Housing Subsidies in a Period of Restraint: The Canadian Experience, 1973-1984

Research and Working Paper No. 16

by J. David Hulchanski & Glen Drover

1986

The Institute of Urban Studies

FOR INFORMATION:

The Institute of Urban Studies
The University of Winnipeg
599 Portage Avenue, Winnipeg
phone: 204.982.1140
fax: 204.943.4695
general email: ius@uwinnipeg.ca

Mailing Address:
The Institute of Urban Studies
The University of Winnipeg
515 Portage Avenue
Winnipeg, Manitoba, R3B 2E9

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J. David Hulchanski

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1.0 INTRODUCTION

Canada from 1973 to 1984 had three official recessions accompanied by policies of monetary and fiscal restraint. During that period, housing expenditures, in contrast to other social programs, fared rather well due to the small size of government housing programs, the negative impact of high interest rates on housing starts, the political impact of affordability problems, and the increased use of tax expenditures. In theory, Canadian restraint measures were intended to be directed in such a way that those who were most in need would be helped by social housing programs. In reality, the social and private housing sectors were treated quite differently. Contrary to popular belief, subsidies on social housing were held to a minimum while private sector assistance fluctuated dramatically depending upon market conditions. In addition, while much of private sector support was provided in the form of relatively hidden tax expenditures, non-market social housing subsidies were provided up-front through direct public expenditures. The net distributional effect of the changes increased the bias of Canada's complex set of housing subsidies toward home ownership and private rentals over various forms of social housing.

In general, the affordability of accommodation and profitability of the housing sector have been a major preoccupation of governments in most OECD countries during the past decade. (Burke, P. et al, 1981; Howenstine, 1983, 119ff; Stone, 1983, 99ff) What has made the Canadian response distinct is not the recession, which had parallels in other countries, but the particular nature of the Canadian economy. Canada is among those few countries which have been classified as dominion capitalist. (Ehrensaft, 1981, 99ff) A defining characteristic of a dominion capitalist country is that while it enjoys an advanced standard of living similar to metropolitan nations such as the United States or Germany, it is also economically truncated. Hence, it is very vulnerable to major structural changes in the world economy and dependent on metropolitan countries to provide the initiative in overcoming recessionary tendencies. Some features which have circumscribed the economic truncation of Canada are export dependency on primary products, a small highly sheltered manufacturing sector, a plethora of foreign-based multinationals, and trade domination by the United States. In housing, as in other areas, economic truncation means that Canada not only is fiscally restrained by its southern neighbour but also restricted in the policy options which are considered politically acceptable. As in the U.S., reliance on private sector housing is greater than most countries of Europe. Similarly, home ownership is ideologically espoused more than rental accommodation. Therefore, intervention in the housing market is more restrictive than in many OECD nations. To understand the Canadian housing response in a period of restraint requires an appreciation of the characteristics of economic truncation.

2.0 ECONOMIC TRUNCATION AND CANADIAN HOUSING

Officially Canada is rarely, if ever, labelled as economically truncated. Instead it is described as a "small open economy" which is very sensitive to international capital flows, (Pesando, 1983, 1) and a "medium-sized country that is heavily dependent on its external trade." (Economic Council of Canada, 1983, 17) Nevertheless, a close examination of the economy and of external trade suggests that truncation is not an inappropriate appellation. The traditional position of Canada as a trading nation relies mainly on the export of primary products (wheat, timber, minerals) and semi-fabricated goods (pulp and iron, not paper and steel). In addition, the bulk of that trade is with one country - the United States. In the two export areas where manufactured goods, rather than primary products, account for growth in Canadian exports, the dependency on the U.S.A. is almost total. The two areas are automotive parts and defence equipment. As a consequence, Canada is not only the United States' largest trading partner, it is practically an extension of the American industrial market.

