is held in deposits at Bausparkassen.

Table 5
Total General Savings in Germany (000 Million DM)

	Total	Savings Banks excluding Bausparkassen	Bausparkassen	Banks
1972	264	—	—	47
1973	283	—	—	50
1974	313	106	68	55
1975	378	131	76	68
1976	413	139	83	73
1977	—	—	90	—

Source: BSA Working Group on Germany, Volume 2, page 2.

The Mortgage Market

A. France

The French mortgage market has a number of unique features relative to Germany and the United Kingdom. These features include: no specialized housing finance institutions, government provision of highly subsidized loans, and an active secondary mortgage market.

The French system has no set of financial institutions that specialize in housing loans. Both the commercial banks and the ordinary savings banks make mortgage loans and collect the special housing account and plan deposits. Because these special accounts tend to be concentrated at commercial banks, these institutions appear to be the largest factor in the extension and holding of residential mortgages. As Table 6 shows, commercial banks originate and hold over 75 percent of mortgage loans.

This concentration of mortgage lending in commercial banks is a relatively recent phenomenon. Prior to 1965 banks were limited to loans of five years and so effectively were out of housing. This restriction was removed in 1965 at the same time that the special housing savings account was introduced. At the time Georges Pompidou stated that housing was the "priority of priorities" for the French government.

In 1966 to facilitate the growth of mortgage credit, the French secondary market was established. The Crédit Foncier de France is the regulatory institution which controls the secondary market. Trading is restricted to mortgages of 10 to 20-year terms on existing and new houses. The loans traded require a minimum "personal contribution" (downpayment) of 20 percent (so a maximum loan-to-value ratio of 80 percent). Approximately one-third of all long-term mortgage loan transactions go through the secondary market. Commercial banks, pension funds, and life insurance companies are all net purchasers of long-term mortgage loans. Table 6 shows sales and purchases on the secondary market.

Table 6
Growth of Mortgage Credit—France—(Billions of FF)

	1974	1975	1976	1977	1978	1979
Eligible for Secondary Market	55	65	83	98	121	154
(a) Loans Granted						
Banks	42	49	62	71	88	113
Other Financial Institutions	8	9	12	15	17	22
Others (including Savings Banks)	5	7	10	12	15	20
(b) Financing of Loans						
Banks	42	48	62	74	93	121
Other Financial Institutions	1	1	2	3	2	3
Others (including Pension Funds and Life Insurance)	12	16	19	21	25	30
Sales in Secondary Market	21	25	29	32	38	47
Banks	10	12	14	15	16	20
Other Financial Institutions	7	8	10	12	15	19
Others	4	4	5	6	6	8
Purchases in Secondary Market						
Banks	10	11	14	18	22	28
Other Financial Institutions	.2	.3	.3	.5	.4	.2
Others	11	13	14	15	16	18

Source: BSA French Group, Volume 2, page 69.

The mortgage market in France is also characterized by a large number of state or public borrowing options. A number of subsidized borrowing schemes are available for those who qualify. As a result, the lending market tends to be segmented by income groups, with lower income groups availing themselves of low interest rate loans. The French government has also at times constrained all lending, including mortgage lending, with credit controls (encadrement du crédit). These credit controls limit the incremental volume of loans that can be made for each institution. Mortgage lending, however, is given some advantage as only 40 percent of bank credit extended to housing is counted against the quantitative ceiling.

Two major subsidized lending schemes are available for homeownership in France. The first, the PAP (Prêts Aidés à l'Accession à la Propriété) is for lower income families. The interest rate in 1980 was set at 8.6 percent for the first nine years and rose to 11.07 percent for the remaining life (15 to 20-year total loan life). The PAP also allows a graduated payment provision in which payments are fixed for the first three years and then rise 3.5 percent per year thereafter.

The second major subsidized plan is the Prêts Conventionnés or Agreement Loans (PCs). This plan is for those who exceed the PAP income limits. The money for this plan comes indirectly from the Crédit Foncier de France. The program is only for new housing and the expansion of existing homes.

