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# Cuban Housing Privatization: A Comparative Perspective on the Future of Housing in Havana, Cuba

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## **Abstract**

Following the fall of the Soviet Union, Cuba faced significant economic hardship and was forced to reinvent its national economic model. To face this obstacle, Cuba opened up to foreign investment in real estate in 1995 and used tourism to grow its economy. However, tourism is ideologically inconsistent with the Socialist values that lay at the foundation of the Castro regime and required the development of a system of property rights. In 2011, Decree-Law 288 was established, which authorized the buying and selling of homes between private citizens without government authorization and at market prices for the first time in the history of the Castro government. This law—coupled with other recent developments in Cuba—suggest that privatization of the housing sector could occur in Cuba within the next few years.

What might housing privatization in Cuba—or specifically Havana, where the majority of Cubans live and where there is the most potential for tourism—look like? Traditional real estate tools are insufficient for addressing this question because housing privatization involves moving from a public-oriented housing system to a market-oriented housing system, and real estate tools work best with the latter. For this reason, a method of analysis from comparative politics known as the Most Different Systems Design, a comparative strategy that looks for shared outcomes between two very different case studies, was used. Uncovered similarities must be explained by the underlying component that is shared between the case studies: in this instance, post-Communist housing privatization. Russia and East Germany (or specifically, their capital cities of Moscow and East Berlin) were chosen as the two most different case studies for a number of reasons: different economy sizes and natures, different levels of popular support for Socialism at the time of privatization, homegrown versus foreign revolutions, different legacies of capitalism, different levels of development of political infrastructure, different privatization schemes, and different levels of success post-facto.

To systematically compare East Berlin and Moscow, housing privatization was explored along three different criteria: governmental housing policies and housing indicators, political context preceding and during housing privatization, and ideology. By exploring these three broad categories systematically, a more robust understanding of the similarities and differences between these two case studies can be achieved. To contextualize government housing policies in terms of the impact they made on the emerging housing market, the Wachter-Kroll Six Graph Model from real estate was used.

Based on this method of analysis, Havana can expect a significant increase in housing stock, an increase in housing quality, a short-term spike in housing prices followed by a long-term decrease, initial mistakes in housing construction levels, tax subsidies and direct grants to be effective tools for promoting housing construction, a significant reduction in public expenditure, strong tenancy rights to be maintained, and ideology to serve an important role in speeding up the transition to a stable housing market. Other research that sheds some light on expected developments in Cuba is also discussed, such as research that Socialist cities tend to require extensive renovation and repair due to inefficient placement and construction of housing, research that popular sentiment toward Socialism in Cuba today is declining which could accelerate housing privatization efforts, and research that the lack of a Cuban manufacturing culture due to pronounced tertiarization may result in the exploitation of Cubans due to increasing dependence on foreign corporations. The limitations of this housing privatization analysis are also discussed.

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**Keywords**

cuba, havana, real estate, housing, privatization, russia, moscow, germany, gdr, east berlin, berlin, housing privatization, Rudra Sil, Si, Rudra, International Studies and Business

**Disciplines**

Latin American Studies | Soviet and Post-Soviet Studies

# **Cuban Housing Privatization:**

A Comparative Perspective on the Future of Housing in Havana, Cuba

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## **RESUMEN EJECUTIVO**

Después de la caída de la Unión Soviética, Cuba enfrentó dificultades económicas importantes y fue obligada a reinventar su modelo económico nacional. Para abordar este obstáculo, Cuba se abrió a la inversión extranjera en bienes e inmuebles en 1995 y empezó a desarrollar el turismo para crecer su economía. No obstante, el turismo es ideológicamente inconsistente con los valores socialistas que forman la base del régimen castrista y requieren el desarrollo de un sistema de derechos de propiedad. En 2011, el Decreto-Ley 288 se estableció y autorizó la compra y venta de casas condicionado a tres condiciones por primera vez en la historia del gobierno castrista: la transacción se pasó entre individuos, ocurrió sin la autorización del gobierno, y se rigió por el precio del mercado. Esta ley - junto con otros acontecimientos recientes en Cuba - sugiere que la privatización del sector de la vivienda pueda ocurrir en Cuba en los próximos años.

¿Cómo sucede la privatización de la vivienda en Cuba? Específicamente, ¿cómo sucede la privatización de la vivienda en la Habana, donde vive la mayoría de la gente y donde existe el mayor potencial para el turismo? Las herramientas tradicionales de la disciplina de bienes raíces no son suficientes para abordar esta problemática porque la privatización implica pasar de un sistema de vivienda público a uno privado. Desafortunadamente, usar las herramientas tradicionales de la disciplina de bienes raíces para analizar un sistema público de vivienda es, como mínimo, inefectivo y probablemente inútil. Por esta razón, un método de análisis de política comparada conocido como el diseño de sistemas más diversos (MDSD), una estrategia comparativa que observa los resultados compartidos entre dos casos muy diferentes. Similitudes descubiertas entre los dos casos según esta estrategia deben ser explicadas por el componente

subyacente que se comparte entre los estudios de casos - privatización poscomunista de la vivienda. Rusia y Alemania Oriental (las capitales de Moscú y Berlín Este) fueron elegidas como los dos casos más distintos por varias razones: tamaños diferentes de la economía, diferentes niveles de apoyo popular por el socialismo inmediatamente anterior a la privatización, revoluciones producidas en el país o afuera, legados distintos del capitalismo, diferentes niveles de desarrollo de la infraestructura política, diferentes esquemas de privatización, y diferentes niveles de éxito después de la privatización.

Para comparar la privatización de la vivienda en Berlín Este y Moscú sistemáticamente, tres criterios distintos fueron explorados: la política de vivienda e indicadores de vivienda, el contexto político anterior y durante la privatización de la vivienda, y la ideología. Mediante la exploración de estas tres categorías sistemáticamente, se puede lograr una comprensión más fuerte de las similitudes y diferencias entre estos dos casos. Además, para contextualizar la política de vivienda en términos del impacto que tuvieron en el emergente mercado inmobiliario, se utilizó el Modelo Wachter-Kroll de la disciplina académica de bienes raíces.

Según este método de análisis, La Habana experimentará un aumento significativo de la reservas de vivienda; un aumento de la calidad de la vivienda; un aumento de los precios de la vivienda a corto plazo, seguido por una disminución a largo plazo; errores iniciales en los niveles de construcción de viviendas; subsidios fiscales y subvenciones directas como instrumentos eficaces para estimular la construcción de viviendas; una reducción significativa en el gasto público; la continuación de un sistema que apoya fuertemente a los arrendatarios; y una transición rápida hacia un mercado de vivienda estable. También, exploramos otras investigaciones que pronostican el futuro de la vivienda en Cuba, tal como una investigación que las ciudades socialistas por lo general requieren renovaciones y reparaciones extensas debido a

la distribución de viviendas ineficientes, una investigación que el sentimiento popular hacia el socialismo en Cuba hoy en día está disminuyendo y como este fenómeno puede acelerar los esfuerzos de privatización de la vivienda, y la investigación que le falta de una cultura de fabricación en Cuba debido a la tercerización pronunciada tal vez resultará en la explotación de los cubanos por una dependencia de las corporaciones extranjeras. También se discuten las limitaciones de este análisis de la privatización de la vivienda.

## EXECUTIVE SUMMARY

Following the fall of the Soviet Union, Cuba faced significant economic hardship and was forced to reinvent its national economic model. To face this obstacle, Cuba opened up to foreign investment in real estate in 1995 and used tourism to grow its economy. However, tourism is ideologically inconsistent with the Socialist values that lay at the foundation of the Castro regime and required the development of a system of property rights. In 2011, Decree-Law 288 was established, which authorized the buying and selling of homes between private citizens, without government authorization, and at market prices for the first time in the history of the Castro government. This law—coupled with other recent developments in Cuba—suggest that privatization of the housing sector could occur in Cuba within the next few years.

What might housing privatization in Cuba—or specifically Havana, where the majority of Cubans live and where there is the most potential for tourism—look like? Traditional real estate tools are insufficient for addressing this question because housing privatization involves moving from a public-oriented housing system to a market-oriented housing system, and real estate tools work best with the latter. For this reason, a method of analysis from comparative politics known as the Most Different Systems Design, a comparative strategy that looks for shared outcomes between two very different case studies, was used. Uncovered similarities must be explained by the underlying component that is shared between the case studies: in this instance, post-Communist housing privatization. Russia and East Germany (or specifically, their capital cities of Moscow and East Berlin) were chosen as the two most different case studies for a number of reasons: different economy sizes and natures, different levels of popular support for Socialism at the time of privatization, homegrown versus foreign revolutions, different legacies of capitalism,

different levels of development of political infrastructure, different privatization schemes, and different levels of success post-facto.

To systematically compare East Berlin and Moscow, housing privatization was explored along three different criteria: governmental housing policies and housing indicators, political context preceding and during housing privatization, and ideology. By exploring these three broad categories systematically, a more robust understanding of the similarities and differences between these two case studies can be achieved. To contextualize government housing policies in terms of the impact they made on the emerging housing market, the Wachter-Kroll Six Graph Model from real estate was used.

Based on this method of analysis, Havana can expect a significant increase in housing stock, an increase in housing quality, a short-term spike in housing prices followed by a long-term decrease, initial mistakes in housing construction levels, tax subsidies and direct grants to be effective tools for promoting housing construction, a significant reduction in public expenditure, strong tenancy rights to be maintained, and ideology to serve an important role in speeding up the transition to a stable housing market. Other research that sheds some light on expected developments in Cuba is also discussed, such as research that Socialist cities tend to require extensive renovation and repair due to inefficient placement and construction of housing, research that popular sentiment toward Socialism in Cuba today is declining which could accelerate housing privatization efforts, and research that the lack of a Cuban manufacturing culture due to pronounced tertiarization may result in the exploitation of Cubans due to increasing dependence on foreign corporations. The limitations of this housing privatization analysis are also discussed.

## **SECTION 1: INTRODUCTION**

The preceding quarter-century has been a time of tremendous change for Cuba. Although it may seem to be business as usual in Cuba to those living in the United States, Cuba has faced tremendous internal turmoil since the fall of the Soviet Union in the early 1990s. Because of the US trade embargo and other reasons, Cuba has faced significant economic hardship in the past 25 years and has needed to reinvent its national economic model. To face these challenges, Cuba opened up to real estate foreign investment in September 1995 through Law 77 and embraced tourism as a way of bringing in much-needed hard currency, even though tourism is ideologically inconsistent with the Socialist values that underpin the Castro regime.<sup>1</sup> Although Cuba today is still struggling to grow its economy, it appears that the nation has largely weathered the economic storm it faced in the early 1990s.

Opening up to foreign tourism—although a necessary evil for the Castro regime—had some difficult side effects. For most of the Castro regime, land and housing were not considered commodities. Housing was provided to individuals as a social good to address the basic human need of shelter, and land was collectively owned by all and leased out on behalf of the citizens.<sup>2</sup> Instead, the late 1990s marked the first time in 40 years where housing projects appeared that did not cater to social interests but rather the wishes and whimsies of wealthy foreigners tourists who wanted to buy property.<sup>3</sup> Although this was a lucrative endeavor for the Cuban government which desperately needed to develop its economy, foreign investors and corporations could only invest in Cuba with some semblance of a system of property rights. A Socialist economic system

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<sup>1</sup> Antonio Zamora. “The Impact of Cuba’s New Real Estate Laws on the Island and the Diaspora,” *Cuba In Transition* 22 (2012), 208-211.

<sup>2</sup> Mauricio Font and Carlos Riobó. *Handbook of Contemporary Cuba: Economy, Politics, Civil Society, and Globalization* (Boulder: Paradigm, 2013), 126-130.

<sup>3</sup> Mario Coyula. “Housing in Cuba,” *DESIGNER/builder* (2000), 7.

that sought to eliminate private ownership was ideologically incompatible with market-oriented corporations looking to turn a profit on privately-owned assets. This compromise began a slippery slope—non-state (i.e. private) ownership is the first step towards a capitalist economy.

In November 2011, Decree-Law 288 was established, which further pushed Cuba towards a market-oriented economic system. For the first time in decades, the law allowed for the buying and selling of homes between private citizens, without government authorization, and at market-determined (as opposed to government-determined) prices. This law procedurally and ideologically contradicted the longstanding practice of *permuta* (i.e. exchange), where two parties could trade homes as opposed to buying and selling housing. Decree-Law 288—especially if it is coupled with the abolishment of government limitations on how many residences can be owned—has laid the groundwork for a residential real estate market.<sup>4,5</sup>

Ideologically, the contradictions are mounting. On the surface, Cuba's Socialist policy objectives have remained the same, but Decree-Law 288 and other new policies by definition contradict Socialist values. The permission of foreign investors to build profit-seeking tourism properties and the creation of a residential real estate proto-market inherently imply that housing is a commodity and not a social good. Furthermore, market-determined real estate prices and the lifted restriction on housing sales contradict equitable distribution of housing and instead contribute to income inequality—a system of haves and have-nots. These new policies have started to reverse the Socialist progress that the Castro regime has made over the last 50 years. This—coupled with widespread popular sentiment that a market-based housing system would

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<sup>4</sup> Antonio Zamora. "The Impact of Cuba's New Real Estate Laws on the Island and the Diaspora," *Cuba In Transition* 22 (2012), 208-211.

<sup>5</sup> "Decreto-Ley 288," *Gaceta Oficial* 35 (2011), 359-373.

result in better housing outcomes<sup>6</sup>—suggests that further acceleration towards a market-oriented economic system is probable. Because of its close connection to the property rights system that is necessary for foreign tourism to succeed in Cuba, market privatization in Cuba is likely to happen in the housing sector first, a process known as housing privatization.

But what will housing privatization in Cuba look like? More specifically, what will housing privatization look like in Havana, where the majority of Cubans live and where the most potential for tourism dollars lies? Will housing privatization be successful? Who will benefit, and who will suffer? A number of interesting questions arise as we think about Cuba's imminent transition to a market-oriented economy, particularly in the housing sector. For many questions, only time will tell what Cuban housing privatization will look like. Nonetheless, scholars have a plethora of case studies to look at of formerly Communist governments privatizing the housing sector—that is, housing privatization in the post-Communist context. By analyzing post-Communist housing privatization in the comparative perspective, lessons can be learned about what housing privatization may look like in Cuba: what challenges will be faced, what pitfalls to avoid, and what opportunities should be taken advantage of.

## **HOW CAN WE PREDICT CUBAN HOUSING PRIVATIZATION?**

Predicting housing privatization—a complicated, multi-faceted process—seems like it would be a difficult endeavor to tackle. Countless different factors should affect how successful housing privatization turns out in the post-Communist context. According to the World Bank, there are at least 44 different indicators needed to compare different housing outcomes once a market-oriented housing system is approaching equilibrium (i.e. a steady state of met demand

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<sup>6</sup> Jared Michael Genova. "¡Hasta La Utopía Siempre! Conflicting Utopian Ideologies in Havana's Late Socialist Housing Market." (2012): 17-44.

and supply). Housing privatization—a complex process where a public-oriented housing system becomes a market-oriented housing system—is precisely so difficult because nations must muddle through a series of disequilibria: periods where supply and demand do not correspond. If 44 indicators are needed to compare stable housing markets, how can it be possible to compare unstable, messy, housing privatization transitions?

Even within nations, housing privatization affects different classes of cities distinctly. In Cuba, the Communist government frequently overinvested in rural locales and second-tier cities at the expense of capital cities. In East Germany, however, the opposite occurred; East Berlin received the lion's share of investment dollars in order to maintain the façade of strong economic growth in the Eastern Bloc.<sup>7</sup> Housing privatization helped ease these market distortions, but clearly this resulted in different housing privatization processes for capital cities, secondary cities, and the rural countryside, even within just one nation.<sup>8,9</sup>

Despite these many differences, housing privatization in the post-Communist context does seem to occur in roughly the same way. Although each nation has its own unique factors and context, housing outcomes tend to converge, particularly with regard to specific characteristics and attributes. Although methods of analysis from the academic discipline of real estate are valuable for predicting housing outcomes based on data, important indicators, and policy classifications, housing privatization is too multi-faceted, complex, and messy of a process to be easily dissected with these tools. Instead, to determine these characteristics, this paper aims to use a method of analysis from comparative politics known as the Most Different

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<sup>7</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 43-45.

<sup>8</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 387-409.

<sup>9</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 1-10.

Systems Design, a comparative strategy that looks for shared outcomes between two very different case studies. If similarities are discovered, then the differences between these two case studies must not be explained by their differences, suggesting general trends that can be applied to other case studies. Similarities found between two radically different examples of housing privatization in the post-Communist context could then be extrapolated to Cuba.

Perhaps the most dissimilar examples of post-Communist housing privatization are East Germany and Russia. Firstly, the two nations differed greatly in terms of the size and nature of their economies.<sup>10</sup> Secondly, popular support for Communism differed wildly between the two nations. In Russia, Socialism was still a relatively legitimate ideology due to its nearly century-long presence, whereas Socialism had lost its popular support due to a number of political gaffes by the time of housing privatization in East Germany. Thirdly, the point of origin of the revolution was different between the two nations. Russia's Socialist revolution grew from an indigenous grassroots movement and fundamentally altered the makeup of society, unlike in East Germany, where the Socialist revolution occurred through a Soviet takeover. Fourthly, each nation had different levels of experience with market-oriented systems prior to privatization. In Russia, the revolution took place while Russia was largely rural and pre-industrial, and it lasted for nearly a century.<sup>11</sup> In contrast, a somewhat robust market-based system had developed prior to the rise of East Germany, so there was more infrastructure present for a switch to capitalism post-facto. Fifthly, the two nations used different privatization schemes. In Russia, a mass privatization scheme was used and entailed the distribution of shares to the public. Typically, this involved breaking up state-owned enterprises and selling the assets of these corporations piece-

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<sup>10</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 15.

<sup>11</sup> Andrew Scott Barnes. *Owning Russia: The Struggle Over Factories, Farms, and Power* (Ithaca, NY: Cornell University Press, 2006), 20-27.

by-piece. In East Germany, the government used the reunification method of privatization. Law stipulated that enterprises needed to be sold “as is” and as a going concern. Joint ventures and raising new capital were not permitted. This was in contrast to most other nations, where joint ventures and selling assets piecemeal were common strategies for investors to develop profitable new corporations, although these phenomena did leave poorly performing assets with the state. Sixthly, by the time of housing privatization Russia and East Germany had developed finance and regulatory systems to a different degree. Because East Germany was merged with West Germany, East Germany was able to take advantage of West Germany’s legislative system, its longstanding legal code, and its robust financial and human resources. In contrast, Russia at the time of housing privatization was still struggling to develop a regulatory system and the political infrastructure that is vital to a swift and speedy transition.<sup>12</sup> Seventhly, the performance of housing privatization in Russia and East Germany was very different. Russia fared poorly through the housing privatization process. In a study comparing the development of housing market systems in reforming Socialist economies, Russia performed the absolute last along five different categories: market performance, overall indicators, fiscal indicators, financial indicators, and public/private roles (a category that considers ownership concentration, private housing production levels, land market controls, and maintenance responsibilities).<sup>13</sup> In contrast, East German privatization is considered a poster child of post-Communist housing privatization. Privatization in East Germany was quite successful and is considered an exception to the rule in post-Socialist privatization.<sup>14</sup>

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<sup>12</sup> Andreja Böhm and Marko Simoneti, eds. *Privatization in Central and Eastern Europe 1991* (Ljubljana, Slovenia: Central and Eastern European Privatization Network, 1992), 20-22, 173-183.

<sup>13</sup> Robert M. Buckley and Sasha Tsenkova. "Housing Market Systems in Reforming Socialist Economies: Comparative Indicators of Performance and Policy," *European Journal of Housing Policy* 1, no. 2 (2001), 266-273.

<sup>14</sup> Andreja Böhm and Marko Simoneti, eds. *Privatization in Central and Eastern Europe 1992* (Ljubljana, Slovenia: Central and Eastern European Privatization Network, 1993), 28-33, 122-139.

## **METHODOLOGY**

To reiterate, this paper will use a method of analysis from comparative politics known as the Most Different Systems Design. This comparative strategy searches for shared outcomes between two very different—almost archetypal--case studies. Similarities discovered between these two radically distinct examples are presumed to remain unexplained by the differences between the cases. Thus, the similarities could be extrapolated to other case studies of post-Communist housing privatization: in this example, Cuba.

East Germany and Russia have been identified as the two very different systems to be used in this analysis. However, it is just as important to identify what factors will be considered: how will different outcomes be measured and compared? To determine the similarities between these two different case studies, this paper will look at three different categories of information: governmental housing policies and housing indicators; political context preceding and during housing privatization; and ideology. By understanding these categories and their change over the course of housing privatization, lessons can be learned about the general trajectory of nations undergoing housing reform after Communist rule. Although East Germany and Russia started from very different origins in terms of housing indicators, economic factors, political infrastructure, and more, both nations experienced housing privatization in the post-Communist context. For this reason, similar trends in how these nations changed over time are relevant and useful for extrapolation, as opposed to what specific outcomes were achieved.

An exploration of what governmental housing policies were passed during the transition period yields information about how regimes tackle the massive and thorny problem of housing privatization through government initiatives. Although there are myriad ways of transitioning the housing sector to a market system, any observed similarities between these two case studies

could suggest that governments tend to address this problem in a similar fashion. Governmental housing policies include initiatives such as urban renewal programs, social housing programs, direct grants for construction, tax subsidies to homeowners, tax deductions to private financing, and much more. These policies stimulate economic activity and housing investment by facilitating and subsidizing the involvement of certain parties (and conversely, impeding and disincentivizing the involvement of other parties). In addition to exploring which kinds of policies are generally implemented, this paper will aim to contextualize these policies through the Wachter-Kroll Six-Graph model, a generalized housing model that dynamically represents the interaction between the market for housing services and the market for housing assets. This contextualization adds further detail to which kinds of policies are passed. Policies can not only be grouped categorically (e.g. social housing programs, tax subsidies) but also in terms of what their impact is on the housing market (e.g. reduces the cap rate, subsidizes construction firms). Put another way, these policies will be characterized through an exploration into how housing indicators and economic factors—such as GDP per capita, population, inflation, housing stock, new housing starts, and households per dwelling unit—changed over time. As previously mentioned, East Germany and Russia did not share similar values for these indicators preceding housing privatization. Nonetheless, trends in how these values changed over time could reveal useful insight about the housing privatization process after the end of Communism in these nations. As with governmental housing policy, the magnitude and direction of these changes alone can be useful information, but greater context adds detail that colors our understanding of the housing privatization process in the post-Communist context. The Wachter Kroll Six-Graph model will be used to understand how these housing indicators fit in the larger context of the housing market and to begin to understand how the changes in these values could relate to the

implementation of governmental housing policy, housing infrastructure, and national economic and monetary policy.

Understanding the political context preceding and during the housing privatization process is another useful tool for expanding our understanding of this phenomenon. All of the selected nations share the unenviable task of moving from a state-planned economy to a free-market system for one of the largest sectors of every economy: housing and housing construction. Furthermore, housing policy is closely linked to the competitiveness of economy compared to others across the globe.<sup>15</sup> For this reason, controlling the housing privatization process is a high-stakes game that creates clear winners and losers, as with other types of privatization. Understanding the political happenings directly around the time of housing privatization—such as the material interests of key economic and political stakeholders—could shed some light on general challenges that formerly Communist nations will face when privatizing housing.

Finally, ideology was chosen as a potential determinant of housing privatization. Did preexisting ideologies have an impact on the housing privatization process, and did ideologies develop during the housing privatization transition? Mainstream literature on post-Communist privatization typically focuses on the material interests of key political and economic actors. However, this approach alone does not adequately explain privatization efforts in the former Eastern Bloc.<sup>16</sup> In the early 1990s, the world community almost unanimously agreed with rapid post-Communist privatization through mass privatization programs, despite no historical precedent for privatization on a nationwide scale and despite widespread criticism of these

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<sup>15</sup> Susan Wachter. “International Housing Comparisons: Introduction and Indicators” (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

<sup>16</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 7.

efforts just a decade later.<sup>17</sup> Furthermore, empirical research on privatization relies on the presence of clearly-defined property structures and transformative mechanisms. Given the high degree of uncertainty following the post-Communist regime changes, key stakeholders appeared to have little insight into which initiatives and measures would best advance their particular goals or economic interests. In her groundbreaking book A New Capitalist Order, Hilary Appel suggests that one crucial shortcoming of the standard empirical approach is the lack of attention paid to the forces that shaped how the preferences of stakeholders formed and to the forces that determined how the distribution of power was perceived.<sup>18</sup> Appel argues that understanding ideology begins to fill this critical void in understanding the privatization process, with ideology defined in the Hayekian sense as a belief system held by individuals but shared by many in a society, such as anti-Communism, pro-Westernism, nationalism, or economic liberalism.<sup>19</sup> Appel explains that ideology drove privatization in Eastern Europe and Russia by determining the initial design of property rights, shaping the definition of interests and distribution of power among groups in society, and influencing how policymakers built support for the implementation process. Collectively, compatibility between policy initiatives and the predominant ideology in society during privatization affected the ease of implementation and the distortion of privatization programs over time.<sup>20</sup> Although Appel's analysis focuses specifically on an analysis of Czech and Russian large-scale privatization, her findings can with some work be expanded to address housing privatization in East Germany and Russia, especially because political support for members of former ruling parties differed substantially across all of the former Eastern Bloc

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<sup>17</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 4.

<sup>18</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 12.

<sup>19</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 8.

<sup>20</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 7.

nations. In Russia, the Communists maintained a good deal of popular support and many even maintained their positions in political office. However, in East Germany popular support for the Communists eroded long before reunification occurred. This paper will begin to scratch the surface of exploring how ideology facilitated or hindered the housing privatization process in these two countries, with the intent of applying this to the Cuban situation.

Collectively, an exploration into these three categories will yield a wealth of information about the specifics of the housing privatization programs in East Germany and Russia, two radically different case studies for housing privatization in the post-Communist context. The similarities uncovered through this analysis could to begin to paint the picture of what Cuban housing privatization might look like a few years down the line.

Finally, it is difficult to draw broad generalizations about housing privatizations within one nation. Particularly in Communist countries, housing services were treated very differently in capital cities, second-tier cities, and the rural countryside. Logically, housing reform would occur differently across these geographies as well. To control for the fact that housing privatization on a national level would affect capital cities, secondary cities, and rural areas differently, this paper will specifically look at East Berlin and Moscow, the respective capital cities of the former German Democratic Republic and Russia. This choice should allow for an understanding of what housing privatization may look like in Havana.

## **A PRIMER ON USING THE WACHTER-KROLL SIX GRAPH MODEL**

Without context, determining the relevant government housing policies, economic policies, and data on housing indicators provides insufficient information about post-Communist housing privatization. Without an overarching framework, it is difficult to interpret this

information to create a narrative about housing privatization in the intermediate term; this is especially useful as it begins to suggest causation and correlation between different factors and begins to rank which factors are more important than others. For this reason, the Wachter-Kroll Six Graph Model is used extensively in the paper to provide context to not only the long-term equilibria implied by housing policy changes but also the short-term disequilibria as well. The Wachter-Kroll Six Graph Model is explained and explored in another section.<sup>21</sup>

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<sup>21</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996).

## **SECTION 2: REAL ESTATE THEORY ON WHAT HAPPENS IN HOUSING MARKETS**

Understanding the Cuban housing situation in the present global context is difficult without an understanding of how housing sectors function at a high level. Since the fall of the Soviet Union, the vast majority of economies have begun the transition towards market-based housing systems.<sup>22</sup> Cuba is quite exceptional in its current rejection of market-based housing systems. However, Cuba's housing policy nonetheless aims to address the same issue that all housing policies seek to fix: how can we house our citizens in the most effective way possible? Of course, the definition of effective used therein can vary considerably. Effective can mean efficient (predominant in market-focused nations), equitable (predominant in Socialist nations such as Cuba), or directed at a given sociopolitical motive, among other definitions. Typically, the definition of effective usually involves some combination of all three factors. This definition varies greatly based on a nation's orientation towards free markets or central planning, among other economic, political, ideological, and historical motives.<sup>23</sup>

### **WHAT MAKES HOUSING POLICY IMPORTANT?**

What makes housing policies important? Why are government policies on housing different than government policies on other goods? Government policy on housing is exceptional because housing itself is a unique good. Housing differs from other economic commodities for a wide swath of reasons: housing is a complex commodity, housing is fixed in space, housing is the major investment of households, housing units have extremely long lifetimes, housing is a

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<sup>22</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995).

<sup>23</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 1.

merit good, choice of housing affects location, homeownership access impacts important socioeconomic and political factors, and housing is strongly related to the national macroeconomy. Although many commodities may have one or more of these distinctive features, only housing presents the special combination of all of them. This combination of attributes has implications on structural aspects of the housing market and on housing transition..<sup>24,25</sup>

Housing is a complex commodity because it is complex to evaluate, produce, manage, and maintain. These qualities also make it complicated for suppliers and demanders to trade it efficiently.<sup>26</sup> Housing is a heterogeneous good: a variety of residences with distinguishable features—architectural style, number of square feet, number of floors, number of bedrooms, number of bathrooms, presence of a backyard, and much, much more—can all provide the same function. Thus, a variety of different attributes must be considered to evaluate, characterize, and price a dwelling or building. In a market-based system focused on efficiency, households, tenants and landlords must gather and process a great deal of information to make housing market choices that maximize utility or profit.<sup>27</sup> In centrally-planned economies such as Cuba, government agencies must gather this information in order to make housing market allocations that achieve their stated aims, such as fair and equitable distribution. Secondly, space constraints are an important consideration for housing as a good. This fixity constraint necessitates that choosing housing implies a choice of neighborhood,<sup>28</sup> a choice of access to jobs, and a choice of

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<sup>24</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

<sup>25</sup> Susan Wachter. "International Housing Comparisons: Introduction and Indicators" (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

<sup>26</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

<sup>27</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

<sup>28</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

access to goods and local services, such as shopping centers and schools.<sup>29</sup> Thirdly, housing is the major investment for households. Housing is expensive to produce, own and maintain. For this reason, housing is generally the most significant investment for households and is typically a substantial fraction of household budgets.<sup>30</sup> Ultimately, this makes housing unique as an asset class as it is both a basic consumption and an investment good.<sup>31</sup> This characteristic makes renting or leasing critical for proper functioning of a housing system. Fourthly, the durability of housing is measured in decades. Housing units have extremely long lifetimes, which implies that new construction provides only a small fraction of the total quantity of housing services and that construction activity is extremely sensitive to minor changes in housing demand. Moreover, the implications of local investment activity affect the physical environment for a long time.<sup>32</sup> Fifthly, housing is a merit good, or a private good which is publicly supplied because it is deemed important that an appropriate quantity is consumed.<sup>33</sup> As a society, we care that all members of society have adequate housing, because shelter is a basic human need. Provision of housing must not only consider what is economically efficient but also what is equitable and just.<sup>34</sup> Housing is a necessity for all individuals, although there tend to exist many substitution possibilities within the set of housing services. In the case that individuals are unable to achieve shelter through the formal housing sector, they may pursue housing services through the informal housing sector by living in slums or shantytowns, building their own residence, or doubling up

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<sup>29</sup> Susan Wachter. "International Housing Comparisons: Introduction and Indicators" (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

<sup>30</sup> Susan Wachter. "International Housing Comparisons: Introduction and Indicators" (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

<sup>31</sup> Adam J. Levitin and Susan Wachter. "Why Housing?" (*Housing Policy Debate* 23, no. 1 2013), 6.

<sup>32</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

<sup>33</sup> Bo Bengtsson. "Tenants' Dilemma on Collective Action in Housing." *Housing Studies* 13, no. 1 (1998), 111.

<sup>34</sup> Harry Rele and Guido Steen. "Measuring Housing Subsidies: Distortionary and Distributional Effects in the Netherlands." *Fiscal Studies* 24, no. 3 (2003), 319.

with an existing household (e.g. moving in with parents or relatives).<sup>35</sup> Shelter as a fundamental human need constitutes a major reason why housing is distinct from other economic goods. Sixthly, housing policy has implications on important socioeconomic and political factors. For example, access to homeownership—a key plank for all housing policies—impacts wealth distribution, who becomes a have and a have-not, and political stability of a society.<sup>36,37</sup> Finally, housing is strongly related to the national macroeconomy. Housing and housing construction constitute a large part of the economy and are a large percent of government expenditures. Moreover, housing policy is closely linked to the competitiveness of economy compared to others across the globe.<sup>38</sup>

The combination of these attributes makes housing unique from other economic commodities and has implications on structural aspects of the housing market and on housing transitions.<sup>39</sup> Housing complexity makes information gathering an important part of pricing and evaluating housing as a good, and information asymmetry is thus a significant issue in housing markets. Housing fixity and complexity mean that housing transaction costs are very high in terms of both monetary and psychic costs. Fixity and asset longevity result in a scenario where housing investment decisions made even centuries prior can have a long-range consequences on the entire future course of geographical areas.

Given the expense and investment involved in the creation of housing, housing finance systems are critical to understanding housing policy. In the case of Socialist nations with planned

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<sup>35</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

<sup>36</sup> Susan Wachter. "International Housing Comparisons: Introduction and Indicators" (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

<sup>37</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995), 1247-1248.

<sup>38</sup> Susan Wachter. "International Housing Comparisons: Introduction and Indicators" (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

<sup>39</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 2.

economies, housing finance systems do not exist in the sense of a market for housing financing with banks, financial institutions, and other private lenders involved in contributing funds. Instead, housing finance is mixed with government and state-enterprise budgets. Furthermore, construction organizations in these economies cannot differentiate between housing financing (i.e. banking loans at competitive market rates) and housing subsidies (i.e. fiscal grants originating from the government), which results in complex market distortions.<sup>40</sup> Given the sheer expense and investment required for a market-based housing system, some form of housing financing system is almost mandatory for proper functioning. Nonetheless, the characteristics of individual housing finance systems differ considerably from country to country. Research by Bertrand Renaud categorizes housing finance systems by their dominant characteristics into six different types. These six types are: undeveloped housing finance systems, missing housing finance systems in former centrally planned economies, fragmented and unstable housing finance systems, segregated but stable housing finance systems, sound and integrating housing finance systems, and advanced housing finance systems. The first of these systems are undeveloped systems, which are found in regions such as sub-Saharan Africa where economic growth is dependent on a few export commodities, per capita income is low, and basic financial infrastructure is practically nonexistent. Informal financing such as social financing from friends and family is prevalent and virtually necessary for any housing construction in countries with undeveloped housing finance systems. In many of these countries, a strong push for the development of commercial housing finance is often premature because basic financial institutions are barely in place and not strong enough to provide for the entire system. Instead, priority should go first to the development of solid housing markets through urban laws and

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<sup>40</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995), 1252.

housing-facing policies and practices. Rather than focusing on housing specifically, public efforts towards the extension of basic urban infrastructure and the supply of serviced urban land and land titling are likely to have a greater initial impact.<sup>41</sup> The second of these housing systems are missing systems in former centrally planned economies, which face a number of challenges. Like in undeveloped housing systems, the absence of a commercial housing finance system is a significant challenge. Moreover in many of these countries (save for Russia) the economies are not fully urbanized, further exacerbating the issue. The majority of these Post-Socialist economies suffer from the following shortcomings, despite making considerable progress in recent years: weak private property rights; a legacy of confusion between housing financing and housing subsidies; still undergoing the process of privatization, the rent reform process, and the creation of a legal framework for real estate, the creation of legal and regulatory reforms of the banking system before commercial housing finance can be put in place; and a dualistic housing system with a large, stagnant state system overshadowing a small, but often rapidly growing private system. Results in terms of a housing finance system have been wanting. Private housing finance remains limited, experimental, and for high-income groups. Furthermore, a coordinated improvement of both primary mortgage lenders (e.g. banks and other financial institutions that originate housing loans) and secondary market facilities (a financial after-market on which these loans can be traded) is essential for safe and sound expansion in these housing finance systems.<sup>42</sup> This type of market activity will allow for the expansion of housing finance availability for citizens and will tie housing finance to credit markets, allowing households to borrow at lower interest rates. However, this linkage could have negative repercussions. Academics such as

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<sup>41</sup> Bertrand Renaud. "The Financing of Social Housing in Integrating Financial Markets: A View from Developing Countries." *Urban Studies* 36, no. 4 (1999), 767-768.

<sup>42</sup> Bertrand Renaud. "The Financing of Social Housing in Integrating Financial Markets: A View from Developing Countries." *Urban Studies* 36, no. 4 (1999), 768-769.

Susan Wachter believe that the linkage of housing finance and global credit markets resulted in an explosion of the use of leverage resulted in the 2007 housing crisis.<sup>43</sup> The third of the housing finance systems are fragmented and unstable systems. These systems result from high inflation and macroeconomic instability combined with directed credit and financial repression. These systems were common in Argentina, Brazil, and other parts of Latin America in the 1980s. Housing finance in these nations tends to be very small in relation to GDP as a result of recurrent macroeconomic mismanagement and/or external shocks. These nations are typically marked by the dominant role of government in housing, typically caused by severe income inequality. Essential components of long-lasting reform for these countries include the separation of subsidies from finance and the targeting of subsidies for social housing.<sup>44</sup>

## **HOUSING POLICY IMPLICATIONS ON NATIONS AND MOTIVES FOR HOUSING POLICY CHOICE**

The choice of housing policy has far-reaching implications on a nation. Firstly, the execution of housing policies “affects the physical appearance and spatial development of metropolitan areas, the economic well-being of households, and their social environments.”<sup>45</sup> Secondly, since housing is a necessity for all individuals, housing policy affects all citizens in a given nation, and the distribution of housing is an important issue for producers and consumers and by extension politicians and government officials. Thirdly, the longevity of housing assets means that housing policy can only be changed slowly over time, as even large changes in new

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<sup>43</sup> Susan Wachter. “International Housing Finance & Market Outcomes: An Overview” (presentation, International Housing Comparisons course, Philadelphia, PA, January 14 2013).

<sup>44</sup> Bertrand Renaud. "The Financing of Social Housing in Integrating Financial Markets: A View from Developing Countries." *Urban Studies* 36, no. 4 (1999), 769.

<sup>45</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 1

commitments to housing subsidy increase total housing stock over a long time horizon. Fourthly, housing policy has implications for and must be coordinated with many other important objectives of economic and social policy such as macroeconomic stabilization, social welfare, appropriate land use, economic development, and more. Fifthly, housing policy is difficult to design and may be difficult to evaluate in many cases. This characteristic is exacerbated by the long-term perspective needed to analyze housing policy decisions and “in part because uncertainty is magnified over long time horizons.”<sup>46</sup> Choice of housing policy has substantial long-term ramifications on the direction of a nation and its economy.

What are the different types of policy instruments that governments can use? Instruments of housing policy can roughly be categorized into three categories: demand-oriented (which includes housing allowances and tax exemptions), supply-oriented (which includes planning and land use policy, building codes, zoning regulations, construction subsidies, and interest rate subsidies), and direct market intervention (which includes rent controls, price controls, rationing systems, queuing systems, and tenant security regulations). Demand-oriented instruments distort existing housing demand, supply-oriented instruments distort the long-term housing supply levels, and instruments of direct market intervention typically have a rapid impact on housing supply and/or demand in the short- (or immediate-) term, although when these policies are maintained over a longer time horizon the ramifications are felt over the long term. The exact nature of how these instruments impact housing demand and supply is beyond the scope of this paper, but the Wachter-Kroll framework explored later in the paper is a wonderful tool for analyzing this phenomenon.<sup>47</sup>

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<sup>46</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 3.

<sup>47</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 23.

Why do housing policies vary so widely from nation to nation? Although all nations seek to have an effective policy, the definition of effective can differ greatly based on desire economic, political, and social objectives. These motives can be generally summarized as directed at efficiency, equitability, or a specific social or political aim. Efficiency motives for housing policies are common in market-focused housing systems and aim to promote allocative efficiency in the economy. Equitability or equity objectives aim to provide suitable living conditions for all citizens and are closely related to an equal income distribution objective. Finally, social and political motives comprise a third objective for housing policies. Social motives tend to be especially evident with regulation linked to housing policy. For example, regulation on minimum health and safety requirements for households “codify the social character of urban life” and represent social norms on what should be considered adequate housing. Housing policy can also be used to further political ideology. For example, Socialist political parties often aim to tailor housing policy to minimize income inequality and divisions between different classes.<sup>48</sup> These parties tend to conceive of housing not as an economic commodity but rather as a merit good that should be provided to all citizens, lest citizens underestimate the importance of decent housing for themselves or be unable to attain it due to wasteful consumption.<sup>49</sup> Differences between countries can thus be quite stark. In the United States, tenants can be evicted on the basis of delinquent payments.<sup>50</sup> However, in Brazil, tenants can only be evicted through protracted judicial proceedings, even at the end of the lease period. The average length of this

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<sup>48</sup> Björn Hårsman and John M. Quigley. "Housing Markets and Housing Institutions in a Comparative Context." *In Housing Markets and Housing Institutions: An International Comparison*, (Springer Netherlands, 1991), 4-10.

<sup>49</sup> Harry Rele and Guido Steen. "Measuring Housing Subsidies: Distortionary and Distributional Effects in the Netherlands." *Fiscal Studies* 24, no. 3 (2003), 319.

<sup>50</sup> “Anti-Discrimination Law is Pro-Tenant,” *Global Property Guide*, February 2008, <http://www.globalpropertyguide.com/North-America/United-States/Landlord-and-Tenant>

process is 120 days.<sup>51</sup> Although these different objectives vary widely, they are not mutually exclusive. Generally, housing policies are directed towards a blend of motives.

Of course, understanding the implications and motives of housing policy is just a component of the overall story. Academic research from scholars of real estate shows that housing policy can have dramatic implications for national housing markets. Typically, Socialist nations with planned economies have nationalized housing systems that aim to more equitably provide housing to all. These nations typically conceive of housing as a fundamental human right and oppose conception of housing as an economic good to be sold and traded.<sup>52</sup> In the case of Cuba, for example, this meant high levels of homeownership, low (and in some cases nonexistent) rent costs, and increased provision of higher quality housing to the most marginalized by society, especially rural and agrarian populations.<sup>53</sup> However, this type of system generally has drawbacks as compared to market-based housing systems. For example, Socialist nations with planned economies tend to have similar housing systems that suffer from a number of common features: high levels of state ownership, trivial rents charged to users and poor maintenance of public housing stock, overwhelming dependence on state financing in new construction, strong state monopolies over production leading to low-quality housing stock that provide poor housing services, the absence of land markets resulting in distorted land use.<sup>54</sup> As

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<sup>51</sup> "Landlord and tenant law is pro-landlord." *Global Property Guide*.