In the nonsubsidized area, mortgage lending arises from the Comptes d'Epargne-Logement and the Plans d'Epargne-Logement. The housing savings account allows a household to obtain a loan equal to the amount of savings plus accumulated interest at a subsidized interest rate. The interest rate on the loan is 1.5 percent over the savings rate (4.75 percent in 1981) and the loan has a life of 8 to 15 years. The maximum loan is FF 150,000 ($27,000). An additional loan of FF 450,000 ($82,000) is available at somewhat below market rates with this account.

The housing savings plan has all the same provisions as the previous account, except that the interest rate on the mortgage loan is 5.5 percent reflecting the higher interest rate paid on deposits in the Plan d'Epargne-Logement.

A final government policy introduced in 1977 was the Employers Housing Contribution (Le 1 percent Logement). Under this law 1 percent of the salary bills must be invested as follows:

(1) paid to a Comité Interprofessional de Logement (Employers Housing Committee) which lends to finance housing,
(2) direct lending at low rates to employees, or
(3) direct construction by the company.

This mandatory corporate involvement shows the clear priority that France has placed on housing finance.

A final government policy is the allowance of a deduction for mortgage interest paid from federal income taxes. A maximum of FF 7,000 ($1,272) per year for the first 10 years of the mortgage loan can be deducted. An additional FF 1,000 ($182) per child can also be deducted. In addition to this deduction, all capital gains on owner occupied housing are tax exempt.

This complicated set of lending options has led to perhaps a unique reliance on a cumulative set of mortgage loans, each with a different interest rate. As Table 7 illustrates, it is not at all unusual for a household to obtain between two and four different loans to assist in his housing purchase. This use of multiple loans is also reflected in the aggregate flows of credit through the financial system. Table 8 shows the sources of mortgage credit in 1980. Normal bank loans at market rates were used in 55 percent of transactions, housing savings account and plan loans were used in 35 percent of transactions, and government subsidized loans were used in 46 percent of home loans.

To summarize, the French housing finance system does not have a specialized lending institution like a savings and loan association. Instead, it relies on a complicated set of government subsidized and contractual savings loan programs. Nearly all loans are fixed rate even in this period of volatile inflation and interest rates.

B. United Kingdom

Compared to the French system, the British system of mortgage loan extension is quite simple. The Building Societies dominate the mortgage lending market, and as Table 9 shows, over three-quarters of all mortgage

loans made in recent years have been from that source. Building Societies are mutual institutions. They try to maximize the return to their shareholders while at the same time providing mortgage credit at the lowest possible rate to encourage homeownership.

Table 7
Use of Multiple Loans in French Financing System—1978—(Percentages)

Number of Loans	PAP Program	PC (Prêt Conventionné)	Nonaided Sector
1	15.7	71.2	46.6
2	49.5	23.3	41.7
3	23.8	3.4	9.8
4+	11.0	2.1	1.9
		Loan Combinations for PCs	
Prêt Conventionné		67.9	
Prêt Conventionné and d'Epargne-Logement		15.3	
Prêt Conventionné and Bank Loan		12.2	
Other		4.6	

Table 8
Lending Volume by Source—France—1980

Percent of Transactions Using Loan Type		Approximate Interest Rate	
35.4%	d'Epargne-Logement	5.50%	
10.9	Additional loans at 2% below market	10.75	
26.2	State subsidized (PAP)	9 12	first 9 years to end
20.3	Prêt Conventionné (PCs)	13	
54.9	Normal Bank Loan	17	

Source: Eve Icole
Centre de Recherche Economique

Table 9
Role of Building Societies in the Housing Market in the United Kingdom

	1971	1972	1973	1974	1975	1976	1977	1978	1979[e]
(1) Total Houses Sold (000's)	945	1,000	875	725	955	940	965	1,055	975
(2) Mortgages Made by Building Societies (000's)	653	681	545	433	651	715	737	802	700
(3) Share of Building Societies (2)/(1)	69%	68%	62%	59%	68%	76%	76%	76%	72%
(4) Volume of Loans by Building Societies (millions £)	2,760	3,650	3,540	2,950	4,970	6,120	6,220	8,730	8,600
(5) Repayments to Building Societies (millions £)	1,160	1,430	1,540	1,460	2,200	2,500	2,790	3,640	3,560
(6) Interest Credited (millions £)	334	392	650	828	981	1,127	1,377	1,516	2,100
(7) Net New Savings (millions £)	1,700	1,801	1,512	1,165	3,191	2,278	4,722	3,367	3,000

Source: Building Society Association, *Stow Report,* page 53, 1979.