<http://www.globalpropertyguide.com/Latin-America/Brazil/Landlord-and-Tenant>

<sup>52</sup> Claes Brundenius. *Revolutionary Cuba: The Challenge of Economic Growth with Equity*. (Boulder, CO: Westview Press, 1984), 85-86.

<sup>53</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986).

<sup>54</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995), 1249.

an example of the last point, this can mean the overbuilding of high-quality housing too far from the city; this housing often goes unused after housing privatization.<sup>55</sup>

The aforementioned concerns, when coupled with macroeconomic distortions and rapidly growing subsidies, ultimately directed Russia and East Germany away from centrally planned housing models to market-based housing systems. What explains the negative outcomes of centrally planned systems? Why does the transition to market appear to be a necessity and not really a choice for Socialist countries? The answers stem from the singular characteristics of housing discussed previously, especially as they pertain to what Marxist analysts call “commodity housing” as well as the administrative shortcomings of a planned economy.<sup>56</sup>

Although housing is not very complex to produce, it is perhaps the most complex economic good to properly analyze, distribute, manage, maintain. As previously mentioned, housing is a durable good that lasts for decades, and housing is quite heterogeneous in terms of design, age, available services, and more. Moreover, housing value is strongly dependent on the quality, social services and infrastructure of the neighborhood where housing is located. Furthermore, the high costs to produce housing, the complex nature of housing transactions, and the characteristic of housing as a fundamental basic need (i.e. shelter) make it the subject of extensive financial, fiscal and physical regulation by governments. These characteristics of housing explain why indirect policy instruments operating in decentralized, locally regulated housing markets work much better than direct, centralized interventions by the state in raising the efficiency of the sector, and meeting the needs *and* preferences of the population. Furthermore, from a macroeconomic perspective, the system of state financing usually creates allocation distortions, deadweight losses, and destabilizing subsidies. Over the long run, this results in severe macroeconomic distortions and

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<sup>55</sup> Alain Bertaud and Bertrand Renaud. "Socialist Cities Without Land Markets." *Journal of Urban Economics* 41, no. 1 (1997).

<sup>56</sup> Bertrand Renaud. "Housing Reform in Socialist Economies." *World Bank Discussion Paper Series* 125 (1991).

rapidly growing subsidies that make a centrally planned housing system fundamentally unsustainable.<sup>57</sup>

## **UNDERSTANDING HOUSING OUTCOMES: THE RELEVANT INDICATORS**

A discussion of housing policy would be incomplete without exploring housing outcomes. Given that housing is a heterogeneous good, housing transactions are expensive and complex, and the housing market is such a large portion of a nation's GDP, understanding housing outcomes in nations and the institutions that develop to support housing markets is a difficult task. The following sections will aim to explore how housing outcomes can be measured and what frameworks can be used to systematically evaluate these outcomes. Put another way, we will discuss what indicators should be considered when trying to compare different housing outcomes and what academic theories can tell us about those outcomes.

There are a variety of different indicators that should be considered when trying to compare housing outcomes. These indicators can be thought of under two different general categories. Housing context indicators reveal the context of the housing market. By understanding the climate for economic growth across all economic sectors, the fundamental basis of what the housing market might look like can be understood. These indicators include macroeconomic indicators (e.g. inflation, interest rates, access to jobs, and income per capita), legal institutions, urbanization, and availability of public services. The second category of indicators is housing-specific indicators. At a high level, these include housing supply (e.g. space per capita, rooms per capita, housing stock, housing starts), housing finance (access to, how much, and under what conditions), housing institutions (presence of credit bureaus, housing

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<sup>57</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995), 1247-1248.

legislation, housing rulings in court, and regulatory systems), primacy, informality, affordability (rent as a percent of income, construction cost as a percent of income, land prices as a function of density), quality, safety, permanence, homelessness, home ownership, and systemic volatility of the housing finance system.<sup>58</sup> According to the Housing Indicators Program, a World Bank program that sought to characterize important housing indicators in the early 1990s, an exhaustive list of useful indicators includes: GNP per capita, national level of urbanization, inflation over the previous decade, country financial depth, capital population, house price to income ratio, rent to income ratio, house price appreciate as a percent, down-market penetration, housing credit portfolio, credit to value ratio, mortgage rate to prime rate difference in basis points, mortgage to deposit difference in basis points, mortgage arrears rate, owner occupancy, public housing stock, unauthorized housing, squatter housing, homelessness, floor space per person, persons per room, households per dwelling unit, permanent structures, water connection, journey to work in minutes, annual new household formation, residential mobility, vacancy rate, housing starts, housing investment as a percent, industrial concentration, import share of construction, construction cost, construction skill ratio, average construction time in months, land development multiplier, land conversion multiplier, infrastructure expenditures per capita, urban density, minimum city lot size, salable land ratio, extent of rent control, permits delay, and foreclosure delay. Ideally, all of this information would be listed in our case studies, which would allow for a powerful comparative perspective on different city case studies. However, due to a lack of data, this outcome is difficult to achieve. Instead, this paper attempts to comment at a high level on ten different categories of important values: socioeconomic context, housing prices, housing finance, housing tenure, housing quality, housing market dynamics, housing

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<sup>58</sup> Susan Wachter. "International Housing Comparisons: Introduction and Indicators" (presentation, International Housing Comparisons course, Philadelphia, PA, January 9, 2013).

production and investment, housing construction, residential land development, and the regulatory environment.<sup>59</sup>

## **UNDERSTANDING HOUSING OUTCOMES: WACHTER-KROLL'S SIX-GRAPH MODEL**

While determining relevant indicators allows us to make comparisons between different nations and their corresponding housing policies, it does not allow for an understanding of how the housing market functions. Put another way, what forces tie housing policies and housing outcomes? How can we understand which levers result in different outcomes?

One framework developed to address this question is Wachter and Kroll's six-graph model, which dynamically represents the interaction between the market for housing as a service and the market for housing as a financial investment. Alternately, the six-graph model attempts to tie housing as a fundamental need for individuals and households with housing as a traded asset in the capital markets. It is important to note that this model aims to understand the real estate space market and real estate asset (i.e. capital) markets, and thus its utility is different when trying to understand housing systems that are not based on market systems (i.e. public housing systems). For these systems, the six-graph model allows for a better understanding of what a market-efficient outcome might look like. For example, the six-graph model can provide a reference point for what a market-efficient amount of housing starts could be. Specifically, Wachter and Kroll's six-graph model is unique in that it allows for a dynamic understanding of how the real estate market moves from disequilibrium towards equilibrium outcomes.<sup>60</sup> For this

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<sup>59</sup> Marja Hoek-Smit. "Volume II: Indicator Tables." *The Housing Indicators Program* (1993), 1-22.

<sup>60</sup> Susan M. Wachter and Timothy J. Kroll. "Real Estate Capital and Space Markets: The Simple Analytics." (1996), 1.

reason, the Wachter-Kroll six-graph model is a more useful model than the DiPasquale-Wheaton four-graph model it was developed from.<sup>61</sup>

The top three graphs in the six-graph model represent the market for real estate space. Assuming adequate maintenance, each unit of space can produce shelter and other housing services in perpetuity. The market represented by the top three graphs is not the market for these structures, but rather the market for the services produced by these spaces. Tenants are charged rent per unit of a given quality per period in exchange for these services; in the long-term, this rent must cover the cost of production for these services. In this model, tenants that own their own housing (i.e. owner-occupied housing) are considered to be renting to themselves. Graph 1 demonstrates the market short-run and long-run demand and supply curves for rental services.<sup>62</sup> The total demand for space in Graph 1 is typically formulated as a function of disposable income, the number of households in a given area, and rent. It is useful to note that a number of housing policy instruments such as rent control, subsidies that increase disposable household income (i.e. supplementary housing assistance), and urban renewal programs can affect the demand for housing. One important lever for the rent market is the tax rate; all else equal, a tax reduction would lead to an increase in real estate prices due to the increase in disposable income.<sup>63</sup> Graph 2 shows the average long-run cost curve for a representative provider of rental services (i.e. “rental firms” such as REITs, property managers, small-scale owners/operators, and owner-occupants who provide services to themselves). Graph 3 represents demand for new

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<sup>61</sup> Denise DiPasquale and William C. Wheaton. “The Property and Capital Markets.” *Urban Economics and Real Estate Markets*. Vol. 23, no. 7. (Englewood Cliffs, NJ: Prentice Hall, 1996).

<sup>62</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996), 1-2.

<sup>63</sup> Claus Michelsen and Dominik Weiß. “What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding.” *Post-Communist Economies* 22 (2010), 391-392.

investment in real estate.<sup>64</sup> This graph associates the number of new construction starts each period with the net operating income (NOI) or returns on real estate.<sup>65</sup>

The bottom three graphs, in contrast, represent the market for real estate assets (i.e. capital market). These assets represent the structures that provide housing services.<sup>66</sup> Graph 4 shows the market short-run and long-run demand and supply curves for these assets. Note that the cap rate ( $i$ )—the expected risk-adjusted interest rate from real estate, which represents the expected income a property can generate—can be calculated here by taking the rent price in Graph 1 and dividing by the asset price in Graph 4. The cap rate is determined exogenously and depends on the rate of return on all other assets and implicitly interest rates, risk, and inflation. All else equal, a drop in the cap rate would result in an increase in rent level in Graph 1.<sup>67</sup> Graph 5 shows the average long-run cost curve for a representative construction firm (i.e. “developers” or construction firms that specialize in new constructions or renovations of existing stock).<sup>68</sup> Construction costs can be increased by a variety of factors, such as land price increases due to land shortages and increases in short-term credit costs. On the other hand, construction costs can also decrease due to a drop in input prices, the provision of direct grants to housing developers, relaxed zoning policy, and mortgage interest reduction.<sup>69</sup> Graph 6 shows the long-run and short-run supply curves for the entire construction industry.<sup>70</sup> At equilibrium, the supply of housing

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<sup>64</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996), 1-2.

<sup>65</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996), 4-5.

<sup>66</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996), 2-3.

<sup>67</sup> Claus Michelsen and Dominik Weiß. “What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding.” *Post-Communist Economies* 22 (2010), 391.

<sup>68</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996), 2-3.

<sup>69</sup> Claus Michelsen and Dominik Weiß. “What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding.” *Post-Communist Economies* 22 (2010), 392.

<sup>70</sup> Susan M. Wachter and Timothy J. Kroll. “Real Estate Capital and Space Markets: The Simple Analytics.” (1996), 2-3.

and the number of new starts depends on the physical depreciation of housing stock. However real estate markets are frequently in disequilibrium. In this case, housing construction starts is equal to gross new investment, which may be greater or less than the equilibrium value if there is an undersupply or oversupply in housing, respectively. Note that the physical rate of depreciation can be influenced by political context. Low-quality construction materials, improper maintenance, overutilization of refurbishment (i.e. too little new construction), and government subsidization of demolition can increase the physical rate of depreciation of housing stock each year.<sup>71</sup>

Of course, any generalized real estate model serves only as an approximation of actual real estate markets, and this model in particular relies on three fundamental long-term assumptions: unitary income elasticity of demand, unitary price elasticity of demand, and infinite supply elasticity. In more general terms, these three assumptions respectively mean that the demand for space increases proportionately with economic activity, that the demand for space decreases proportionally with increases in price, and that housing construction costs remain constant. One important insight we can distill from these assumptions is that the housing stock is inversely proportional to rent, if we assume that in the long-run rent should be a fixed percentage of income for the whole population.<sup>72</sup>

The strength in the Wachter-Kroll model (and by extension, the DiPasquale-Wheaton) model is its ability to generalize the complex housing market. However, a number of simplifications are required to make this general equilibrium model. For example, aspects like bargaining, leverage effects, monopoly power of the government in land supply, the political

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<sup>71</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 392-393.

<sup>72</sup> Susan Wachter. "Housing in Market-Based Systems: Equilibrium and Disequilibrium Concepts" (presentation, International Housing Comparisons course, Philadelphia, PA, January 16, 2013).

economy of housing supply or strategic interactions between real estate developers are omitted.”<sup>73</sup> Moreover, this model does not predict what happens when individual economic agents make mistakes or act off of imperfect information, the so-called trembling hand problem. Overbuilding by construction developers can still happen, which can result in an oversupply of housing stock in the housing market.

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<sup>73</sup> Claus Michelsen and Dominik Weiß. “What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding.” *Post-Communist Economies* 22 (2010), 390.

## **SECTION 3: HOUSING PRIVATIZATION**

### **A PRIMER ON HOUSING PRIVATIZATION**

What is housing privatization, and what does it aim to accomplish? In the most general sense, privatization is about replacing the public sector with the private sector.<sup>74</sup> Somewhat more specifically, housing privatization is a series of policies that move from a government-owned and -managed housing system to a market-run housing system. However, this definition is too vague to systematically classify the various programs and initiatives that could hold the moniker of housing privatization. Privatization policies vary widely in their goals, outcomes, and definitions; therefore, it is important to develop a common language around the terms.<sup>75</sup>

The goal of privatization with respect to housing may vary widely from country to country. These objectives could include: reducing public expenditure, divesting central or local government of financial or administrative problems, using a market-based system to maximize efficiency, or using a market-oriented housing system to legitimize market systems. Today, academics recognize that moving to a market-based housing system results in a decline in government spending, no rationing, an increase in supply, a decrease in rent and housing costs, and an increase in quality (especially due to improved location). However, a market-based system requires the ability to borrow—otherwise residents are constrained to renting—and a mortgage market that can resolve the time inconsistency problem. The time inconsistency problem relates to the fact that residents have a demand for housing before they have saved the money necessary to buy a house; a mortgage allows residents to purchase a house today and pay

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<sup>74</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 2.

<sup>75</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 1-2.

for it over time as their earnings increase. The goal of privatization may be just one or a combination of these objectives.<sup>76</sup>

Evaluation privatization is also difficult. In the case of privatization, what is considered as good outcome? Two approaches can be proposed: evaluation based upon the aims of the privatization and evaluation based on objective criteria.

The definition of privatization varies widely across different countries and time periods. Furthermore, privatization is more of a spectrum than the term would otherwise suggest. In West Germany in the early 1990s, “social housing” was owned by private companies but funded and regulated by the government. In the United States, housing is owned, built, and funded by private citizens; however, housing is strongly regulated by the government, and there is heavy government intervention in the housing finance (i.e. mortgage) system.<sup>77</sup> The variety of options for housing and housing finance systems requires that housing privatization be thought about more comprehensively. Under one conceptualization, housing sectors sit along an axis ranging from an ideal publicly- or state-run housing system to an ideal privately-run housing system. Housing privatization—by this definition—involves a significant shift of the housing system from a public-oriented housing sector towards a market-oriented housing system.

## **PUBLIC AND PRIVATE HOUSING SYSTEMS**

What differentiates a public-oriented housing system from a market-oriented one? Housing privatization can be thought about along four different criteria: provision, subsidy and taxation, regulation, and objective.<sup>78</sup>

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<sup>76</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 2.

<sup>77</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 2-3.

<sup>78</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 4.

Public provision of housing means four things. Firstly, housing is owned by the government—either federal or regional—or government institutions. Secondly, the main source of investment strategy comes from the government, such as through taxes or revenues borrowing. Thirdly, the housing is implemented and managed by the state bureaucracy. Fourthly, accountability for a public housing system falls on government officials or elected representatives; inadequate housing outcomes manifest themselves as complains or even protests by individual constituents. However, private provision of housing sits on the other end of the axis. Firstly, housing assets are owned by private individuals (e.g. homeowners or landlords), collectives of individuals, or private institutions. Secondly, individuals or institutional sources make up the main source of investment funds. Thirdly, housing is implemented and managed by autonomous private companies and individuals, typically with the market acting as the facilitator of the system. Fourthly, accountability is to investors and customers; inadequate housing outcomes manifest themselves as insufficient profits or complaints by tenants.<sup>79</sup>

Under public subsidy and taxation, the government typically subsidizes housing through a subsidy to production (e.g. direct capital subsidies to house building) but does not tax institutions. Under private subsidy and taxation, the government very rarely subsidizes housing, but if there is a housing subsidy it is typically done through a subsidy to consumption (e.g. housing allowances or tax relief). Furthermore, institutions that participate in private housing sectors are taxed.<sup>80</sup>

Regulation under a public housing sector happens directly through the state, given that housing provisions occurs through the state as well. State control and regulation is also used to control housing output levels. However, under a private housing system, regulation is present but

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<sup>79</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 4.

<sup>80</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 3-5.

through the use of law. Instead of the government determining housing output levels, the market is used to facilitate and determine that appropriate amount of housing needed.<sup>81</sup>

The objective of a public housing system is to meet socially or politically defined needs and demands. Public housing systems, for example, are common in Socialist nations, where housing is seen as a public service and a fundamental human right as opposed to a consumed commodity. The objective of a private housing system, in contrast, is private profit for those who fund the housing system and private consumption for individuals and institutions who want to consume housing as a commodity.<sup>82</sup>

Collectively, these four criteria define an ideal public housing sector and an ideal private housing sector. Through this paper, we define housing privatization in the post-Communist context as moving from a public housing sector to a private housing sector along two or more different criteria: provision, subsidy and taxation, regulation, and objective.

## **HISTORY OF HOUSING PRIVATIZATION**

In developed countries, the move from public housing systems to market housing systems has evolved over just the last few decades. Nonetheless, housing systems have possessed both private and public elements in the Western world for almost a century. Early in the 20<sup>th</sup> century, housing systems were dominated by public ownership and public expenditure. Nonetheless, private lending for homeownership was supported by the United States government as far back as the 1930s. Although this phenomenon is not as old as it is in the West, private attributes have

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<sup>81</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 3-5.

<sup>82</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 3-5.

also been present in Eastern Europe (in nations such as Hungary) for at least a half-century.<sup>83</sup> Prior to World War II, government involvement in housing systems was predominantly limited to traditional housing finance systems. Government-owned banks allocated credit at below-market rents to attractive loan applicants. Unfortunately, funds were typically rationed to just a very small percent of the population and frequently to just civil servants or government bureaucrats. Following World War II, government involvement increased across a number of important economic sectors, and housing was no exception. Social housing programs developed that aimed to increase homeownership through greater government involvement in construction, provision, subsidy, and/or regulation. One important development was the creation of marginal enclave public programs. These programs were intended to serve those in marginal communities, but ultimately incurred large resource costs and served few. Starting in the 1980s, however, governments began to adopt housing privatization and incorporate more and more private attributes into largely public housing systems. This policy move spread rapidly across the world. The US, UK, and Western Europe transitioned in the 1980s; Eastern Europe and Russia transitioned in the 1990s; and China, India, and parts of Latin America began the transition in the 2000s.<sup>84</sup>

Why did housing privatization begin to spread so quickly? In retrospect, these policies (especially in the West) seemed like obvious win-win outcomes, especially for election-minded politicians. Firstly, housing privatization allowed governments to significantly reduce public expenditure. In the UK, housing expenditure decreased from 5.6% of total public expenditure in 1980 to 1.2% of total public expenditure by 2000 due to housing privatization efforts that began

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<sup>83</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 1-4.

<sup>84</sup> Susan Wachter. "Housing in Market-Based Systems: Equilibrium and Disequilibrium Concepts" (presentation, International Housing Comparisons course, Philadelphia, PA, January 16, 2013).

under the Conservative Party. The funds freed from these efforts could then be poured into tax cuts or into other spending programs such as social security, health, education, and defense.<sup>85,86</sup> Secondly, housing privatization resulted in a housing system that was more efficient, better distributed, and more malleable to housing policy instruments. A market-oriented housing system was more efficient because of more effective cooperation between agents of demand (i.e. homeowners and renters) and agents of supply (i.e. construction firms, rental agencies, and investors) through increased producer competition and increased consumer choice. The system was more malleable to policy changes as a greater variety of housing policy instruments could be used; for example, housing subsidies could be targeted more directly to those that needed them with less bureaucratic headache. Finally, the system was better distributed because chronic housing shortages were addressed and well-off government bureaucrats no longer benefitted disproportionately from the provision of good-quality subsidized apartments because of their government connections and know-how. Thirdly, politicians were able to benefit from ideological associations with housing privatization. Although housing privatization represented a decrease in total public expenditure on housing, citizens were sold on the increased consumer choice and consumer power they benefitted from (including, but not limited to, greater mobility or ease in moving). Furthermore, citizens were excited to see an end to what was termed a “culture of dependency” and the rise of an “enterprise culture” that provided many in the working class with the first experience of property ownership.<sup>87</sup> A number of Western politicians in the 1980s—including such icons as Margaret Thatcher—benefitted handsomely from housing

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<sup>85</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 4-13.

<sup>86</sup> Paul N. Balchin and Maureen Rhoden. *Housing Policy: An Introduction* (New York: Psychology Press, 2002), 8-10.

<sup>87</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 4-13.

privatization and its ancillary effects; one important but unanticipated side effect was an increase in self-employment as workers benefitted from greater mobility and increased need for housing.<sup>88</sup> The many benefits of housing privatization—coupled with the decreased expenditure the policy implied—was a no-brainer for most governments, which helps explain why it was adopted relatively quickly.

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<sup>88</sup> Mariusz Mark Dobek. *The Political Logic of Privatization: Lessons from Great Britain and Poland*. (Praeger, 1993), 27-44.

#### **SECTION 4: HOUSING AND HOUSING POLICY IN CUBA**

Some of the most dramatic changes in housing outcomes in the Western hemisphere have occurred in Cuba over the last fifty years. Unfortunately, little information is available on this radical transformation due to the Castro regime's totalitarian nature. General secrecy and widespread lack of transparency have plagued academic efforts at collecting reliable and consistent data.

What data is available is typically created by and sourced from the regime itself. This is problematic for a number of reasons. Firstly, scholars have struggled to analyze economic performance of Socialist countries such as the Soviet Union, China, Poland, Czechoslovakia, and the German Democratic Republic due to the lack of important indicators of information such as independent (i.e. undistorted) price signals, which serve as a relatively reliable and consistent way of analyzing how demand and supply interact. Secondly, in these types of countries, it is difficult to compare data from year to year as data bases differ, definitions change, and product coverage varies. This is most frequently problematic when comparing pre-Socialist and post-Socialist time periods, but it can also be troubling after significant policy changes occur within a Socialist nation as was the case by late 1960s Cuba. Thirdly, and perhaps more importantly, data in centrally-planned nations formed under a strong ideological basis is inherently unreliable. Put another way, the Cuban government clearly wishes to show the superiority of its social and economic systems, which makes the temptation to distort information overwhelming.<sup>89</sup> The research that comes out of the US suffers from the opposite bias. Much research is completed by or funded by Cuban refugees, many of whom have an ideological conflict with the Castro regime

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<sup>89</sup> Claes Brundenius. *Revolutionary Cuba: The Challenge of Economic Growth with Equity*. (Boulder, CO: Westview Press, 1984), 19-21.

and hope to see its swift demise. This paper tries to take the middle path and present a balanced view by using sources with both biases, but it is difficult to claim objectivity due to the bias inherent in the sources used.

Academic research shows that this type of distortion can be seen in economic statistics from the Soviet Union, as Soviet index numbers contained inflated output levels and frequently omitted unfavorable values from economic reports. The same situation appears to have occurred to some degree in Cuba. The Castro regime has avoided revealing poor economic performance through both the omission of certain indicators for a given year or by presenting data over a longer (e.g. five-year) timeline; both of these tactics have been used by the Cuban government. In Cuba, this phenomenon was exacerbated by Cuba's charismatic leader Fidel, who demonstrated time and time again that he was not above distorting stories and facts unreasonably to make a point. At the most deliberate level, distorting information involves faking numbers and data to paint a favorable economic picture.<sup>90</sup>

Although specific housing figures and indicators may be unreliable, understanding how housing policy and housing outcomes have changed in Cuba is valuable for understanding where housing policy and housing outcomes might be following housing privatization. Because finding information on housing policy from before, during, and after the revolution is rather difficult, this paper presents a comprehensive literature review exploring both housing outcomes and housing policy from before the revolution to the present. In particular, the policy initiatives are important as they begin to paint a picture of how housing policy was envisioned, shaped, and implemented in Cuba over the past half-century.

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<sup>90</sup> Claes Brundenius. *Revolutionary Cuba: The Challenge of Economic Growth with Equity*. (Boulder, CO: Westview Press, 1984), 19-21.

## **PRE-REVOLUTIONARY CUBA**

The history of Cuba's housing situation is unique, if only because of Cuba's unique position in history. By the end of the 1800s, Cuba was the jewel of the Spanish crown and its most important remaining colony. In that era, Cuba's enormous sugar earnings and its role as the center of Spain's declining empire meant that Cuba urbanized earlier and accumulated relatively greater wealth than most other Latin American nations. This wealth was reflected in the building landscape of Cuba as an expression of Spanish colonial power and was especially obvious in the public and private buildings of Havana and other urban areas. Curiously, urbanization in Cuba in 1899 exceeded that of the USA by some metrics. 1899, 28.5% of the Cuban population lived in cities of more than 20,000, a greater proportion than even the United States at that time, which had only 23.8%.<sup>91</sup>

## **CUBA AT THE TIME OF THE REVOLUTION**

Before the revolution, Cuba was a neocolony of the United States, with all of the income inequality this status brings. In 1953, over 80% of rural dwellings were *bohíos*, thatched-roof huts with dirt floors. In 1953, less than 10% of rural dwellings had electricity or plumbing. In 1953, 95% of urban dwellings in Havana had electricity. Less than 50% had complete sanitary facilities. Roughly 50% were considered of acceptable quality. 6% of Havana's population lived in squatter settlements. Between 650,000-750,000 housing units were considered substandard out of a total housing stock of 1,400,000 housing units. Moreover, economic crisis exacerbated the

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<sup>91</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 1-2.

difficult housing situation. After World War II, there was rampant real estate speculation until the revolution, creating economic instability in the nation.<sup>92</sup>

In terms of housing policy, Cuba was rather advanced by the 1950s. One of Cuba's most important policies pertained to rent control—essentially a combination of rent freezes or reductions for most units and some moderate increases, usually for newer properties—starting in 1939 until the revolution and beyond. Cuba's rent control program was one of the earliest in the world. Each law that was developed increased the number of new rental construction properties under regulation; increase came from bringing in more and more previously unregulated properties under consideration. However, investors found ways to circumvent the law, such as unregulated subletting, furniture fees, and “key money.” Furthermore, investors started building condominiums with the help of a 1952 law to avoid the regulation. These condos were sold to tenants on installment plans (ostensibly since national mortgage were unavailable), and mortgage rates were usuriously high. Pre-Revolutionary Cuba also established a law that granted a “right to occupancy” for rental tenants (i.e. condo buyers didn't apply). This occupancy granted rental tenants the right to be evicted only with just cause. Out of a total urban rental stock of 460,000 housing units, an average of 70,000 evictions were ordered each year in the mid-1950s. The country also had relatively strong labor movements, which helped limit marginalization of low-income rental tenants. Nonetheless, the macroeconomic relationship with the United States had important implications for social inequality and economic disparity within the nation. Roughly 25% of workers' incomes were spent on housing in 1950s, which was high compared to other countries at the time.<sup>93</sup>

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<sup>92</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 2.

<sup>93</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 2.

## REVOLUTIONARY CUBA AND HOUSING REFORM

At the start of the revolution, the Urban Reform Law set into motion drastic changes to Cuban housing policy that affected the nation for decades. Seeking to remove the vicegrip that landlords held on Cuban properties, the Urban Reform Law generally eliminated multiple ownership, gave renters a chance to buy their homes at low costs, and put into motion reforms that would ultimately put the state in charge for constructing, allocating, and maintaining housing.<sup>94</sup> Leading up to the promulgation of the Urban Reform Law, revolutionary Cuba put a few housing laws into effect as stopgaps of a sort. The most important of these transition housing laws were a series of “vacant lot laws,” which attempted to eliminate land speculation and stimulate construction by forcing landowners to either start building within six months or sell their vacant or sparsely developed land to someone willing to do so. However, the Urban Reform Law was the first comprehensive set of laws that pertained to housing. Enacted in October 1960, the Urban Reform Law established the concept of housing as a public service, with the stated goal of eventually making it available at no cost to residents.<sup>95</sup> In these early years, eliminating the use of housing for profit was the main goal.<sup>96</sup> In the vocabulary of a previous section, the housing policy objective in Cuba moved from a strong focus on efficiency—an important outcome of market-based housing systems—to an enormous focus on equity and equitability. One stipulation of the Urban Reform Law prohibited rental housing entirely—including private renting and subletting.<sup>97</sup> Instead, current tenants were extended the first priority to buy the residences they lived in under the condition that they repay the remaining principal (i.e. no

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<sup>94</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 5.

<sup>95</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 2.

<sup>96</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 4.

<sup>97</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 5.

interest) to owners over time.<sup>98</sup> Instead of renting, the Urban Reform Law developed the legal concept of usufruct leasing, in which the government maintained common ownership of the property but effectively leased the right to tenants, as long as the property was not damaged or destroyed. For this reason, the policy of usufruct was a logical extension of prerevolutionary “right to occupancy” policies that prevented eviction without cause.<sup>99</sup> Given the fact that the mortgage market largely developed to circumvent rent control, mortgages were given the same treatment as rent; all mortgage agreements were cancelled. Non-institutional mortgage lenders (e.g. individual lenders and private mortgage companies) received no compensation, but commercial banks received bonds equivalent to the value of their mortgage holdings. Commercial banks received compensation because their mortgages were often insured and not offered at the usurious interest rates of noninstitutional lenders. Another major stipulation of the Urban Reform Law was the nationalization of *cuarterías*—typical inner-city slum housing with families living in one or two small rooms and sharing sanitary facilities—with no compensation to the slumlords.<sup>100,101</sup> Furthermore, families living in the *cuarterías* and other sub-standard housing stopped paying rent.<sup>102</sup> Although the new government had no qualms with hurting speculators, large landlords, and private mortgage lenders, it did not desire to hurt small landlords and small mortgage holders, many of whom held income-generate property for financial security in their old age. For this reason, the Urban Reform Law also stipulated that former landlords and mortgage holders receive a lifetime pension of up to 250 pesos a month

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<sup>98</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 4.

<sup>99</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 5.

<sup>100</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 2-3.

<sup>101</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 5.

<sup>102</sup> Mario Coyula. “Housing in Cuba,” *DESIGNER/builder* (2000), 1.

(roughly \$250 USD per month at the time). Although this was a decently large sum at the time, it was nothing compared to the 3 to 5 million pesos received annually by some large landlords in the period. The consequences of the Urban Reform Law were enormous, and the legislation set the overall legal framework for housing for Cuba over the next two decades. The new Cuban government gave security of tenure and virtual protection against eviction for both homeowners and leaseholders, ended private ownership of housing for profit, effectively ended speculation in buildings and land, and redistributed roughly 80 million pesos to tenants from landlords through rent reduction laws.<sup>103</sup>

The radical change to new housing policy meant that new housing institutions also had to be developed. One of the most important housing institutions is a housing finance system. Housing finance makes homeownership more feasible, as homeowners can take out a mortgage instead of being forced to rent until they save up enough money to purchase a house in cash. Within weeks of the start of the Cuban revolution—January 1959—the National Institute for Savings and Housing (INAV) was created. INAV used proceeds from the national lottery to finance housing with no-interest and low-interest (less than or equal to 5%) loans in order to finance over 8,500 units but it only lasted two years.<sup>104</sup> Another significant institutional change was the development of a massive direct government building program. Previously, the vast majority of housing was constructed by private construction firms and investors; with the regime change, the Socialist government would now be responsible for paying for and running national housing construction.<sup>105</sup> At first, this program would be facilitated by readily available materials

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<sup>103</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 2-4.

<sup>104</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 5-6.

<sup>105</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 5-6.

and excess capacity in the construction industry immediately after the revolution, as unemployed construction workers and others could be quickly absorbed into new projects. However, resources soon became hard to come by, especially after the start of the 1961 US-sponsored trade embargo.<sup>106</sup> New government regulation also limited and regulated the buying and selling of houses. Citizens were limited to the ownership of one primary residence and a vacation home. In the case that citizens wanted to sell a dwelling, they could only sell at government-set prices, and the state had the first option to buy the property. Inheritance of a dwelling—regardless of whether the tenure was through homeownership or usufruct leasing—was limited to only those who had lived with the deceased in the dwelling for a year or more. These strict restrictions meant that relatively little legal private buying and selling of land occurred for decades, although “informal” sales were not uncommon. Furthermore, the government-regulated exchange of houses became popular, where two individuals would swap residences by gaining authorization from the relevant government agency.<sup>107</sup> This exchange method—known as *permuta*—would persist for decades and still remains an important way to trade properties today. To summarize, a number of housing institutions were developed at the start of the revolution. This included a limited housing finance system, a state-sponsored massive-direct-building housing program, restrictions on the buying and selling of properties, and a system of exchange known as *permuta*.

## **HOUSING AND HOUSING POLICY FROM 1965-1970**

Although major housing reforms were put into place in the first years of the revolution, the government was forced to prioritize other policies it deemed more important in the face of

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<sup>106</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 8.

<sup>107</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 5.

limited resources. These resource constraints foreshadowed difficulties that Cuba would face for decades to come. One priority was assigned to Agrarian reform laws required the provision of government-built, rent-free, furnished dwellings located in newly-developed rural towns. This policy of “urbanizing” the countryside reflected Cuba’s strong commitment to overcoming differences between rural and urban areas, but it also required a disproportionate amount of resources.<sup>108</sup> One of the best examples of this investment—an impressive rural settlement that required a disproportionate level of resources—is the Las Terrazas rural community that was inaugurated in 1971. The village was meant for reforestation workers in Sierra de los Organos, and the community began with 46 one-story detached houses with light-prefabricated walls and pitched clay-tile roofs so it would blend with the environment. Years after its initial construction, two-story apartments and a beautiful hotel would be added to the community as well.<sup>109</sup>

However, overinvestment in rural areas ultimately resulted in the neglect of urban areas, especially Havana. New housing construction was insufficient to accommodate just the depreciation of housing stock, let alone the population increase caused by a massive baby boom and increased rural migration to cities. Furthermore, few resources were devoted to maintenance and repair of existing stock, a problem that continues to exist in Cuba even until this very day.<sup>110</sup> Another major priority involved the immediate destruction of shantytowns. Although this initiative was successful, it would only exacerbate the perennial housing shortage that plagues Cuba to this day.<sup>111</sup>

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<sup>108</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 6.

<sup>109</sup> Mario Coyula. “Housing in Cuba,” *DESIGNER/builder* (2000), 3.

<sup>110</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 6.

<sup>111</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro’s Cuba*. (Boston: Joint Center for Housing Studies, 2002), 5-6.

Issues with housing reform were obvious even by late 1964, when a national housing conference was held to chart directions for future policy. Nonetheless, housing production was still subordinated to other needs of the economy in the late 1960s. Roughly 6,500 units were built each year over the period, grossly insufficient for the population at the time. In particular, the government focused on structural and productive investments, allocating just meager resources to housing. Virtually no construction was completed in larger urban areas, especially Havana. Because of severe shortages of both materials and labor, a lightweight prefabricated building system was used extensively for one- and two-story construction. This policy focus—known as industrialized construction—was strongly pursued, and experimentation also began with prefabrication systems for more complex building systems.<sup>112</sup>

To deal with the insufficient housing construction, private citizens constructed “self-built” housing—households obtained their own materials, leveraged social relationships for help with labor, and hired self-employed building tradespeople as needed. The national government by and large ignored private, self-built housing, and would continue to do so until the 1970s and beyond.<sup>113</sup>

Despite insufficient government construction, the government attempted to provide basic amenities as well as possible. This meant the provision of latrines and cement floors to 100,000 rural dwellings and the development of electricity and other urban infrastructure in low-income urban neighborhoods.<sup>114</sup>

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<sup>112</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 8.

<sup>113</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 8-10.

<sup>114</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 6.

## HOUSING AND HOUSING POLICY FROM 1971-1975

The government failure to achieve major objectives in other sectors marked the change of the revolution to a new phase, a period that was called “institutionalization.” After more than half a decade of dismal rates of new housing construction, there was considerable pressure to increase building, especially in urban areas such as Havana.<sup>115</sup> In contrast to the “urbanization” of the countryside, a type of “ruralization” had occurred in Havana due to the widespread presence of makeshift self-constructions and additions, such as shacks built on rooftops, livestock living in backyards, and porches renovated into extra rooms.<sup>116</sup> However, despite the best intentions to improve housing quality in Havana, the situation was complicated by the difficulty of obtaining construction materials and an acute shortage of labor. Cubans found ways to improvise—although construction materials remained in short supply, domestic production of cement and other had improved the situation markedly. However, the labor situation remained the biggest obstacle and was driven chiefly by a sharp drop in productivity and increased worker absenteeism in the 1960s. Taking advantage of citizen participation in self-built housing construction, the government formed microbrigades—teams of roughly 30 employees from a given workplace—to work with skilled workers from the Ministry of Construction to build housing for the workplace labor force. The microbrigade system also served as a method for recruiting former construction workers, fostering greater workplace camaraderie, and ensuring that new housing was located close to workplaces. Microbrigades proved to quite an effective tool—over half of the roughly 19,000 units built annually from 1972-1975 were constructed by

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<sup>115</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 10-12.

<sup>116</sup> Mario Coyula. “Housing in Cuba,” *DESIGNER/builder* (2000), 3.

microbrigades. Put another way, the microbrigade system appeared to double<sup>117</sup> or even triple<sup>118</sup> annual government housing construction in the early 1970s.

In the early 1970s, housing legislation extended exemptions from making housing payments to very-low-income families. This meant that by this period rent-free leases had been provided to residents of rural new towns, *cuartería* residents, and now very-low-income families.<sup>119</sup>

Implications of earlier housing policies began to be felt in this period. For example, housing shortages forced citizens to live together and government policies ensuring the absolute security of tenure limited the ability to evict tenants, which led to an increasing number of situations where visitors effectively moved in by overstaying their welcome and where divorced couples were forced to live together. In response, the government passed legislation to differentiate between the principal legal resident, legal occupants, and guest occupants in households. Furthermore, housing in many cases was assigned to citizens based on their workplaces. When employment ceased for these workers through retirement or work transfers, they could sometimes be left homeless. This situation was exacerbated by the fact that local officials were reluctant to evict these tenants to keep skilled laborers in their areas and to maintain a stable work force. Finally, insufficient housing construction and maintenance resulted in severe housing deterioration, which led to families living long-term in shelters intended only for temporary relocation.<sup>120</sup>

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<sup>117</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 10-12.

<sup>118</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 6.

<sup>119</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 12-13.

<sup>120</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 12-13.

## **HOUSING AND HOUSING POLICY FROM 1976-1980**

Macroeconomic instability exacerbated the housing crisis in the late 1970s. Increasing energy costs, a worldwide recession coupled with inflation in capitalist nations, and a sharp decline in the global commodity sugar price simultaneously reduced Cuban sugar revenues and increased import costs. Planners optimistically expected to produce roughly 100,000 housing units annually by 1980, but instead just under 50,000 units were completed each year, a drastic shortage. Just 16,400 of these units were built by the government; the rest were privately built. Housing policy continued to focus on industrialized, prefabricated housing as the main way to deal with the housing shortage. However, policymakers also adopted a number of new initiatives to ameliorate the housing problem: local assistance through the distribution of housing materials to self-built housing, a fivefold increase to the budget for maintenance and repair of housing, and an end to increases in microbrigades (creating more support for state brigades of skilled worker).<sup>121</sup>

## **HOUSING AND HOUSING POLICY FROM 1981-1985**

The early 1980s marked a renewed focus on housing. The 1981 census showed that roughly 50% of Cuban housing stock had been built post-Revolution, and there was also a significant increase to housing amenities due to the availability of electricity, water, sanitary facilities, and basic domestic appliances. Nonetheless, the Cuban government was still unable to address the perennial housing shortage. Housing starts averaged just over 45,000 units annually in the 1970s; this level equaled the 45,000 units needed annually to replace old units and provide for population growth. Furthermore, this total did not include the new housing stock needed to

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<sup>121</sup> Jill Hamberg, *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 14-16.

renovate the hundreds of thousands of dilapidated structures or the new housing stock needed to thwart the emerging phenomena of doubling up or overcrowding. By the 1980s, housing deterioration was starting to have adverse effects, as vacate orders and building collapses became increasingly common. The 1980s also marked significant social changes in Cuba. The baby boom generation of the 1960s reached adulthood at the same time that divorce rates skyrocketed in Cuba; both of these phenomena increased the demand for housing. Because government-built housing was primarily distributed through workplaces, many young Cuban households turned to self-built housing, resulting in the rapid expansion of self-built construction.<sup>122</sup> The early 1980s also marked a resurgence in the extralegal and illegal housing markets. Byzantine government policies on subletting and housing transfers—coupled with excess spending power—resulted in an increase in under-the-table payments in otherwise legal exchanges of housing and land. Despite growing concerns with the Cuban housing market, housing construction continued to improve.<sup>123</sup> In the early 1980s, roughly 82,800 new units were constructed each year. Roughly 30,000 of these new units were government-built, and the remainder were self-built construction.<sup>124</sup>

In December 1984, sweeping housing reforms were enacted through the *Ley General de la Vivienda*. The new law was composed of eight major policies, but generally converted leaseholders in government-owned housing into homeowners, permitted limited short-term private rentals, and fostered self-built housing construction. Firstly, the law converted 460,000 Cuban rent-paying households (roughly 20% of homeowners) into homeowners through low-rent

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<sup>122</sup> Jill Hamberg, *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 18.

<sup>123</sup> Jill Hamberg, *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 20.

<sup>124</sup> Jill Hamberg, *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 8.

amortizations and 740,000 self-built households into homeowners without any fee. Secondly, the law changed how state-built housing was allocated; housing was to be allocated through local public agencies instead of workplaces. Thirdly, the law permitted free-market sales of land, housing, and roof development rights, although the state still maintains the right to purchase the property, and the law resolved inheritance issues. Fourthly, the law provided for active public involvement in self-built construction and offered low-interest loans to cover building costs. Fifthly, the law permitted owners to rent rooms for under six months. Sixthly, the law put the onus for major renovations to housing stock onto the government as opposed to individual homeowners. Seventhly, the law created formal regulations to deal with non-payment by tenants and illegal occupants. Finally, the law maintained a limited number of housing units linked to workplaces.<sup>125</sup>

## **HOUSING AND HOUSING POLICY FROM 1986-1990**

The extensive housing reforms stemming from the 1984 Housing Law were limited due to the financial hardships experienced by the Cuban government with the gradual decline of the Russian economy. Insufficient hard currency prevented sufficient housing construction and repair, and microbrigades continued to weaken during the late 1980s. Due to the lack of resources, the government attempted to address various housing objectives such as economic development, equity, and improving conditions for members of the worst strata, and using collective allocation to fight corruption.<sup>126</sup> Finding reliable data for this period is difficult

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<sup>125</sup> Jill Hamberg. *Under Construction: Housing Policy in Revolutionary Cuba* (New York: Center for Cuban Studies, 1986), 21-23.