In complete contrast to the French, they only make variable rate mortgages. The borrower need only be given 15 days notice of an interest rate adjustment and be told the new payment needed to avoid negative amortization. The borrower then has the option of raising his payment or extending the life of the loan. Negative amortization is evidently not encouraged. According to statistics made available at a leading Building Society, over 70 percent of households choose to raise their payments when interest rates are raised. Conversely, when interest rates fall, few households attempt to reduce their payments indicating a surprising desire (or possibly inertia) on the part of British households to reduce their mortgage debt.

Britain has no secondary mortgage market. Building Societies originate most mortgages and hold them to maturity. The effective life of a VRM mortgage in Britain is five and one-half years. The lack of a secondary market in the British system has been explained in various ways. The most persuasive explanation concerns the lack of regional and institutional fund imbalances. Because of nationwide branching and the lack of deposit rate ceilings, competition in the deposit market offsets the need for a secondary market in loans. The lack of a secondary mortgage market also leads to the apparent segmentation of mortgage finance from the overall capital market. Mortgage interest rates have typically been substantially lower than long-term government bond rates, in part because of this segmentation. Also, since the VRM mortgage is in essence a short-term instrument, during a period of a normal yield curve, one would expect a lower interest rate then on a long-term instrument.

The British system, with complete rate setting freedom on the deposit and mortgage side, would appear to be exactly the goal towards which the deregulation of the American system aspires. In fact, the British system experiences a credit rationing problem known as the "mortgage queue." It is contended that the British system operates with a continuing excess demand for mortgage credit because deposit and mortgage rates are too low and not competitive with other open market rates. Exacerbating this excess demand for mortgage credit is the tax deductibility of mortgage interest payments for all loans up to £25,000 ($48,000). The essential problem is that the deposit rate is too low and so Building Societies do not attract enough funds to meet mortgage demand. It has been felt that borrowers would not pay the rate required to give depositors a competitive rate. Thus, the British system appears similar to the American system, with depositors subsidizing lenders, though without the "benefit" of formal deposit rate ceilings. This segmented system undergoes periodic stress when deposit rates rise dramatically, but remains intact because of the lack of substantial competition for the retail savers funds.

This "mortgage queue" problem is reflected in a very low loan-to-value ratio, in the 60–65 percent range, and the growing use of more expensive "top-up" or second mortgages. In addition, this "mortgage queue" has attracted both commercial banks and Trustee Savings Banks to enter the mortgage market at higher interest rates to eliminate part of this excess demand. Increased sophistication on the part of borrowers and lenders and

the massive increase in government competition for retail savings seem to be on the verge of disrupting the "specialized circuit of finance" that British housing has enjoyed.

C. West Germany

The German system of mortgage lending shares many similarities with the French mortgage lending system. A substantial portion of mortgage lending involves contractual savings schemes and multiple mortgage loans made at fixed rates of interest. It is similar to the British system in that one institution, the Bausparkassen, specializes in collecting savings for housing—though only for the second mortgage loan.

Three types of institutions specialize in housing finance: mortgage banks (Hypothekenbanken), savings banks (Sparkassen), and the building-savings bank (Bausparkassen). The Sparkassen are major providers of first mortgage loans. As Table 10 illustrates, they provided 25 percent of mortgage credit in 1980. They offer both fixed and variable rate mortgage loans normally for an 8 to 12-year term. The preferred source of first mortgage credit are the mortgage bankers who provided 20 percent of mortgage credit in 1980. They offer 15 to 30-year mortgages at a fixed rate of interest. They finance these mortgages by issuing bonds of a matching maturity. Most large mortgage bankers are owned by commercial banks who might initiate the "mortgage loan package."