<sup>126</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 7.

because the housing censuses completed in both the 1980s and 1990s contained little specialized information.<sup>127</sup>

### **HOUSING AND HOUSING POLICY FROM 1990-2000 (THE SPECIAL PERIOD)**

Following the demise of the Soviet Union and the Eastern Bloc, Cuba's economy faced a tremendous shock. Cuba suddenly faced the loss of its major trading partners (which constituted 85% of total trade), a 50%+ decline in oil imports, a steep decrease in supply of Russian parts for its increasingly Russian machinery, curtailed access to privileged prices, and the termination of almost all of its lines of credit. This dramatic economic hardship resulted in the Castro regime declaring the beginning of the Special Period, essentially a wartime state in a time of peace. In order to maintain the most important social programs such as universal education, however, Cuba desperately needed to increase its hard currency reserves and foreign-facing economic activity.<sup>128</sup> Due to low export levels and dramatic financial hardship, the Cuban government opened up to tourism beginning in 1993. This change required sweeping changes to housing laws. Starting in 1994, Cuba opened real estate up to foreign investment as part of a strategy to combat low economic activity. Foreign firms could enter into joint ventures with the Cuban government, and non-resident foreigners could purchase homes for the first time. In addition, Cuban citizens were allowed to rent up to two rooms in their home to other Cubans or tourists through a rental scheme known as *casas particulares*. In May 2000, regulations changed: housing purchases by non-resident foreigners were prohibited, and only the rental of units was allowed.

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<sup>127</sup> Mario Coyula. "Housing in Cuba," *DESIGNER/builder* (2000), 8.

<sup>128</sup> Mario Coyula. "Housing in Cuba," *DESIGNER/builder* (2000), 5-6.

Although components of the housing sector opened up to market activity at the start of the Special Period, the vast majority of the housing system remained publicly-run, especially the housing provision and housing construction components. This characteristic—coupled with material scarcity and oil shortages—meant that most social housing products were immediately stopped, including both traditional large-scale prefabricated housing construction projects and even more simple Microbrigades. Given Cuba’s already critical housing shortage, this policy decision exacerbated an already incredibly problematic situation. As a stopgap measure, the Cuban government developed a new variety of social housing construction known as the Social Microbrigade, which used local materials, local labor, and soft technologies to build homes out of soil-cement blocks, micro-mortar tiles, light concrete beams, and more.<sup>129</sup>

The curtailing of social housing construction and scarcity of building materials made self-built housing—the cornerstone of the Cuban housing sector for decades by this point—simultaneously more important and harder to pursue. To deal with their unsatisfied needs, many Cubans turned to illegal or extralegal solutions to their problems, such as building new detached homes, attaching new home additions, or splitting existing residences. To deal with material shortages, Cubans recycled old materials of very poor quality or bought building materials on the black market.<sup>130</sup>

The late part of the Special Period also saw the rise of Cuban non-governmental organizations (NGOs). One important one was Habitat-Cuba, which petitioned international NGOs and non-profits for financial and material aid to build housing in Cuba. Habitat-Cuba couples these outside resources with use of local materials and adequate technologies to create unique solutions to the housing shortage problem. For example, wood is in scarce supply in

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<sup>129</sup> Mario Coyula. “Housing in Cuba,” *DESIGNER/builder* (2000), 5-7.

<sup>130</sup> Mario Coyula. “Housing in Cuba,” *DESIGNER/builder* (2000), 8.

Cuba, but it is an essential material for window and door construction. One initiative explored bamboo as an alternative to wood through the development of appropriate technology and by planting bamboo groves for harvesting. The increased role of NGOs intersected with growing environmental consciousness, and Cubans became more and more focused on promoting environmental awareness and on discovering environmentally sustainable approaches to economic problems such as housing shortages.<sup>131,132</sup>

Finding reliable data for this period is difficult because the housing censuses completed in the 1980s and the 1990s contained little specialized information.<sup>133</sup> According to housing census data from the early 2000s, 141,000 new housing units were constructed and 250,000 housing units were renovated and conserved from 1996-2000.<sup>134</sup>

#### **HOUSING AND HOUSING POLICY TODAY (THE LATE SOCIALIST PERIOD)**

Although the Cuban economy improved in the early 2000s, housing construction levels plummeted. Housing construction levels dropped from roughly 40,000 units annually in the late 1990s to just 15,000 units annually in 2003 and 2004.<sup>135</sup> From 2001 to 2005, 134,000 housing units were constructed nationwide. Due to important housing initiatives, over twice that (278,000 housing units) was produced from 2005-2010. Despite this impressive increase, the national

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<sup>131</sup> John McAuliff and Bela August Walker, "A Look at Cuban NGOs," *Fund for Reconciliation and Development*, 2002, <http://www.ffrd.org/cuba/cubanngos.html>

<sup>132</sup> Mario Coyula. "Housing in Cuba," *DESIGNER/builder* (2000), 6.

<sup>133</sup> Mario Coyula. "Housing in Cuba," *DESIGNER/builder* (2000), 8

<sup>134</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro's Cuba*. (Boston: Joint Center for Housing Studies, 2002), 11.

<sup>135</sup> Esther Katheryn Whitfield, ed. *Havana Beyond the Ruins: Cultural Mappings After 1989*. (Durham, NC: Duke University Press Books, 2011), 94-96.

housing deficit remains incredibly high: the national housing shortage is over 1,000,000 units<sup>136</sup> in a country with 3,700,000 total housing units.<sup>137</sup>

Housing stock levels also dropped significantly due to weather damage caused by hurricanes, tropical storms, and flooding. From 2001 to 2008, 139,000 units were destroyed and 965,000 units were damaged across the nation. All of these damaged units required extensive repairs and rebuilding. Although Havana did not face the brunt of this weather damage, it did suffer from drop in availability of construction materials; many of these resources were dedicated to repairing schools, hospitals, and clinics.<sup>138,139</sup>

In response to critical housing shortages, the government launched a major initiative in September 2005. Unfortunately, the initial goals of this project were overly ambitious; although these goals were not achieved, 110,000 new units were completed in just 16 months. The goals of the initiative have gradually been reduced every year; by 2008, the annual requirement was for 50,000 units. The initiative did spur new housing construction, but it also suffered from fraudulent reporting from local municipalities that reported phantom units as completed.<sup>140,141</sup>

Important housing reforms passed in the early 2010s. In November 2011, Decree-Law 288 passed, which allows Cubans to buy and sell their homes without authorization from the government and with the sale price determined by both parties and not the government, marking the beginning of the first residential real estate market in Cuba in over a half-century. Cubans are

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<sup>136</sup> Joaquín P Pujol. "Where is Cuba Going? Economic Policies that Have Been Adopted and Results Thus Far." *Cuba In Transition* 22 (2012), 10.

<sup>137</sup> Antonio Zamora. "The Impact of Cuba's New Real Estate Laws on the Island and the Diaspora," *Cuba In Transition* 22 (2012), 208-211.

<sup>138</sup> Joaquín P Pujol. "Where is Cuba Going? Economic Policies that Have Been Adopted and Results Thus Far." *Cuba In Transition* 22 (2012), 9-11.

<sup>139</sup> Esther Katheryn Whitfield, ed. *Havana Beyond the Ruins: Cultural Mappings After 1989*. (Durham, NC: Duke University Press Books, 2011), 94-96.

<sup>140</sup> Joaquín P Pujol. "Where is Cuba Going? Economic Policies that Have Been Adopted and Results Thus Far." *Cuba In Transition* 22 (2012), 9-11.

<sup>141</sup> Esther Katheryn Whitfield, ed. *Havana Beyond the Ruins: Cultural Mappings After 1989*. (Durham, NC: Duke University Press Books, 2011), 94-96.

even allowed to sell their homes and keep the proceeds before leaving the country, although restrictions on the number of properties that can be owned and which properties can be mortgaged persist. This policy change marks a radical departure from the previous *permuta* or exchange model, and represents the first time the Cuban government has legitimized a market system during the reign of the Castro brothers.<sup>142</sup>

## CONCLUSION

The need for a summary of housing policy and outcomes in Cuba stems from the dearth of housing information available today. This lack of information is caused by the Cuba's status as a secretive Socialist state and the US embargo. The little data on Cuban housing that is available is likely biased; Cuban housing data is tainted with pro-regime bias, and American research coming out of Miami or funded by Cuban refugees living in the US is likely tainted with anti-regime bias. This paper attempts to present a balanced perspective by using both sets of sources.

In the last century, Cuban housing policy moved significantly away from and then gradually crept back towards a market-oriented housing system. Prior to the revolution, the Cuban housing market was a market-oriented housing system with some public intervention. Power in the housing system seems to have been in the hands of landlords and investors, although this perspective may be somewhat anachronistic. Cuba passed some of the earliest rent control and "right to occupancy" laws in the world. This policy stance suggests that although capitalists definitely possessed more power than tenants, Cubans tenants may have possessed relatively more power than tenants in other nations. Unfortunately, Cuba's status as an American

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<sup>142</sup> Antonio Zamora. "The Impact of Cuba's New Real Estate Laws on the Island and the Diaspora," *Cuba In Transition* 22 (2012), 208-211.

neocolony marginalized the average Cuban. A large percentage of national property was in American hands, and there is some evidence of rent usury: a larger percentage of worker income was spent on housing in Cuba than in other nations. In terms of urban development, accounts are mixed; there is some evidence that Cuba possessed the most advanced buildings and infrastructure in Latin America, but other evidence refutes this stance. A major issue at the time was rampant disparity between urban locations and rural locations. Rural farmers lived in dismal conditions; although there were issues with the urban housing situation, it was significantly better than the countryside.

The rise of the Communist regime resulted in a significant transition to a public-oriented housing system. The Urban Reform Law marked a monumental ideological achievement, but in the first few years of the revolution actual housing outcomes suffered due to poor implementation. Housing shortages that started in the 1960s only compounded over the 50 years that followed. At least from a theoretical perspective, rent control policies started in the 1950s and amplified greatly post-revolution have resulted in misallocated housing, insufficient housing quality, and insufficient housing stock.<sup>143</sup> The state-owned housing construction sector, coupled with a complete dearth of housing finance options, has greatly restricted housing options and only exacerbated housing issues. Although significant gains were achieved for Cubans living in the rural countryside, insufficient housing investment has persisted for decades in Havana and other important cities. Slower-than-anticipated economic growth and the inherent inefficiency of a centrally-planned, public housing system has only exacerbated early housing shortages, resulting in a constantly growing housing deficit. At the present, the housing shortage is at least 1,000,000 housing units in a country with just 3,700,000 total housing units; this number may

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<sup>143</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 391.

still be too low due to overcrowding caused by suppressed formation of new households, as occurred in the former Soviet Union in the 1990s.

Attempts by the Cuban government to solve this housing shortage—through prefabricated housing construction, Microbrigades, and Social Microbrigades—had some success but did not address the problem. By far, the most important contribution to address the chronic housing shortage has been the rise of self-built housing by Cuban citizens. Self-built housing construction essentially began with Cubans who decided to take matters into their own hands. Self-built housing acts as a sort of “necessary evil:” it is not an ideologically legitimized form of housing provision in a Socialist country but it solves an important social ill.

In the last 15 years, Cuban housing policy under the Castro regime has moved significantly towards a market-oriented housing system. At the start of the revolution, Cuba’s housing policy objectives were ideologically driven: housing is a basic social need, not a commodity; housing should be distributed equitably; and the government should be the primary housing decision maker.<sup>144</sup> Ostensibly, Cuba’s policy objectives have remained the same, but recent policy initiatives by definition contradict these policy aims. The permission of foreign investors to build profit-seeking properties for tourism as well as the creation of a residential real estate proto-market by definition implies that housing is a commodity and not a social good. Furthermore, market-determined real estate prices and the lifted restriction on housing sales contradict equitable distribution of housing and instead contribute to income inequality—a system of haves and have-nots.

It is curious to think about what policies the new Cuban government did not implement at the start of the revolution or has not implemented yet during the revolution. Firstly, there was

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<sup>144</sup> Teddy Kapur and Alastair Smith. *Housing Policy in Castro’s Cuba*. (Boston: Joint Center for Housing Studies, 2002), 4.

little redistribution of housing. Small families living in large mansions remained in place, as did small families living in one-room slums. The only exceptions were unoccupied units speculatively held off the market or vacated by families who emigrated, which were used by public agencies or distributed to the families that were most in need. In this stage, greater equality was achieved by improving conditions for those in the worst housing, not by lowering anyone's living standard; there was no forced redistribution of occupied housing. Secondly, urban land was not nationalized. Although the maximum price for land was set at a low uniform rate (4 pesos per square meter, roughly \$4 USD per square meter at the time), the fact that there was still a price range allowed for differences in land rent, which derived from variations in topography, location, and improvements. This policy would have an important impact on density in later years.

## SECTION 5: ANALYSIS OF EAST BERLIN

### POLITICAL CONTEXT

In some ways, post-Communist privatization of East Germany appeared similar to other post-Communist privatizations. The German Democratic Republic (i.e. GDR, East Germany) faced challenges included a low standard of living, an undersupply of housing, low-quality housing stock, little construction, and a weak economy. However, the East German case was especially complicated because of its unique status as a simultaneous reunification and privatization. The German Democratic Republic was subsumed under the control of the Federal Republic of Germany (i.e. FRG, West Germany); due to the latter's political institutions, East German institutions needed to move to market-based systems. This complexity added challenges, such as large-scale emigration of East German citizens to West Germany and income inequality between the FRG and the GDR.

Following WWII, the FRG government was run by a right-wing coalition comprised predominantly of Christian Democrats after the nation's first general election in August 1949.<sup>145</sup> The first chancellor was Konrad Adenauer, a representative from the Christian Democratic Union. The early administration achieved a number of quick victories such as the speedy development of a social market economy with rather well-functioning market mechanisms. The FRG soon enjoyed what political commentators called a *Wirtschaftswunder*, or economic miracle. Although the FRG struggled to settle ethnically German refugees from East Germany, Poland, and Czechoslovakia, the nation saw a steady rise in living standards, the abolishment of rationing, and a rapid recovery of industrial output. As the nation moved into the 1950s, West

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<sup>145</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 41.

Germany developed stronger and stronger relations with the Western democracies, culminating in becoming a full member of NATO in 1955. The Christian Democrats maintained widespread support into the 1960s, although Adenauer was pushed to step down after a scandal involving his Defense Minister. In 1969, the Social Democratic Party (SPD) gained popular support, resulting in West Germany's first full-scale government change through the capture of both the presidency and the chancellorship in a coalition with the Free Democrats. The SPD coalition enacted both domestic reforms but was chiefly known for its policy of *Ostpolitik*, which eased tensions between West Germany and the Eastern Bloc. Among other actions, the FRG government recognized the existence of the East German government, increased trade, and otherwise began to normalize relations. These policies were met by resistance from the Christian Democrats. In October 1982, the SDP coalition came to an end after just under 15 years. Re-election of the Christian Democrats saw a strong market focus and improved relationships with the West; this environment persisted until the rapid deterioration of East Germany beginning around 1989.<sup>146</sup>

East Germany had a rather distinct political situation. Unlike in other nations, the Socialist revolution in East Germany was not homegrown and was instead imposed by the Soviet Union. An election was held in the Soviet occupation zone for a People's Congress in May 1949; however, the election was structured in a way that favored the empowerment of the Soviet-backed Socialist Unity party (SED). By October 1949, the People's Congress ratified a constitution for the German Democratic Republic. Although the GDR was constitutionally a parliamentary democracy, decisive power fell to the SED. In the first two decades following the GDR's formation, the SED regime focused on building a viable planned economy through the construction of basic industries; this goal was difficult due to a dearth of natural resources,

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<sup>146</sup> *Encyclopædia Britannica Online*, s. v. "Germany," accessed May 12, 2014, <http://www.britannica.com/EBchecked/topic/231186/Germany>.

limited geographic area, and a low population. Challenges continued to arise, including low food production caused by widespread emigration of thousands of East German farmers. Mass emigrations began to taper off in 1952, when the GDR sealed its borders with the FRG outside of Berlin. Mounting dissatisfaction with the SED regime led to popular uprisings in the 1950s due to high production quotas, ideological controls on artistic and intellectual activities, and low consumer good production. East German emigration to West Germany increased dramatically in the early 1960s. In response, the East German government sealed off East Berlin in August 1961, first with barbed wire and later through what would become known as the Berlin Wall. This policy marked an end to widespread emigration of East Germans and thus helped stabilize the GDR economy, which eventually became the most highest-performing economy in the Eastern Bloc. Civil and political freedoms were further restricted in the late 1960s. The 1970s was a much better decade economically for East Germany, due in particular to the West German policy of *Ostpolitik*. The international recognition of the GDR resulted in increased trade with Western Europe, which bolstered East Germany's limited hard currency reserves. The economic policy of focused on industrial production resulted in insufficient consumer goods production, neglect of necessary maintenance and infrastructure, and chronic housing shortages. Furthermore, East Germans experienced greater contact with West Germans, which became a major source of political dissatisfaction; East Germans disapproved of the lack of economic progress their nation faced compared to the technologically advanced FRG. In the 1970s, political and civil freedoms continued to be limited, and the SED stressed the Socialist quality of the German state and its irrevocable ties to the USSR. This reaffirmation of Soviet ties would become problematic in the late 1980s when the Soviet Union embraced *glasnost* and *perestroika*. The 1980s was also problematic due to the rapid deterioration of the GDR's economic situation, despite significant

attempts by the SED regime to maintain the façade of stability. Eventually, the confluence of political dissent, the demise of the Eastern Bloc, and a poor economic situation resulted in the fall of the GDR.<sup>147</sup> Even after political reunification, unrest remained in East German cities, including some violent demonstrations by neo-fascists.

By the time of political reunification, the situation in East Germany was stark economically, quite unlike West Germany and its *Wirtschaftswunder*. Excluding the brief tenure of the SDP coalition in the 1970s, the West German government always supported a strong private sector. In contrast, East Germans at the time of reunification had lived for years in relative austerity compared to West Germans, and most of East German industry—despite being quite strong compared to Socialist economies<sup>148</sup>—lagged greatly behind the rest of Western Europe.<sup>149</sup> GDP per capita was especially low, especially compared to the FRG. Per capita income in the FRG was \$19,200 in 1989, compared to \$14,600 in the UK and \$20,600 in the US.<sup>150</sup> The poor economic situation meant that an easy solution for East Germans at the time of reunification was simply moving to West Germany, which was financially quite well-to-do. Limiting East German emigration to West Germany would be a major headache for German policymakers for a number of years following reunification.

## HOUSING UP UNTIL PRIVATIZATION IN EAST BERLIN

Housing indicators and housing policies leading up to the time of reunification were radically different. In the FRG, the dominant philosophy shared by both Christian Democrats and

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<sup>147</sup> *Encyclopædia Britannica Online*, s. v. "Germany," accessed May 12, 2014, <http://www.britannica.com/EBchecked/topic/231186/Germany>.

<sup>148</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 43.

<sup>149</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 41-42.

<sup>150</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 41.

the opposition Social Democrat coalition was a *Soziale Marktwirtschaft*—a socially-responsible market economy. In practice, this meant relying on the private sector for housing, both in terms of owner-occupation and private renting. Nonetheless, there were some safeguards, including social housing and housing allowances known as *Wohngeld*.<sup>151</sup> In the GDR, housing was considered a social good and provided by the state. The state acted as both the main housing developer, managed private and public housing, and controlled private activity in the housing sector.<sup>152</sup> Although the governments took very different approaches to managing housing (a market-based system as opposed to a state-run system) and classified housing distinctly (a market good as opposed to a social good), each government's housing system dealt with both private and public elements of housing.

The West German housing system became more market-oriented in the 1980s along with the rest of Western Europe. The construction and allocation of new social housing declined due to declining political support and the political benefits of privatization. Furthermore, construction loan conditions were relaxed as more and more loans were repaid, and much social housing was converted to market-rented housing. Although this resulted in an increase to housing costs, the government reacted by increasing housing allowances through the *Wohngeld* bill. By the end of the 1980s, further measures were undertaken to move the system more towards the free market: for example, the tax advantages of nonprofit housing organizations were abolished. By the end of the 1980s, owner-occupied housing was 42% of the housing sector, private rented housing was 42% of the housing sector, and social housing for rent constituted the remaining 16%.<sup>153</sup>

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<sup>151</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 42.

<sup>152</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 43.

<sup>153</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 42-43.

Although housing in the GDR resembled the housing sector in other Socialist nations, there were some peculiarities, such as private ownership and relatively large levels of public housing construction leading up to 1990. Because East Germany's revolution was not homegrown, a robust housing sector developed preceding Socialism. Housing did not fall under the sole mandate of the state until WWII, when the Soviet Military Administration in the Soviet Occupation Zone began to implement significant reforms which were later adopted by the government of the GDR. In addition to bringing housing under state mandate, the Soviet Military Government also expanded strict rent controls—a policy that originally began with the Nazis in 1936—through Order No. 9 in July 1945. Although a large degree of GDR housing stock was destroyed by the war, the Soviet Military Government (and later the GDR government) also limited housing construction of tenement or apartment housing and only tacitly approved the private ownership of pre-war tenement buildings.<sup>154</sup> Unlike many other East European countries, very little existing housing was converted to public housing. Instead, privately owned residences remained in private hands, whereas occupants were encouraged to purchase homes in which they were tenants. Privately owned rented housing was managed by the state, and most owners had little interest in their properties. To combat any potential inequality from private housing, strict rent controls were extended. Although rent control had been an established policy for decades, research suggests that rent regulation results in an insufficient supply of housing,<sup>155</sup> as it reduces investors return on building real estate and thus reduces the number of housing starts for each period. Furthermore, the short-run demand on rent-controlled markets regularly exceeds the long-run demand when rent control is abolished, suggesting that rent control causes demand to

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<sup>154</sup> J. A. A. Sillince. *Housing Policies in Eastern Europe and the Soviet Union*. (Routledge, 2004), 335-341.