The "mortgage loan package" is really a multiple mortgage loan which resembles the cumulative loan system in France. In Germany, the first mortgage loan cannot exceed 50 percent of the value of the house and usually averages 35 percent of the house value. As a result, a loan package must be assembled with a second mortgage made by the building savings movement, the Bausparkassen. The Bausparkassen accounted for over 40 percent of mortgage credit extended in 1980. As described earlier, they attract their funds from a contractual saving scheme which entitles the borrower to a subsidized mortgage loan. The loan life is typically 8 to 12 years and will usually cover 30 percent of the value of the house.

The combination of this below market contractual savings and lending scheme and the government premium on deposits makes the German system quite similar to the French multiple mortgage/subsidized Epargne-Logement system. The major difference arises from the small number of government assisted first mortgages (less than 9 percent of volume) compared to the large portion of PAP and PC loans in France.

One consequence of the below market nature of the Bausparkassen loan is that, as in the British system, there is a "loan allotment queue," with individuals often required to wait for their below market rate loan. Partly mitigating the excess demand for credit are the deposits of contractual savers who do not intend to purchase a home. Attracted by the large government premium, nearly 25 percent of depositors do not use their savings accounts for home purchase.

A major consequence of both the French and German plans is that a portion of the mortgage market is insulated completely from the overall

Table 10
Sources of Mortgage Credit—Germany—(Millions DM)

	1970	1971	1972	1973	1974	1975	1976	1977	1977 (Percentages)	1980 (Percentages)
Bausparkassen	12,459	12,782	15,845	19,551	18,182	18,814	21,456	23,800	44.1	42.4
Sparkassen	5,057	5,870	7,402	7,408	5,857	6,250	8,295	10,200	18.8	25.4
Mortgage Banks	4,392	5,869	9,474	10,437	9,862	8,681	7,129	8,300	15.4	19.5
Insurance Companies	1,665	2,106	2,194	2,781	2,922	2,293	2,063	2,000	3.7	9.3
Public Sector	2,741	3,264	3,427	3,788	4,088	3,544	3,914	4,500	8.3	3.7
Total	37,140	44,680	54,640	58,840	52,650	47,290	51,140	54,000	—	—

Source: BSA Germany Working Group, Volume 2, page 26.
1980 numbers from tables prepared by Eve Icole.

capital markets. The contractual savings scheme, combined with the government bonus, insulates a portion of the mortgage loan volume from market rate financing. These schemes are really in part a self-subsidy and in part a government subsidy plan.

The British system, on the other hand, is more like the thrift industry relationship in the United States. Below rate mortgage loans can only be made as long as there are savers, usually different from mortgage borrowers, who are for various reasons willing to receive below market interest rates on their savings. Both the British and American systems have been surprisingly resistant in this regard. As the "unsophisticated saver" disappears, however, the British, because of the variable rate mortgage, are at least theoretically able to move to market interest rates and so prevent insolvency. In the United States, the presence of the "old portfolio" of fixed rate mortgages makes it impossible for thrifts to pay market rates on liabilities without experiencing large losses and insolvency. The present system is just barely surviving as a result of the continued presence of depositors (nearly one-third of all savers) willing to accept below market rates.

The German system also has several significant tax subsidies for homeownership. Until recently, no tax relief has been granted for mortgage interest payments. Recently, to encourage homeownership and to spur the production of rental units a limited interest deduction was introduced for two-family units.

While the interest deduction is at present limited, another substantial tax benefit is available to owner occupiers. The income tax law provision known as the "7 B writeoff" allows the construction or acquisition cost of a home to be written off at 5 percent per year for a maximum of eight years. (Not more than 80,000 DM cumulative depreciation can be taken). This depreciation provision is thus a very attractive incentive for homeownership. Unlike the U.S. law which only applies to rental residential real estate, the depreciation can only be taken on the property once—though the one-time depreciation is transferrable.

To summarize, the German housing finance system relies on a combination of long-term fixed rate financing and a self and state subsidized contractual savings scheme to provide a somewhat sheltered housing finance system. Germany's fairly low inflation rates have protected the German system from some of the breakdown apparent in the United States and Britain.