<sup>155</sup> "Rent Regulation After 50 Years," *TenantNet*, 1993, <http://tenant.net/Oversight/50yrRentReg/history.html>.

be “pent-up.”<sup>156</sup> Secondly, housing construction remained quite high in the GDR leading up to the country’s demise. In the 1970s and 1980s, there was a renewed boom in state housing construction, due in particular to Erich Honecker, the General Secretary of the SED.

Unfortunately, housing construction was still insufficient to meet demand, especially due to low housing quality.

Despite the presence of private housing and other peculiarities, the GDR housing sector generally resembled that of other Socialist nations, especially due to dismal housing outcomes. Housing stock in East Germany, as in other Socialist nations, was insufficient in terms of amount, quality, and amenities. Housing policy in the GDR had distorted market activity, resulting in conditions in 1990 that were abysmal. Even though the housing policy of the former GDR maintained reflationary policy (e.g. low interest rates), the housing system was largely marked by shortages in supply and poor quality of dwellings. An explanation for this result can be partially explained by the fact that the costs for new construction were cheaper than maintenance costs and because households typically preferred new flats since they were rent-controlled under the old regime. As a result, the maintenance of historical domestic buildings was widely neglected, and the GDR implemented massive programs for construction. A 1989 survey revealed that 780,000 households requested new flats to live in due to low quality of existing housing supply. However, the bare number of housing units appeared to be more than sufficient, as almost 400,000 flats—roughly 5% of the housing stock--were vacant.<sup>157</sup> By the 1980s, nearly half of the GDR housing stock was in a very bad condition, due to insufficient maintenance and reinvestment starting in the 1930s. Quality was low due to the widespread use

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<sup>156</sup> Claus Michelsen and Dominik Weiß. “What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding.” *Post-Communist Economies* 22 (2010), 397.

<sup>157</sup> Claus Michelsen and Dominik Weiß. “What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding.” *Post-Communist Economies* 22 (2010), 395.

of prefabricated panel construction; nearly 90% of public housing construction used prefab construction methods by the 1990s. Housing amenities were generally lackluster but looked better in the nation's capital—95% of East Berlin residences had an indoor toilet compared to just 61% of Dresden residences in 1990. In general, East Berlin benefitted from the lion's share of focus in terms of housing outcomes; housing outcomes were much poorer everywhere else. The private construction sector in East Germany, also similar to other Socialist nations, was nearly nonexistent.<sup>158</sup> New private building for rent was discouraged, and old privately rented buildings could be bought and sold but were virtually worthless due to low rent levels caused by the 1930s-era rent controls. Between the construction of the Berlin Wall in 1961 and 1973, private construction decline sharply due to the focus on state building for rent. Following 1973, 10% of housing production was completed privately by owners but was heavily controlled and regulated. Throughout the entire period, there appears to have been little unauthorized self-building.<sup>159</sup>

In summary, the GDR suffered from an undersupply of housing, low-quality housing stock, and insufficient housing starts to meet housing demand leading up to reunification. More specifically, the housing sector in the GDR suffered from four major issues. Firstly, most of the GDR housing stock was from the 1930s; these homes were of low quality, insufficiently maintained, and lacked amenities. 700,000 of the 7,000,000 total dwellings in the GDR were fit only for demolition. Secondly, despite efforts by Honecker and a falling population, housing supply was insufficient to meet housing demand. Thirdly, rents were too low due to rent controls that regulated rent levels at 1930s levels; rents were insufficient to even cover management and

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<sup>158</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 42-44.

<sup>159</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 43-44.

maintenance costs. Fourthly, the centrally-planned housing sector resulted in a total absence of market signals for production and consumption, leading to an inefficient and ineffective use of resources.<sup>160</sup>

## GOVERNMENT HOUSING POLICIES IN EAST BERLIN

The fall of the Berlin Wall in late 1989 marked the beginning of reunification between Germany and the German Democratic Republic (GDR). However, the joining of the two German states exposed politicians to enormous challenges when combining the two economic systems. In the GDR, these challenges included large-scale emigration, low standard of living, an undersupply of housing, low-quality housing stock, little construction, and a weak economy. To address these issues—and especially the low standard of living concern—politicians promised a fast convergence of standard living across the two states. Industry privatization, however, was at the top of the political agenda, and a Federal agency known as the *Treuhandstalt* was given the mandate of privatizing the former state-owned enterprises by turning over them to new owners or—in many cases—closing them down.<sup>161</sup> Housing policy following reunification took a somewhat similar route. Unsurprisingly, the Christian Democrat coalition sought to create a “social market” housing system out of the state-dominated GDR through extensive privatization. Policymakers believed that state control should be decentralized and replaced with private decision-makers guided by profitability.<sup>162</sup> For this reason, continuing the preexisting GDR

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<sup>160</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 43-45.

<sup>161</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 41-42.

<sup>162</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 43-46.

housing sector would have been untenable, although maintaining a public housing sector would have been technically possible with sufficient funding.

To achieve this goal, politicians radically revised the housing policy of the GDR. The aim of privatizing housing stock was first laid down in the Unification Treaty, although housing enterprises were not treated as state-owned enterprises in terms of implementation shortly following reunification. Instead, state-owned housing assets were passed into the ownership of the local authorities, who were given the mandate to gradually privatize the housing stock by first setting up housing enterprises under private law and eventually selling these enterprises to private investors.<sup>163</sup>

Housing policy shifted from a planned housing system to a market-based housing system, and government officials introduced numerous subsidies designed to stimulate construction of new homes and refurbish existing housing stock, tax incentives, direct investment grants and credits to real estate developers, direct aid for construction costs, low-interest loans, urban renewal policy and demolition programs.<sup>164</sup> Starting in January 1991, government officials also instituted rent reform, which gradually ramped up rent from 1936 levels based on earned income of East Germans; because these incomes lagged behind West German income levels, East German rents continued to lag behind the rest of the country for years. However, the housing allowances implemented under the *Wohngeld* were also extended to East Germany, which helped to alleviate some of this new burden.<sup>165</sup> In total, federal subsidies to the East German housing

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<sup>163</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 46.

<sup>164</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 387-389.

<sup>165</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 47.

market (including tax subsidies, direct grants and credits, demolition incentives, and urban renewal subsidies) totaled EUR 34.789 billion from 1990 to 2008.<sup>166</sup>

Following reunification, German politicians were concerned about rapid emigration of East Germans to West Germany, massive numbers of restitution claims,<sup>167</sup> and the disastrous economic situation in the former GDR, which was not competitive on world markets. In the conceptualization of the Wachter-Kroll six-graph model, these changes would pull in the demand curve in Graph 1 through both a decrease in population and a low consumer disposable income. Furthermore, the change in economic system would make consumer's effective disposable income even lower, as the state would provide fewer social services, increasing costs for individual citizens. Over the long run, this would result in insufficient housing construction and thus inadequate housing supply for East Germans. In order to avoid these problems and to stimulate economic activity and housing investment, politicians implemented *ad hoc* urban renewal programs to strengthen demand for housing in East Germany by improving public spaces and developing local public infrastructure, offered high tax deductions to attract private debt capital for new construction and refurbishment, and developed social housing programs to subsidize construction of new dwellings. Conceptually, the Wachter-Kroll six-graph model provides a framework for understanding the impact of these policies. Firstly, the urban renewal programs in the long-run would push out the demand curve in Graph 1 by increasing demand for real estate in East Germany and competing demand away from West Germany. However, rent is fixed over the short run and the impact of these programs was gradual, so in the short-run rent increased by very little, though over the long run they would increase housing supply. Secondly,

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<sup>166</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 393.

<sup>167</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 47.

the high tax deductions offered to lenders for financing construction and refurbishment pushed out the demand curve in Graph 4 by increasing returns on real estate for a given level of rent, therefore reducing the cap rate. In the short-run, this would manifest itself as an increase in asset prices, as investors are willing to pay more for a given level of rent, but over the long run this would manifest itself as an increase in housing supply. Thirdly, the programs for social housing reduced average costs of construction, pulling down the curve in Graph 5. This had little impact in the short-term, since construction takes time to complete. However, this policy had the long-term implication of reducing housing prices since over the long term the per-unit asset price must equal the per-unit asset construction cost.<sup>168</sup> Given that there is no change to the cap rate, rent in the long term should also decrease proportionally. As explained previously, housing stock is inversely proportional to rent over the long run for a given income level. This assumption implies that housing stock will increase as rent decreases over the long run. In summary, decreasing the average cost of construction through subsidies should have had the long-run implication of increasing housing supply, decreasing rent prices, and decreasing asset prices. Furthermore, subsidizing construction costs adds a protective measure against negative demand shocks. In the case that demand drops significantly (perhaps through a drop in population or consumer income), low construction costs allow for new housing starts and thus long-run increases to housing supply at lower housing prices.

It is important to note that one consequence was poorly anticipated. The transition to a new economic system caused excess supply in the short run. Although excess supply is a standard market reaction following an external shock in a typical real estate cycle, the magnitude and duration of the shock depends on the intensity of the shock and market conditions, especially

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<sup>168</sup> Susan M. Wachter and Timothy J. Kroll. "Real Estate Capital and Space Markets: The Simple Analytics." (1996), 6.

the elasticity of supply. Here, one interpretation is that a privatized housing system resulted in a more efficient utilization of old, dilapidated housing stock and thus resulted in more housing supply over the long run, and that depreciation rate of housing assets decreased due to better maintenance. Research suggests the change to this variable was largely unanticipated.<sup>169</sup>

The housing market shortly following reunification follows this conceptualization well. Housing prices soon began to rise, driven by the end of rent control policies and increases in disposable income. By 1993, housing prices were approximately 13% higher than in 1990. The scarcity of development sites and unknown legal relationships concerning property inhibited early investment in construction, but by 1992 a construction boom had already swept East Germany.<sup>170</sup> Housing completions started to rise sharply in 1993 and peaked in 1997. Over this period, over 600,000 new dwellings were constructed and roughly 85,000 flats were renovated. This is roughly equal to a housing supply increase of 6%. However, over the same period, demand rose by only 64,000 households, resulting in a vacancy rate of 13.2% of total housing in East Germany. By 2000, one million flats were vacant.<sup>171</sup>

As might be anticipated, the initial housing subsidies did much to increase supply, but in the case of East Germany they resulted in overshooting by construction developers who produced too much housing. Ultimately, this overshooting caused a crash in the East German housing market due to housing oversupply, which was especially problematic given that politicians were so keen on improving economic development in the former GDR. This was exacerbated by policies that reduced the tax advantage of real estate investing and that cut

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<sup>169</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 397-398.

<sup>170</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 388, 399-400.

<sup>171</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 399-401.

construction grants to real estate developers. These changes in conjunction resulted in a decrease in the number of new construction starts and in prices. What were the implications of these changes? Firstly, the reduction in tax advantage pulls in the demand curve in Graph 4 for a given level of rent, thereby increasing the cap rate. In the short-term, this drops the asset price below the cost to construct new buildings, which discourages construction, maintenance, and reinvestment. This manifests itself as a decrease in housing starts in Graph 6 through a shift along the supply curve. Secondly, the reduction in grants to construction developers raised the average cost of construction in Graph 5, further amplifying the issue that price is insufficient to meet demand. In the long run, the fact that asset price is below the cost of construction will result in a decrease in the number of construction firms in the industry, pulling in the supply curve in Graph 6 and decreasing housing starts even more. Eventually, the industry production rate will be lower than the rate of depreciation for the stock, and the size of housing stock will decrease. This decrease in housing supply ultimately drives rents and asset prices up through a shift along the demand curves in Graphs 1 and 4. Eventually, this results in an equilibrium outcome where houses are set at the cost of construction. This is the same price level as before the shift in cap rate, but rents are now higher and set at the higher required rate of return.<sup>172</sup>

Although the market started to stabilize, corrections in the housing market are slow due to the durability of housing. Eventually, politicians decided to subsidize demolition of buildings and change housing policy to reduce investment incentives. Although urban renewal programs were maintained, direct grants and credits for construction were reduced. These policy changes had the impact of increasing the depreciation rate of housing stock (for the demolition subsidies) and further reducing the cap rate (for the grant reductions). These policy changes had the same

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<sup>172</sup> Susan M. Wachter and Timothy J. Kroll. "Real Estate Capital and Space Markets: The Simple Analytics." (1996), 12.

impact as the post-crash policymaking by further decreasing the number of construction starts per period.<sup>173</sup>

Today, the situation in the former GDR remains relatively similar. Housing stock in 2008 was at roughly the same level as housing stock in 2011. Furthermore, prices are still declining, although they are now declining at a slower rate. In the former GDR, housing markets are still in disequilibrium and will remain that way until housing stock decreases sufficiently and vacancies drop.<sup>174</sup>

To summarize, the analysis shows that the transition from a planned to a market-based housing system resulted in sharply rising prices and rents due to GDR housing policy, which supplied insufficient housing because of both rent control and an inadequate construction policy. The increase to prices and rents post-reunification was followed by a surge in construction activity, which was amplified by incentives implemented by politicians to invest in real estate. Unfortunately, this eventually resulted in overshooting by construction firms, resulting in a housing market crash and an oversupply of housing that has persisted to the present. Today, politicians are finding that it is much harder to correct an oversupply in housing as opposed to an undersupply. Furthermore, it resulted in spatial misallocation of East German cities, as housing stock was built mainly on the outskirts of cities.<sup>175</sup>

## **IDEOLOGY IN EAST BERLIN**

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<sup>173</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 404-406.

<sup>174</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 404-407.

<sup>175</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 46.

The disintegration of citizen support for Socialist ideology played a key role in the rapid privatization of the housing sector in East Germany. Following the end of Soviet occupation of East Germany, the success of the SED was more or less predicated on towing the party line of the USSR. As the USSR and its satellites restructured in the late 1980s, the SED attempted to prevent the reform processes occurring elsewhere from spilling into the GDR. A critical example of this phenomenon was with the ban of the *Sputnik*, a popular German-language magazine published in East Germany about happenings in the Soviet Union. The GDR government—run by old party hardliners and entrenched in their conservative form of German socialism—sympathized little with Gorbachev’s notions of reform and banned the magazine and other publications to limit available information on policies such as *glasnost* and *perestroika*. Political science research from the period shows that the ban of the *Sputnik* magazine on November 19, 1988 resulted in widespread protests. By most indications, this ban was futile: a good deal of East Germans kept up with the news via the West German media. *Sputnik* had a limited readership base: only 5,300 subscribers and 1,455 individual purchasers. Nonetheless, the magazine was very popular due to its choice of interesting topics and the fact that it was one of a very limited number of Soviet publications written in German. The broader appeal of the magazine was apparent in the late 1980s, as it was widely passed from person to person, copied, and photocopied. Indeed, the *Sputnik* ban moved to push many people into direct political action—initially heated discussions among the citizenry, eventually handwritten flyers and banners created in complaint, and ultimately protests. Initially, citizens protested for a reformed, more humane Socialism than that which was espoused by the GDR political elite, especially since chances of reunification initially seemed remote. The *Sputnik* was one of a larger series of

incidents that worked to mobilize the citizenry into political action due to growing political differences between the political ruling class and the more reform-minded citizenry.<sup>176</sup>

Economic deterioration in the GDR only served as a catalyst for further political trouble. At the end of the 1970s, the East German economy began to run into serious issues due to a massive foreign debt. The GDR government began a “forced export effort” coupled with a steep drop in imports, even of crucial items such as spare machinery parts. These actions began a rapid deterioration in quality of export goods, ultimately leading to rampant obsolescence, growing stoppages, and eventually plant damage. Although this policy gaffe was likely influenced by a variety of issues, perhaps the most preeminent explanation is that the SED regime dedicated too much funding to Honecker’s program involving the massive subsidization of basic goods and housing.<sup>177</sup>

Although decreased purchase power due to the massive foreign debt remained was problematic, the government provided a large basket of social goods that should have mitigated these effects. Perhaps the best anecdote of how economic issues impacted individual East German well-being is the Coffee Crisis of the late 1970s. In East Germany, one of the most important imports was coffee due to strong East German consumer preference for the good. In the late 1970s, the worldwide coffee market saw a massive increase to coffee prices; in 1977, worldwide coffee prices peaked. For the GDR government, this meant that the annual cost for coffee imports rose to 400% of the levels from the early 1970s; this increase was particularly an issue due to low levels of hard currency faced by most Socialist nations in the period. To address this shortfall, the GDR regime withdrew the popular *Kosta* brand and replaced it with a new *Kaffee-Mix* which ostensibly consisted of half coffee and half rye. Soon, *Kaffee-Mix* was the only

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<sup>176</sup> Paul Cooke and Jonathan Grix. *East Germany: Continuity and Change*. No. 46. (Amsterdam: Rodopi, 2000), 69-72.

<sup>177</sup> Paul Cooke and Jonathan Grix. *East Germany: Continuity and Change*. No. 46. (Amsterdam: Rodopi, 2000), 73.

coffee brand available except for at the most expensive restaurants and coffee shops; provision of *Kosta* and other brands was effectively withdrawn from public offices and state enterprises. The new coffee not only tasted poorly but also wouldn't work properly in state-provided coffee machines, leading to widespread boycotting of the product and fueling criticisms that the GDR government was creating a two-class society. The crisis subsided once coffee prices began to fall following 1977 and with bilateral trade agreements with other coffee-producing nations. Nonetheless, this episode clearly indicates how poor economic performance served as a catalyst for popular unrest.<sup>178</sup>

As the economy declined and factories began to deteriorate, worker dissatisfaction began to rise. In the GDR, the workplace was an institution that was central to Marxist-Leninist ideology and played an important social function, as worker social identity was linked to work brigades and collectives within the workplace. Put another way, the workplace not only was the external manifestation of the SED's fundamental Marxist ideology but also monopolized the public sphere: everything from child care and medical care to sports clubs and shopping. As dissatisfaction set in at the workplaces—by this point a social microcosm of society—it destabilized the GDR dictatorship.<sup>179</sup>

Across all issues, GDR citizens became increasingly disenchanted with Socialism. An unfortunate confluence of events dashed political support: other Eastern Bloc nations began to increasingly turn away from Socialism with the fall of the Iron Curtain, workplace satisfaction was at an all-time low, economic conditions deteriorated, and the regime passed unsavory policies. These isolated conditions would ultimately combine and spill over into political action and discontent with the regime as a whole and ultimately Socialist ideology. By the end of the

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<sup>178</sup> Mary Fulbrook, ed. *Power and Society in the German Democratic Republic, 1961-1979*. (New York: Berghahn Books, 2009), 255-265.

<sup>179</sup> Paul Cooke and Jonathan Grix. *East Germany: Continuity and Change*. No. 46. (Amsterdam: Rodopi, 2000), 73.

1980s, East Germans bought less and less into Socialist ideology. This sentiment was clearly manifested through *Eingaben* (political petitions) and the threat of *Nichteilnahme* (non-participation) at upcoming local elections. Most of the *Eingaben* dealt with complains about housing, but some even protested the continuing ban of the *Sputnik* magazine. Increased political activism by previously politically passive citizens was perceived by the GDR ruling elite as a growing threat. The increased levels of speaking out against undemocratic procedures was a red flag that citizens were moving towards greater levels of political mobilization and underscored a fundamental rejection of the prevailing Marxist ideology of the SED regime in the GDR.<sup>180</sup>

Post-reunification, this fundamental change in support for Socialist policy would have important ramifications on policy, and ideology played an important role for both politicians and citizens throughout the early reunification period. For West German politicians, promoting housing privatization legitimized their ideology, as private property was a fundamental pillar of a market-oriented society. The formerly-West-German Christian Democrats saw private ownership as a prerequisite for responsible action, since the consequences of people's own actions react directly and undiluted on the people taking the action themselves. In addition to addressing relatively narrow concerns about the housing market, privatizing the housing sector would mean a major victory for this viewpoint. In terms of specific policies, FRG policymakers chose not to transform state housing into conventional Western forms of rented housing through either social renting or market renting,<sup>181</sup> despite the fact that this may have improved housing outcomes sooner in East Germany.<sup>182</sup> This was likely due to an ideological decision by Christian

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<sup>180</sup> Paul Cooke and Jonathan Grix. *East Germany: Continuity and Change*. No. 46. (Amsterdam: Rodopi, 2000), 73-76.

<sup>181</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 46.

<sup>182</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010).

Democrats in the 1980s to promote growth in home ownership over the role of social housing or market renting. This philosophy once again plays into the Christian Democrat ideological plank that responsible action is predicated on individuals acting rationally; by selling housing to individual homeowners, FRG policymakers put the onus on individuals to efficiently manage the housing stock, despite the fact that individual homeowners arguably lacked the information needed to make responsible housing choices.<sup>183</sup>

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<sup>183</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 46, 48.

## SECTION 6: ANALYSIS OF MOSCOW

### POLITICAL HISTORY OF RUSSIA

To understand Russian struggles with housing privatization, it is perhaps best to start with the political history—the legacy of property in Russia before the Bolsheviks and ultimately the creation of the Soviet command-administrative system. Russia very much grew up under the Soviet system. Starting in 1917, the country was shaped and industrialized under Socialist rule. For almost three-quarters of a century, the Soviet system created all housing in the nation—cities were built, housing was allocated, architecture was chosen, and much more all under the reign of a command-administrative system. By describing the property rights system in Czarist Russia and the early workings of property in Soviet Russia, a more complete understanding of the state's control of property can be achieved.

When the Bolsheviks seized control of the Russian empire in 1917, Russia was not a burgeoning capitalist paradise but rather a feudal system emerging from some early bouts of industrialization. In the early 1700s, all Russian lands belonged to the Czar. In the mid-1800s, the Russian serfs did receive a small amount of land following their emancipation. However this property was burdened with heavy redemption payments, and land was owned collectively and administered through a village commune. By the end of the Czarist period, property remained almost entirely in the hands of the Czar and the nobility, although the first decade of the 1900s saw changes that created the existence of private farms and other instances of private property. Even industrialization was state-run: the government created and funded whole factories by decree and even named their managers and laborers.<sup>184</sup>

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<sup>184</sup> Andrew Scott Barnes. *Owning Russia: The Struggle Over Factories, Farms, and Power* (Ithaca, NY: Cornell University Press, 2006), 21-22.

In the early years after the revolution, the Bolsheviks did not seek to abolish private property entirely and for a brief stint even experimented with state capitalism through programs such as the New Economic Policy. In the late 1920s and the early 1930s, Stalin reversed early economic policy with extensive nationalization and crash industrialization. Virtually all of the Russian economy came under state control. Stalin's policy defined what would ultimately be considered "Socialist" ownership, and enormous administrative elite developed to manage new state assets. As the Stalinist state expanded to administer property in all economic sectors, it also centralized authority. The command system created Stalin would by and large persist for the rest of the existence of the Soviet Union.<sup>185</sup>

Despite attempts to reform the bureaucracy, the hyper-statization of the Soviet economy persisted through both Khrushchev's and Brezhnev's regimes. By the 1980s, the Soviet economy was still growing, despite slowing growth rates, manifest inefficiencies, violations of the system's own rules, growing bureaucracy, and a general lack of cooperation between ministries. During Gorbachev's tenure, radical reforms to private property were initiated but couched in the language of Socialist ideology. Although these policies marked a break from previous Soviet policies, some scholars argue that they did not go far enough. Nonetheless, Gorbachev's policies did achieve some important goals; they decentralized authority, began to break up ministries, and formally established the beginning of private enterprise in the Soviet economy.<sup>186</sup>

The final disintegration of the Soviet Union can be illustrated through certain major events. Firstly, the March 1990 free local body elections made political powers dependent on voters' confidence for essentially the first time, ultimately leading to the rise of a persistent

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<sup>185</sup> Andrew Scott Barnes. *Owning Russia: The Struggle Over Factories, Farms, and Power* (Ithaca, NY: Cornell University Press, 2006), 21-32.

<sup>186</sup> Andrew Scott Barnes. *Owning Russia: The Struggle Over Factories, Farms, and Power* (Ithaca, NY: Cornell University Press, 2006), 23-42.

political confrontation between representative bodies and executive structures. Secondly, the abolition of the USSR Constitution Article 6—which stipulated the leadership role of the Communist Party in the political life of the nation—deprived the Communist Party of its *de jure* political monopoly. Thirdly, the presence of major political differences and struggles was thrust into public awareness with the free election of Soviet deputies to the Gorbachev-created Congress of People's Deputies of the Soviet Union and live broadcasts of legislative debates. In this final phase, Soviet deputies fell largely into two camps: proponents of Western-style democracy and market economies (including Boris Yeltsin among others) and status-quo proponents who wished to “create order” by relying on already existing institutions in the Soviet Union (including Communist Party leaders, military representatives, and KGB). What was at stake was not only political future of the former Soviet Union but also millions of dollars of assets. Many of the status-quo proponents would turn out to be involved in the failed 1991 coup d'état. Finally, the declaration of sovereignty by the USSR republics led to the eventual disintegration of the Union and, more importantly, the divergence of political and economic viewpoints. This event is perhaps best characterized by the June 1990 declaration of sovereignty by Russian Soviet Federative Socialist Republic.<sup>187</sup>

The importance of this political context cannot be overstated. Russia's history reveals how its industrialization and political formation is very distinct from Western, market-oriented nations and even from other Socialist nations where prevailing Socialist regimes did not arise from homegrown revolutions. Even in nations where a homegrown revolution took place, the extensive level of economic development and industrialization that occurred under the thumb of Socialism differs from the experience of other nations; in Cuba, at least the foundation of a

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<sup>187</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 79-82.

housing market and industrialized economy was set by the United States during Cuba's tenure as an American neocolony. It should also be no surprise then that housing policy developed distinctly from other nations in the Soviet Union.

## **POLITICAL CONTEXT IN MOSCOW**

At the time of housing privatization, Russia faced a number of challenges to successful housing privatization. The final disintegration of the Soviet Union meant that Russia needed to not only needed tackle the gargantuan challenge of moving their economy to an entirely different economic system but also develop a more robust legal and regulatory system. Even more crippling was the period of rampant economic and financial instability in 1990 and 1991. Directly preceding privatization, Russia faced hyperinflation of somewhere between 240%-500%; an economic recession caused by government mismanagement and hyperinflation; a significant increase in the national external debt caused by a significant drop in exports; and predatory behavior by enterprise managers as they "carved up" state-owned enterprises, created private contracts, and removed earnings limitations. Yeltsin administration policies seemed ineffectual: expansionary monetary policy designed to retain budget allocations for enterprises and social programs resulted in hyperinflation, attempts to balance the budget designed to maintain basic social programs resulted in animosity between the government and enterprises and placed undue financial burden on producers and local authorities, and little was done to combat the predatory behavior of managers and the *nomenclatura* privatization formerly state-owned enterprises.<sup>188</sup>

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<sup>188</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 80-81.

## HOUSING UP UNTIL PRIVATIZATION IN MOSCOW

The challenges Russia faced during post-Communist housing privatization originated with the rise of the Bolsheviks in 1917: the socialization of all sectors—including monopolized state housing planning, monopolized state housing construction, and highly centralized housing provision and distribution—had drastic implications on the housing sphere, which did not bode well for when housing privatization eventually occurred. Indeed, it is clear that this conceptualization of the housing sphere sits very close to the ideal publicly-run housing system in our earlier characterization of housing system outcomes.<sup>189</sup>

In 1921, all land was nationalized, but owners of small homes were allowed personal use of their own dwellings. During the Bolshevik's state capitalist New Economic Policy, individual citizens were allowed to build and possess small homes.<sup>190</sup> Over time, however, more and more housing became constructed and owned by the government. This housing was distributed by municipal authorities or workers cooperatives based on a set amount of square meters per person in a given family, and tenants generally had no choice in what housing they were offered. As in other nations where housing is considered a social good, rent and utilities were heavily subsidized by the government. Housing could not be bought and sold, but the Soviet government did allow for housing to be exchanged with other families.

From the 1920s to the 1950s, Soviet families generally lived in dismal housing conditions. Those that actually possessed housing frequently lived in barracks, “dormitories” (mass housing for workers), or—for the lucky few—communal apartments.<sup>191</sup> During this

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<sup>189</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 84-86.

<sup>190</sup> “Housing in the Soviet Union,” *Master and Margarita*, 2009, <http://www.masterandmargarita.eu/en/09context/housing.html>.

<sup>191</sup> “Housing in the USSR,” *Communal Living in Russia*, 2008, <http://kommunalka.colgate.edu/cfm/essays.cfm?ClipID=376&TourID=900>.

period, the Communist government passed policies or adopted Constitutional articles that extended state control over all assets and curtailed personal ownership. Citizens were allowed to small amounts of personal property and to their savings, although the government aimed to eliminate this private property over the long run.<sup>192</sup> Although a government goal was offering private apartments for each family, families continued to live in tenements or communal apartments into the 1970s. By the 1980s, high-rise projects with private apartments became the main form of housing in cities, but as many as one-third of all citizens remained on the housing waiting list.<sup>193</sup>

These housing developments occurred under the backdrop of important Soviet social trends. Firstly, Soviet policy encouraged mass emigration of workers from the rural countryside into urban areas. Rural residents would frequently adopt informal jobs or face underemployment in cities to acquire some form of housing. In 1917, just 20% of Russians lived in cities, but by the 1990s, 80% of Russians lived in cities. Secondly, insufficient housing resulted in overcrowding and prevented new household formation, suggesting that housing shortage numbers available from the Soviet period may understate how much housing demand was unmet. For example, young couples would frequently remain with the family instead of forming new households, and divorced couples were sometimes forced to remain in the same apartment instead of separating.<sup>194</sup>

The most important changes to Soviet housing policy, however, occurred during the period of reform in the late 1980s. With the initial period of *perestroika*, status-quo

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<sup>192</sup> “Housing in the Soviet Union,” *Master and Margarita*, 2009, <http://www.masterandmargarita.eu/en/09context/housing.html>.

<sup>193</sup> “Housing in the USSR,” *Communal Living in Russia*, 2008, <http://kommunalka.colgate.edu/cfm/essays.cfm?ClipID=376&TourID=900>.

<sup>194</sup> “Housing in the USSR,” *Communal Living in Russia*, 2008, <http://kommunalka.colgate.edu/cfm/essays.cfm?ClipID=376&TourID=900.ou>

administrative approaches were used to solve economic problems. As might be expected, old standard attempts at practical solutions were highly ineffective and smacked of old Communist Party undertakings. For example, a major economic and social initiative was the Housing 2000 program. Originally based on a plan created by the 1986 Communist Party Congress, its goal was to provide every family with a self-contained housing unit by the year 2000. Unfortunately, the plan was infeasible from the start due to inaccurate projections: the projected housing stock increase was too low due to the underestimates in how many new households would form—in many instances multiple generations of families were living under one roof.<sup>195</sup>

Despite the Housing 2000 program's underestimation of necessary housing construction, the Russian housing construction sector—which was remained state-run at first—still fell short. Although housing construction increased somewhat at first, the Russian recession slowed housing construction in 1990 and 1991 to below 1989 levels. Furthermore, the distribution system remained ineffective: families waiting for the distribution for state housing faced endless lines. When families did attain housing, what they received was unsatisfactory. Due to high housing demand, rents were high, but a lack of incentives and funds resulted in low-quality housing that suffered from poor construction materials and inadequate maintenance. From 1988 to 1990, political focus shifted to the housing sector due to both the challenges the sector had faced and the significant budgetary cost it incurred, both in terms of construction and maintenance.<sup>196</sup>

## **GOVERNMENT HOUSING POLICIES IN MOSCOW**

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<sup>195</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 81-82.

<sup>196</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 82.

By 1990, the need to switch to a market-based system was clear; Gorbachev issued the first formal proclamation on the necessity of this shift that year. Gorbachev's policy sought to privatize state and public housing stock by transferring housing to owners through mass voucher privatization; tenants of state-run housing essentially became owner-occupiers free of charge. Furthermore, maintenance stopped being run by the state and instead became self-financed. Change, however, was initially slow. At first, no real changes took place, despite Gorbachev's proclamations. In the fall of 1990, the 500-Day Plan or Shatalin-Yavlinski program was introduced to the legislature. The plan called for a one-year period of cheap housing sales, followed by housing sales at market price. Unfortunately, it was not adopted.<sup>197</sup>

In July 1991, legislation passed in Russia permitting many tenants to purchase their units and, in turn, receive a significant amount of floor space for free. Additionally, local governments were empowered with the ability to provide other determinations. Notably, in Moscow, the government decided to not charge tenants at all for privatizing their homes; this was not the case in other cities.<sup>198</sup>

The sales procedure in Moscow involved the following components:<sup>199</sup>

- The law only pertains to state-owned (department-owned) and municipality-owned housing stock.
- Only tenants officially registered as the occupant of the flat can purchase the unit.

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<sup>197</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 82-83.

<sup>198</sup> Nadezhda Kosareva and Raymond Struyk. "Housing Privatization in the Russian Federation." *Housing Policy Debate* 4, no. 1 (1993), 8.

<sup>199</sup> Nadezhda Kosareva and Raymond Struyk. "Housing Privatization in the Russian Federation." *Housing Policy Debate* 4, no. 1 (1993).

- The tenant is effectively offered a voucher free of charge. The value of the voucher is the price of a square meter of an average-quality housing unit in the city in which the tenant lives times the number of square meters to which he is entitled.
- Tenants are offered the entire housing unit for free.
- Each family can only purchase a single unit under the privatization procedures.
- During the transition period (of unspecified length, the old system for housing allocation, but those allocated a unit have the right to purchase it under the aforementioned conditions.<sup>200</sup>

The summer of 1991 marked an early attempt at creating a market-based housing system in Russia, but this transition would be heavily influenced by housing and economic policy in the late 1980s. The recession, drop in housing spend, and chronically insufficient levels of housing construction meant that the housing supply—the x-axis in Graphs 1 and 4—was much too far to the left, pushing up short-term rents and housing prices. The national government issued a number of policy reforms to complement housing privatization efforts. Firstly, the national government gave local governments permission to raise rents starting in May 1992. Secondly, it began efforts to resolve questions about the implicit property rights that tenants and owner-occupiers would possess, although progress was slow. Thirdly, it passed laws stating that long-term subsidized credits could be used for purchase. Fourthly, it developed a method for quickly assessing the value for which properties can be purchased from the government. Fifthly, it pledged to implement housing allowances to support tenants in the transition to a market system. Sixthly, it expressed an interest in improving housing management. These six actions would theoretically lay the foundation for a robust property rights system and for a healthy housing

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<sup>200</sup> Nadezhda Kosareva and Raymond Struyk. "Housing Privatization in the Russian Federation." *Housing Policy Debate* 4, no. 1 (1993), 1-5.

market.<sup>201</sup> A healthy housing market would first require rents to rise, and yet Russian citizens lacked the ability to bear rent increases due to the Russian recession and a weak macroeconomic transition to the private sector. Implementing generous housing allowances, a clear system of property rights, and an easing of rent controls would give the economy the jumpstart it needed to move to a market-based system. Rents would rise in Graph 1, stimulating the demand for rental industry investment in Graph 3. This would ultimately increase the number of housing starts per period and raise housing prices until the demand could be sufficiently met, as was the case in East Germany. As rents would rise, housing allowances would make up for the rent increases that Russian citizens could not pay, and new housing developers, rental firms, and construction firms would emerge to fill in the gaps that the state-run construction firms could not handle.

Unfortunately, this process did not emerge due to issues in implementation. Although the national government allowed for rents to increase, local government did not act to ease rent controls. Property rights remained murky, and formal resolution of implicit property rights that tenants possessed did not occur. The State Savings Bank (*Sberbank*)—which had a virtual monopoly on long-term housing finance in 1992—did not offer loans for the purchase of privatized housing units, despite the privatization law’s statement that credits could be purchased. Although the government did create a process for the timely appraisal of properties, the price the government used was not a price that related to market value, which inhibited early developer and potential homeowners from developing an early system of market values. The lack of rent increases meant that no housing allowance was implemented, and the state continued to maintain its monopoly of state maintenance companies, although local governments did try to

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<sup>201</sup> Nadezhda Kosareva and Raymond Struyk. "Housing Privatization in the Russian Federation." *Housing Policy Debate* 4, no. 1 (1993), 12.

develop some competitors.<sup>202</sup> Rampant inflation in the period exacerbated the issue of determining appropriate home prices.

By 1993, the state construction industry began privatization. New private enterprises for building and marketing new dwellings was allowed, as was the use of private funds for housing construction. Private housing construction and development firms soon surfaced in Moscow; these firms typically focused on completing housing projects that were started and subsequently abandoned by the state or on purchasing undeveloped land on the urban fringe and building single-family homes. Many projects were initiated without any preliminary analysis of the market or actual demand; instead, these projects were based on a Russian interpretation of how rich people were supposed to live. Housing financing remained difficult to obtain; Moscow housing developers on average financed over 70% of total housing cost with their own funds. A legitimate market-based system of land prices did not emerge, and the local Moscow government continued to offer land for free plus a square-meter-based fee. Finally, developers were required by the Moscow government to offer 40%+ of newly-built apartments to the government free of charge as a condition of permission to build; barely 50% of housing units were sold at market price.<sup>203</sup> Across the board, the government impeded progress towards a market-based system. In Graph 1 of the Wachter-Kroll framework, rent controls prevented rent prices from increasing sufficiently to spark housing supply increases. In Graph 2 and 4, a lack of available housing financing limited the number of representative rental and construction firms that could even enter the market in the first place. In Graph 3, policies that reduced the number of units that could be sold at market prices dropped the cap rate, reducing demand for rental industry investment. In Graph 4, a lack of land prices prevented adequate housing asset prices from being developed. All

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<sup>202</sup> Nadezhda Kosareva and Raymond Struyk. "Housing Privatization in the Russian Federation." *Housing Policy Debate* 4, no. 1 (1993), 12.

<sup>203</sup> Olga Z. Kaganova. "Russian Home-Building in Transition." *Journal of Real Estate Literature* 7, no. 1 (1999).

of these impediments resulted in a level of new housing investment in Graph 6 that was very, very low. Housing developers would not be able to turn a profit without extralegal or illegal activity.

By the early 2000s, little had changed. Although the legal framework on property rights and housing market operations began to emerge, these new laws were disproportionately unfavorable to developers. Rental controls and price policy on housing utilities remained in place; these policies slowed down the pace of privatization. Rents stayed artificially low and standardized; the amount charged for rent theoretically should equal the maintenance fee, but owner-occupiers are expected to pay property taxes not paid by renters. Russian citizens tried to play both the private and public housing systems off of each other to achieve the greatest deal. Renters are legally entitled to improved state-provided housing if living in sub-standard units, but they forfeit this right if they privatize their low-quality housing. Unfortunately, a sustainable housing system had not emerged.<sup>204</sup>

## **IDEOLOGY IN MOSCOW**

The maintenance of popular support for Socialist ideology played a key role in the slow and inefficient privatization of the housing sector in Russia. The Soviet Union's distinct ideology—forged in the crucible of the nation's nearly century-long struggle with the adoption of Marxist ideology—had a strong impact on housing throughout the nation's history. A central tenant of Marxist ideology has been the rejection of private ownership of capital and of the means of production. This ideology resulted in the suppression of land markets, particularly in

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<sup>204</sup> Ruslan Yemtsov. *Housing Privatization and Household Wealth in Transition*. (United Nations University, World Institute for Development Economics Research, 2007).

Soviet Russia due to its long period of rule under Socialist ideology.<sup>205</sup> As an extension of this principle, land officially had no value under the Soviet system, which resulted in significant disparities between Moscow and other, non-Socialist metropolises.

Successful adoption of an extensive system of private property required a change in norms that was difficult for Russians to stomach ideologically. For almost a century, the USSR all but totally prohibited legal private enterprise activity, providing Russian citizens with little experience navigating capitalist institutions and traditions. What private enterprise did exist took place under an extensive black market system, corroborating the Socialist message that private business was not only exploitative but also immoral. For post-Communist privatization to be successful, the ruling regime needed to both teach citizens the concepts and principles of capitalist economics and counteract the negative stigma against Capitalism built up over decades, in addition to the already difficult task of implementing effective policies for moving the economy out from under state control.<sup>206</sup>

By the early 1990s, a transition to a market-based Russian economy seemed imminent. *Glasnost* and *perestroika* created a nascent private sector in Russia, and the rise to power of Boris Yeltsin and other seemingly pro-market politicians in August 1991 foreshadowed the swift adoption of change. Nonetheless, public opinion was slow to change in Russia. By the end of 1991, just 31% of Russians wanted to work for private businesses, and public sentiment towards the private sector seemed to become even less positive by the late 1990s.<sup>207</sup> Although privatization was supposed to rationalize the Russian economy through the free market, political

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<sup>205</sup> Alain Bertaud and Bertrand Renaud. "Socialist Cities Without Land Markets." *Journal of Urban Economics* 41, no. 1 (1997), 137.

<sup>206</sup> Perry L. Patterson. *Capitalist Goals, Socialist Past: The Rise of the Private Sector in Command Economies*. (Boulder, CO: Westview Press, 1993), 41-42.

<sup>207</sup> Perry L. Patterson. *Capitalist Goals, Socialist Past: The Rise of the Private Sector in Command Economies*. (Boulder, CO: Westview Press, 1993), 42-43.

commentators argued that privatization was taking place haphazardly and inefficiently. Russians balked at the widespread practice of “stripping” or “rolling,” where investors would purchase state firms and sell their assets piecemeal to others. These practices smacked of speculation and seemed to add little value to the Russian economy.<sup>208</sup>

These cultural challenges—and above all, the inculcation that ownership is theft—could explain some of the peculiarities with Russian housing privatization. Firstly, the manner in which housing privatization occurred in Russia was quite distinct. Unlike in other post-Socialist countries where housing was sold at discount prices to residents, dwellings were offered to their residents in Russia free of charge following the transfer of state ownership to the municipalities. This significant policy difference can be explained in part by ideologically-driven political entrenchment for politicians, even following the decision to pursue housing privatization. Despite the knowledge that a state-run system couldn’t work, Russian politicians struggled to find a unified voice to pursue market reforms following the fall of the Soviet Union.<sup>209</sup> Unlike in other post-Communist nations such as the former Czechoslovakia, anti-Communist sentiment in Russia was quite weak. Surveys throughout the 1990s corroborate this claim: 62% of Russians had a positive opinion of the old Communist regime in 1993, and 70% of Russians had a positive opinion of the old Communist regime in 2000. This ideological contrast made throwing off the shackles of Communism very difficult. As could be expected, this popular opinion shaped the relative degree of legitimacy of political actors and institutions through the post-Communist transition. Because of tacit public approval, legislative institutions from the late Soviet period were maintained, and Soviet-era politicians maintained their political posts. Thus, when housing

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<sup>208</sup> Perry L. Patterson. *Capitalist Goals, Socialist Past: The Rise of the Private Sector in Command Economies*. (Boulder, CO: Westview Press, 1993), 44-45.