Conclusion

The United Kingdom, France, and Germany have all attempted to create a "privileged circuit of finance" for housing. In all countries, this has involved an attempt to subsidize mortgage interest rates either through direct or indirect means. The British system, most similar to that in the United States, is characterized by the dominance of Building Societies. Despite the lack of interest rate regulations and their complete reliance on the variable rate mortgage, the system is characterized by an excess demand for mortgage credit reflected in "mortgage queues." Despite this problem, the exis-

tence of a large tax deduction for mortgage interest, subsidized mortgage finance, and high inflation rates have raised the proportion of homeowners from 42 percent in 1960 to 54 percent in 1978.

France's policy emphasis on homeownership began in the mid-1960s with the initiation of a set of contractual savings for housing plans, the start of a secondary mortgage, and the provision of government subsidized loans. The French system is characterized by a set of complex multiple loans, the lack of a specialized housing finance institution, and only modest tax deductions for mortgage interest payments. However, the increased emphasis on self and state subsidized finance has resulted in a surge in homeownership since 1970 as Table 11 shows. Homeownership in France has increased from 41 percent in 1960 to 45 percent in 1970 to 51 percent in 1978.

Germany has historically provided the smallest incentives for homeownership. Until recently, no tax incentives were available for homeowners and the specialized finance system was limited to a contractual savings scheme essentially similar to the contractual savings scheme available for nonhousing purposes. In the past several years, economic incentives have been provided for homeownership. Germany, partly as a result of its past set of minimal policies, has a low and stable rate of homeownership of 37 percent.

To conclude, it appears that France and Germany are increasingly attempting to replicate the incentives and homeownership experience of the United States and the United Kingdom. This is occurring at the same time that the United States and the United Kingdom are reformulating the privileged role of housing and housing finance in the economic system.

Table 11
Owner Occupancy Rates (Percentages)

	1960	1962	1968	1970	1975	1978
France	41	41.3	43.2	45	46.7	51.2
United Kingdom	42	—	—	49.8	52.9	53.9
Germany	39	—	—	35	—	37

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Discussion

John J. Mingo*

Ken's paper is by far the most interesting paper that was presented at this conference. It's also the only paper you cannot criticize because it's simply a report of the facts. So I have no criticism. But unlike most papers that I and most of my colleagues read, I really went to school on this one. And let me share with you the way in which I think I went to school. Let's take a review of France and England, as I understood Ken's paper, and then see what that implies for what we've been doing.

France, unlike England, has regulated deposit ceilings as I understand it, but the below-market rates are tax-free to some extent and at the end of the holding period for the account there is a government bonus. There is also a chance to get a below-market loan, or a portion of a loan that is below-market. In addition, France has some taxation of employers wherein they are asked to invest in housing up to 1 percent of the wage bill. Again, as in our country, because the mortgage rates are below market, there tends to be some form of rationing (quantitative limits) and, as Ken reports, there tend to be multiple loans. You get one loan rate at x percent, another loan at y percent which is above x percent, and the third loan at a still higher rate until you've exhausted your need for loans and exhausted your pocketbook.

England starts off with a different tack. They have no deposit rate ceilings, and they do have what ostensibly keeps the institutions in business—that is, variable rate mortgages. But as Ken points out, the connection between the rate being paid on the deposit side and the rate being charged on the variable rate mortgage is still subject to the same kind of regulation and legislation that we have, except in a less formal way. In fact, my understanding of the British regulatory system with respect to financial institutions in general is that it is a lot less formal than our system, but no less burdensome from the economic standpoint. I suppose we could argue all day about whether formality is more or less efficient. As Ken points out, during certain time periods it becomes politically difficult to raise the variable rate mortgage ceilings. Therefore, it becomes politically difficult to raise the rates on deposits, but when that happens of course there's disintermediation and when there is disintermediation, as in this country, there are queues. At least that's what they're called in Britain and that sort of conjures up a notion of people standing in line in London, lines several blocks long, to get mortgages, and that conjures up a second image of people lining up several blocks in New York City to get paid off on a deposit in this country. But, be that as it may, these completely polar opposite ways of doing things really aren't all that different in their essential weaknesses. In

*John J. Mingo is Senior Associate at Golembe Associates, Inc.