<sup>209</sup> Maria Plotnikova. “A Model of the Housing Privatization Decision: The Case of Russia.” (Henley Business School, Reading University, 2010), 3.

privatization decisions were made, the Russian legislature was dominated by pro-Communist politicians. The unusual decision to avoid a market mechanism for housing privatization during the post-Communist transition to a market-based system is a manifestation of this political struggle.<sup>210</sup>

Ideological decision-making was not limited to politicians. Ideology is also apparent with individual citizen decisions during the period. Because of mass housing privatization policies, residents acquired a valuable asset free of charge by agreeing to privatize. However, despite this lucrative opportunity, few Russians accepted the homeownership offer in the early 1990s. Despite the fact that privatization was free and despite the strong public support for housing privatization—as exemplified by 70% of nationally surveyed households wishing to own their dwellings in 1993—only 18% of eligible dwellings were privatized in that year. Low adoption levels were due in part to woes caused by poor execution. For example, many older Russians continued to rent due to the pain of completing the necessary paperwork.<sup>211</sup> Nonetheless, the low levels of adoption are somewhat surprising. This response contrasts greatly with the right to buy policies that existed in non-transition economies such as the U.K. and the Netherlands, where public housing was offered for sale to the tenants in the early 1980s and was enthusiastically adopted by citizens. The response to housing privatization was also slow as compared to other post-Communist nations such as Hungary.<sup>212</sup> Although some research suggests that certain issues like a desire to avoid paying for maintenance could explain the lackluster response, there remains considerable uncertainty around the phenomenon, and little can explain the gradual acceleration

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<sup>210</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 142-144.

<sup>211</sup> *Encyclopædia Britannica Online*, s. v. "Russia," accessed May 12, 2014, <http://www.britannica.com/EBchecked/topic/513251/Russia>.

<sup>212</sup> Maria Plotnikova. "A Model of the Housing Privatization Decision: The Case of Russia." (Henley Business School, Reading University, 2010), 3.

of adoption. Why were just 50,000 units privatized annually in the early 1990s while 1,000,000+ units were privatized by the early 2000s?<sup>213</sup> Ideology—the decades-long notion that ownership is theft in the Soviet mindset—could explain the early lackluster response and the gradual increase in housing privatization over time, despite decreasing incentives to do so.<sup>214</sup> Appel explains that in Russia, politicians could neither easily reject Communism as alien nor overlook the foreign connotation of a liberal property rights system. This was exacerbated by a refusal by politicians to develop an ideological legitimating campaign.<sup>215</sup> As Russians gradually moved towards adopting a free-market ideology, a greater number of citizens decided to privatize their homes.

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<sup>213</sup> Maria Plotnikova. “A Model of the Housing Privatization Decision: The Case of Russia.” (Henley Business School, Reading University, 2010), 28.

<sup>214</sup> Maria Plotnikova. “A Model of the Housing Privatization Decision: The Case of Russia.” (Henley Business School, Reading University, 2010), 23.

<sup>215</sup> Hilary Appel. *A New Capitalist Order: Privatization & Ideology in Russia and Eastern Europe* (Pittsburgh, PA: University of Pittsburgh Press, 2005), 172-174.

## **SECTION 7: CONCLUSION: WHAT CAN WE EXPECT FOR HAVANA?**

A comparison of two distinct cases of post-Communist housing privatization—East Berlin and Moscow—allows us to draw inferences about commonalities in future examples of post-Communist housing privatization and to elucidate what might occur in Havana if housing privatization occurs. What convergences have we seen between East Berlin and Moscow?

Firstly, housing stock increased markedly between both nations. Housing shortages are a problem that the vast majority of Socialist nations face due to the inefficiency of a centrally-planned, public-oriented housing system. Indeed, it appears from the comparative method of analysis used in this paper that Havana can expect to see a dramatic increase in housing stock. This increase is long overdue and should begin to address the chronic housing shortage of over 1,000,000 housing units in Cuba today.

Secondly, post-Communist housing privatization resulted in an increase to housing quality over time in both East Berlin and Moscow. As the burden on housing construction and provision is decentralized, consumer power and consumer choice increase. Unlike centrally-planned systems—where coordination issues belie the potential to meet the needs of all customers—a decentralized system is able to address the difficult coordination problem of designing, constructing, and provision of housing that meets consumer needs. That—coupled with more effective cost controls—means that not only is higher-quality housing built but also new housing is built with the attributes that consumers want, resulting in it being considered higher quality.

Thirdly, in both Moscow and East Berlin, housing prices initially spiked, as housing prices under the Socialist regime were much too low across the board as some rents and costs

were borne by the government. In the short-term, housing privatization resulted in a spike in housing prices and rents, caused predominantly by the grossly insufficient supply of viable housing. This problem is exacerbated by the fact that Socialist nations typically do a poor job of recycling old buildings into new properties, meaning much housing investment happens on the outskirts of cities; housing demand in contrast is typically greatest in the city center, further contributed to insufficient housing supply. Over the long-run, as the housing market begins to function properly and achieves a stable long-term equilibrium, housing prices decrease.

Fourthly, housing privatization results initially in mistakes in housing construction levels. In East Berlin, investor overconfidence in rising home prices and an extensive array of government-provided subsidies resulted in irrational exuberance and too much housing construction. This ultimately resulted in a crash in home prices before prices leveled off in the long-run. In Moscow, the government did not properly lay the groundwork for housing privatization to occur: a strong legal system was not developed, insufficient subsidies were provided, and the government did not phase out public housing construction quickly enough. This resulted in a situation where the public housing system continued to be the main entity involved in housing construction and a housing shortage persisted at the same time that housing allowances for citizens were phased out. This placed undue burden on the average Russian citizen and prevented Russia from attaining a speedy exit from the recession and slow economic growth it faced in the 1990s and early 2000s.

Fifthly, government policy tools such as tax subsidies and direct grants appear to have a significant and important impact promoting housing supply. In the case of East Berlin, the presence of these tools resulted in over-construction and eventually housing supply bubble. In the case of Moscow, the absence of these tools resulted in sufficient housing construction by

private firms. Proper application of just the right amount of these policy initiatives promotes a swift transition to a stable housing market.

Sixthly, housing privatization in the post-Communist context results in a significant reduction in public expenditure. Socialist typically suffer from slower economic growth than their non-Socialist peers due to a centrally-planned economic system. In both the Moscow and East Berlin cases, privatization of the housing sector freed up funds for investment in other important industry sectors and infrastructure. Housing privatization also transfers the responsibility for future repairs from the state to private firms, which reduces future incurred public expenditures.<sup>216</sup>

Seventhly, across both country examples, tenancy rights have stayed strong. In many market-oriented housing systems, tenants have very little power compared to landlords and investors. However, in the post-Communist transition to a market-oriented housing system, tenants maintain strong rights to occupancy. In some cases, the difficulty of evicting tenants is so great that it acts as a powerful disincentive for businesses participating in the residential real estate market.

Eighthly, ideology seems to impact or correlate with a more rapid housing privatization transition. Put another way, when policymakers communicate the transition to a market-oriented system in the language of the ideology, the transition to a stable housing market appears to complete more quickly, although it is not known whether this relationship is causal or simply correlated. In any case, politicians appear to have an important role. In East Berlin, a series of political gaffes resulted in turning popular sentiment against Socialism, which shaped and accelerated the housing privatization transition. In Moscow, politicians did not properly consider

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<sup>216</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 169-171.

the need to address and ease ideological concerns, which may have slowed the housing privatization transition process down. Other research seems to corroborate this.<sup>217,218</sup>

## **WHAT DOES OTHER RESEARCH SUGGEST WHAT WILL HAPPEN IN HAVANA?**

Based on this analysis method from comparative politics, Havana can expect a significant increase in housing stock, an increase in housing quality, a short-term spike in housing prices followed by a long-term decrease, initial mistakes in housing construction levels, tax subsidies and direct grants to be effective tools for promoting housing construction, a significant reduction in public expenditure, strong tenancy rights to be maintained, and ideology to serve an important role in speeding up the transition to a stable housing market.

However, other research on the post-Communist privatization process can build out our understanding of the challenges and obstacles Cuba may face as it transitions to a private housing sector. Perhaps the most important of these challenges are those that are faced by cities developed under a Socialist system after the nation transitions to a market-oriented economic system. Specifically, housing misallocation may mean that some land needs to be demolished before it's valuable, especially for housing tenements built on the exterior of cities. Spatial misallocations of housing are alluded to in both the East Berlin and the Moscow examples. Researchers have discovered that cities that develop under Socialist governments, systems, and norms have distinct layouts from those that develop under market-based systems, although the intensity to which this occurred was different between East Berlin and Moscow due to their differing political histories. Accordingly, the challenges presented by these architectures are

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<sup>217</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 173-174.

<sup>218</sup> Hilary Appel. "Mass Privatization in Post-Communist States: Ideas, Interests and Economic Regime Change." *ProQuest Dissertations and Theses* (1998), 16, 286.

relevant to East Berlin, Moscow, and ultimately Havana, although the magnitude of the challenges once again will vary. Under Socialist governments, city and housing systems develop without any reference to private individual property, market mechanisms, or private financing. Put separately, almost all urban growth is based on three major price distortions: land value (i.e. location, quality, and amenities) is not priced, capital bears no interest, and energy prices are much cheaper than world market prices. This results in cities with strikingly different layouts than market cities, which has an important impact on layout. Socialist cities develop much like concentric growth circles on a tree. Cities have a central industrialized city core where all the jobs are that has low urban density, and households tend to be concentrated on the periphery with increasing urban densities further and further from the core. This layout originates a challenge known as the “fallow land” syndrome, an issue common in planned economies without market systems. The “fallow land” syndrome occurs when existing land is improperly recycled and maintained and new buildings instead are built further and further from the city on undeveloped land. This results in a situation where high-value land located in city centers is not used to its utmost potential and as a result citizens face long commute times and costs every day to get to work, lowering labor productivity. Furthermore, property developed under this system can have minimal asset value when a market system is adopted, as these properties are too far from services to be allocatively efficient, even though they may have many high-quality amenities.<sup>219</sup> Unfortunately, evidence shows that this is the case in Russia, where newer properties were built progressively farther and farther away from the city center, where the central business district was.<sup>220</sup> It also occurred in East Germany, where large sections of housing stock following

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<sup>219</sup> Alain Bertaud and Bertrand Renaud. "Socialist Cities Without Land Markets." *Journal of Urban Economics* 41, no. 1 (1997), 137-150.

<sup>220</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995), 1253-1254.

housing privatization were useless because they were large urban estates at the urban periphery.<sup>221</sup> Ultimately, the legacy of the Socialist housing systems at the time of reform typically involves the following components: extremely high state ownership, trivial rents charged to tenants and poor maintenance by state housing institutions, the overwhelming of state financing in new construction, strong state monopolies over production, barren uniformity and low quality of the housing stock resulting in poor-quality housing services, and the absence of land markets resulting in a variety of negative consequences on Socialist city layout.<sup>222</sup>

One of the major findings of this paper is that tenancy rights remained disproportionately strong following housing privatization in the post-Communist context. This outcome would corroborate what happened during Cuba's early political history: Cuban policymakers enacted some of the earliest rent control policies in the world in the period before the Cuban revolution, and there has been a long history of pro-tenant housing policy under the Castro regime. These precedents suggest that once Cuba privatizes it may maintain rent control policies for the purpose of equity. However, research suggests this may be a bad idea. This outcome can perhaps most clearly be seen through American landlord-tenant law, which underwent a politically contentious revolution in the 1960s and 1970s. The reforms enacted over these two decades were caused by social and political currents that emerged in the 1960s<sup>223</sup> and resulted in an increase to rent control policies throughout the United States. Rent control statutes now affects a significant percentage of US multifamily rental housing stock and are used in major cities such as New

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<sup>221</sup> David Clapham, ed. *Housing Privatization in Eastern Europe*. (London: Greenwood Publishing Group, 1996), 48.

<sup>222</sup> Bertrand Renaud. "The Real Estate Economy and the Design of Russian Housing Reforms, Part I," *Urban Studies* 32, no. 8 (1995), 1249.

<sup>223</sup> Edward H. Rabin. "Revolution in Residential Landlord-Tenant Law: Causes and Consequences." *Cornell Law Review* 69 (1983), 520.

York City, Boston, San Francisco, and more.<sup>224</sup> Economists today almost unanimously agree that rent control has a negative impact on housing markets by creating a housing shortage.<sup>225</sup> Rent control increases demand and restricts the supply of rental housing by artificially depressing prices, ultimately exacerbating the housing shortage the policy intended to address.<sup>226</sup> Although rent control adversely impacts housing, it benefits current tenants by disproportionately hurting future tenants and those persons unable to vote through the reduction of available renting options.<sup>227</sup> Given the present housing shortage caused by the Socialist housing system, maintaining rent control policies through the housing privatization process is unadvisable.

Cuba-specific research also sheds some light on what the Cuban housing privatization process may look like. Although using the Most Different Systems Design to analyze two very different case studies lays the basic framework for the convergence across all post-Communist housing privatization processes, this method of analysis does not pretend to all of the unique peculiarities of the Cuban situation.

At the present moment, popular ideology in Cuba appears to be approaching the sentiments of East Germans in the late 1980s. Solving the regime's economic problems will not only selecting the right reforms for economic progress but also addressing popular sentiment. There is no question that the belief system and social norms of Cuban citizens has been indelibly changed by the last half-century of Communism. Nonetheless, there is some evidence that Cuban popular sentiment has started to adopt a pro-market stance since the beginning of the Special Period. Put another way, the ideological grip of the Socialist utopian narrative has gradually

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<sup>224</sup> Edward H. Rabin. "Revolution in Residential Landlord-Tenant Law: Causes and Consequences." *Cornell Law Review* 69 (1983), 527.

<sup>225</sup> "Rent Control," *IGM Forum*, 2012, [http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV\\_6upyzeUpI73V5k0](http://www.igmchicago.org/igm-economic-experts-panel/poll-results?SurveyID=SV_6upyzeUpI73V5k0).

<sup>226</sup> Edward H. Rabin. "Revolution in Residential Landlord-Tenant Law: Causes and Consequences." *Cornell Law Review* 69 (1983), 581.

<sup>227</sup> Edward H. Rabin. "Revolution in Residential Landlord-Tenant Law: Causes and Consequences." *Cornell Law Review* 69 (1983), 520.

weakened as Cubans see the global market revolution and aim to improve the quality of their lives. The housing market is one important battleground for exploring and understanding the war for dominant economic ideology in Cuba. Housing under Socialist ideology is built on a platform of collective property and of universal rights, including shelter. In contrast, housing under a free market ideology is fundamentally grounded in private property and the ability to earn income on privately owned goods and commodities, such as housing. Although these two ideologies are somewhat contradictory, the beliefs of Cubans are not a simple binary. Curiously, these two narratives intersect in intimate ways in the housing transaction process, where they inform and reflect sets of practices that reproduce utopias of socialism and capitalism, respectively. For example, Cubans may agree with and rely on certain components of the Socialist process, while at the same time utilizing their understanding of how the informal housing market works to acquire the most profit possible on a given housing transaction.<sup>228</sup> According to some research, Cubans believe that a transition to a market-oriented economic system will allow them to work for themselves, buy a greater variety of goods and services at affordable prices, a system where services are compensated on value and not entitlement, greater freedoms to do what they want with less government interference bureaucracy.<sup>229</sup> Although it is likely that Cubans will achieve some of these desired outcomes in the long run, there is no question that they are idealizing what the free market experience will look like. In the short run, privatization and shifting the economy towards a market-oriented economy will likely result in economic hardship and the expropriation of normal citizens by wealthy investors and foreign corporations; at the very least, this was the case in Russia and the other formerly Socialist nations in the 1990s. Nonetheless, the battle for

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<sup>228</sup> Jared Michael Genova. "¡Hasta La Utopía Siempre! Conflicting Utopian Ideologies in Havana's Late Socialist Housing Market." (2012): 113, 140.

<sup>229</sup> Jared Michael Genova. "¡Hasta La Utopía Siempre! Conflicting Utopian Ideologies in Havana's Late Socialist Housing Market." (2012): 65-100.

the hearts and minds of Cubans is critical to the success of any future privatization efforts. Once the Cuban government attempts to implement reform, successful implementation of privatization policies will depend greatly on the perspective and support of the Cuban people, who will interpret and support these policies through the lens of their own belief system. Although the Cuban government is virtually a dictatorship—and so public opinion appears to have little political influence through mechanisms such as the vote—the thoughts and beliefs of the Cuban people are extremely relevant in terms of their participation in the emerging free market system that the current economic reforms are moving towards.

Another critical obstacle the Cuban government must face is tertiarization and its ramifications on Cuban work culture. Cuba's status as an American neocolony meant that its economy was underdeveloped and largely dependent on the United States. This dependence was never fully overcome in the following decades, as Cuba began to rely almost exclusively on the USSR and the Council for Mutual Economic Assistance for traditional commodity exports. Under this system, Cuba was led by necessity to adopt a paternalistic and extremely distorted international trade pattern, which resulted in the emergence of an irrational domestic price structure. Before the Special Period, this dependence resulted in the adoption of capital-intensive techniques that could only be sustained through external subsidization, a dearth of international competitiveness in the agricultural and industrial sectors of the economy, the decay of Cuba's productive capacities, and a general lack of domestic self-sufficiency in the economy. Put separately, this dependence resulted in fundamental problems regarding the structure of the Cuban economy. Starting in the Special Period, the Castro regime adopted a number of reforms to address these structural inadequacies. Up until the current moment, these measures have

delivered a very modest recovery and have just begun to challenge the state Socialist model.<sup>230</sup> Furthermore, the Special Period served to exacerbate these issues as more and more of Cuban economy activity became dominant on providing services (and namely tourism) to generate income. If Cuba does move towards housing privatization, this longstanding tradition of tertiarization could be problematic. As the Cuban government moves towards a decentralized, market-oriented housing system, individual citizens and agents will be responsible for the provision of housing, for constructing housing, for providing financing, and for distributing housing. Although research suggests that Cubans have embraced the role of housing middleman through the *corredores* present today in Cuba's informal housing market,<sup>231</sup> there is not a strong manufacturing or construction culture today in Cuba. This may result in further exploitation of Cubans by foreign investors, as foreign firms take advantage of these institutional deficiencies to place themselves as the agents involved in the housing process. Without Cuban entrepreneurs stepping up and filling the voids left by the state, Cuba risks becoming dependent on American corporations and the American economy once more.<sup>232</sup>

## LIMITATIONS OF THE ANALYSIS

There are some important assumptions and considerations that must be mentioned as limitations to this analysis. Firstly, comparisons to Moscow and East Berlin are roughly 25 years old, and much has changed in the last two-and-a-half decades. Secondly, both of these examples did involve post-Communist housing privatization, but they specifically were examples of post-

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<sup>230</sup> Mauricio Font and Carlos Riobó. *Handbook of Contemporary Cuba: Economy, Politics, Civil Society, and Globalization* (Boulder: Paradigm, 2013), 124-125.

<sup>231</sup> Jared Michael Genova. "¡Hasta La Utopía Siempre! Conflicting Utopian Ideologies in Havana's Late Socialist Housing Market." (2012): 65-100.

<sup>232</sup> Mauricio Font and Carlos Riobó. *Handbook of Contemporary Cuba: Economy, Politics, Civil Society, and Globalization* (Boulder: Paradigm, 2013), 130-133.

Communist housing privatization in the context of the fall of the Eastern Bloc in the 1990s. Although Cuba was heavily economically dependent on the USSR, the nation consistently tried to separate itself ideologically from the Soviet Union following the Cuban Missile Crisis. This ideological separation from the Soviet Union may mean that the Moscow and East Berlin cases do not apply. Thirdly, this case study assumes that Cuba's recent policy initiatives foreshadow an imminent transition to a privatized housing sector. However, Cuba may instead move back towards a Socialist model or find another economic sector than tourism to develop. These developments could preclude the Cuban government from continuing to develop a robust property rights system and could mean a move back towards fundamentally Socialist values, laws, and norms. Fourthly, the East German example may be invalid for this analysis because German reunification was a unique historical event where two nations were simply combined into one.<sup>233</sup> Fifthly, Cuba's geographical proximity to the United States and its political history as an American neocolony for a half-century mark a contrast with the sociopolitical and cultural history of the former Soviet Union and German Democratic Republic. American involvement and political interference in Cuba could impact the course of Cuban housing privatization.

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<sup>233</sup> Claus Michelsen and Dominik Weiß. "What Happened to the East German Housing Market? A Historical Perspective on the Role of Public Funding." *Post-Communist Economies* 22 (2010), 406-407.

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