Britain there is not the weakness of worrying about whether an institution exists or does not exist because of this neat connection between the interest rate on the deposit side and the variable rate on the mortgage side.

Also, in both France and England (I'm ignoring Germany for the moment) there seems to be a beautiful egalitarian way of spreading around the burden of the subsidy for housing. As far as I can tell, the housing subsidy in these two countries, and in Germany as well, is paid partly by all taxpayers in the form of a government bonus at the end of holding the deposit. It's paid partly by those interest rate-inelastic savers who enter into the government savings program but don't take the other end of it, the mortgage. It's paid partly by the housing borrower himself and partly in the form of these things called "queues" and "multiple mortgages," and partly by employers. That's beautiful and probably more complicated than this country. But when you cut through all of it, it seems to me that the one clear bit of similarity between what's going on in France, England, Germany and the United States, besides the fact they're all incredibly Byzantine, is that their legislators have done the same thing that our legislators have done for many, many years. They have avoided the central issue, or set of issues. The set of central issues being—how much should housing be subsidized, from whom should wealth be transferred to pay for the subsidy, and how should it be transferred? Those are questions which this conference has avoided asking. I'll get into that a little bit later.

In this country in the past, as some of our speakers have told us, there has been a tendency for the housing subsidy, undefined as to size, to be paid largely by interest inelastic savers. There was no, as far as I can tell, law which required that to happen. There was Reg Q. Reg Q imposed a cartel on institutions which allowed them to take advantage of those interest inelastic savers. But there was no law—certainly not section 593 of the Tax Code—which required those institutions, especially thrifts, to pass the economic saving (monopsony rent, if you will) stemming from those inelastic savers on to the mortgage borrower. In fact, as someone has pointed out, if you or I had been running those institutions we probably would have looked at the law and become selfish and passed those savings through to our reserves rather than to the mortgage holder. I'm not a historian and I can't explain why that happened but it did. I can predict, however, that now that we are in a regime where there is no effective Regulation Q (and there will be no Regulation Q in the future by law) thrift institutions and commercial banks will probably take advantage of the few remaining inelastic savers as they should have in the past. They will book to their own surplus that economic rent rather than pass it on to borrowers.

But that still begs the issue, which is what we've been avoiding at this conference. We've been discussing, in my view, a series of relatively inefficient ways of accomplishing an objective which nobody has yet defined. I have no doubt that there will be specialized thrift institutions in the future just as there will be specialized banks. People will tend to do what their comparative advantage is. Thrifts will tend to originate and service mortgages. That's what they've been doing, that's what they are trained to do. I

have no doubt that the best set of alternative mortgage instruments will be developed. I have no doubt that the best set of instruments will be developed in spite of regulators who are slowing down the process rather than letting the marketplace develop, given sufficient disclosure. I also have no doubt that the central issues will not be addressed by the Congress. Again, those issues remain: how much? from whom? to whom?

What does all this really come down to? It comes down to the question of: is 1.2 million housing starts in this country more appropriate than 900,000? Which is the better number? Is it socially better to have the average size of those 1.2 million housing starts 1,600 or 800 square feet? If it is 1,600 square feet, as opposed to 800 square feet, are we willing to pay the $2 billion as opposed to $1 billion? Then, after you go through all of that, you have to decide the most efficient way of doing it, and I think many economists would agree it is far cheaper—once having decided how many tens of billions of dollars you wish to spend—to do it straightforwardly by direct payments rather than by having an entire infrastructure which does the job inefficiently.

I thought I would end up by telling you how I feel about the U.S. Congress. I thought I'd end with a joke rather than start with a joke. I'm sure most of your local communities have T.V. stations to make public service announcements where they flash a message across the screen during prime time programming: "It's 10:00 p.m., do you know where your kids are?" Well, in Washington, D.C. we have a special one. Stations flash across the following message: "It's 10:00 p.m., do you know where your *Congressman* is?" There is even a special version of that, in the offices of Congressmen, which reads, "It's 10:00 p.m., do you know what *time* it is?"