While the historical roots of dependency were established just after Confederation (1867), the foreign ownership of Canadian companies intensified with the growth of the multinationals. "Since World War II, foreign corporations in resource extraction and in manufacturing have become so dominant in Canada that they have replaced Canada's native trading and banking bourgeoisie as the predominant force in the Canadian state." (Laxer, 1973, 127) By the mid-sixties, 58% of all manufacturing assets and 63% of all profits were dominated by non-resident ownership. The growth of the American branch plant, in particular, soon became the established institutional form within which the production of most manufactured goods took place. Increasingly domestic manufacturing was oriented to the U.S. or simply undertook the responsibility of "Canadianizing" American goods. The branch plant was never designed to enter export markets. Instead resource extraction was given a priority.

All of this should not be taken to mean that there was an American conspiracy or that there are no indigenous multinationals. "The large American sector within the Canadian economy has been acquired, company by company, in straightforward and legitimate business dealings." (Rotstein, 1984, 25) Canadians, or at least a small Canadian elite, have sold their assets quite voluntarily. On the other hand, there can be little doubt that some of the consequences of foreign ownership have been the erosion of technological innovations and productivity, the maintenance of high interest rates, the frequent inability of Canada to undertake new domestic initiatives without impinging on American policy, and trade imbalances heavily reliant on national resources. Indirectly these all affect the housing sector and housing policy either because they have tended to lower Canadian wages relative to the Americans, increased prices (including house prices), or restricted direct expenditures of the welfare state on social housing. The dependency on U.S. demand, for example, means that the Canadian business cycle parallels the U.S. with a lag which, in turn, influences Canada's residential building cycle and mortgage rates.

A recent public document acknowledges that about 90% of technology used in Canada is imported and that Canada trails most developed countries in the private funding of research and development. (Canada, Department of Finance, 1984b, 25) The low rate in R & D expenditures is particularly obvious in foreign controlled firms. The problem is aggravated by declining productivity levels and wage rates. On average, Canadian performance is poor relative to OECD countries and since 1978 it has deteriorated. (Rotstein, 1984, 45) Canada's capacity to maintain high quality affordable housing is affected by the decline. Since the decline has also occurred at a time when inflationary rates have been high, nominal increases in wages of Canadian workers have not been accompanied by improvements in productivity. Real wages have fallen during the recessionary period and the capacity of the average worker to maintain housing standards has deteriorated.

The heavy reliance upon the export of resources (about 60% of all exports) is associated with two other distinctive features of the Canadian economy: "tied" growth and consistently high unemployment rates. "Tied" growth refers to the close dependency on changes in U.S. demand to stimulate the Canadian economy. Hence, the Canadian cycle of growth parallels, in many respects, what happens in the U.S.A., though the Canadian pattern of growth or decline lags behind its American counterpart due to the delayed demand for resources. In the period from 1973 to 1984, Canada had three official years of recession: (1974-75, 1980, and 1981-82) though most of the period has been associated with lacklustre economic performance. (Canada, Department of Finance, 1984a, 9) Prior to 1974, Canada's overall economic performance was strong. It began to slip from 1974 to 1980 and has been relatively poor compared to the U.S. since 1981 (Table 1). The uncertainty of American demand for basic resources has not only meant that Canadian Growth since the mid 1970s has fallen to about half of its earlier trend, but also has generated very high levels of unemployment. (OECD, 1982, 7) As Table 1 indicates, Canada usually has a higher unemployment rate than most OECD countries. With the exception of the United Kingdom, which in recent years has had even higher rates, Canada has had one of the worst records in terms of unemployment among developed countries. Not surprisingly, unemployment is disproportionately concentrated in the resource-based sector. Many forecasts maintain that the double digit unemployment of 1982-84 will probably remain to the early 1990s. (Rotstein, 1984, footnote 36)

The response of the Canadian government to the recessionary challenge has been a mixture of restrictive monetary policies and compensating fiscal policies. The restrictive monetary policies were initiated in 1975 following the worldwide inflation which began to accelerate following the increases in oil prices by OPEC nations (1973) and wheat prices in the U.S.A. (1972). They have only begun to ease off during the past two years. The rationale for a restrictive policy was that the cycle of inflationary expectations could be controlled through the money supply. The result was a reduction of high inflation rates to between 5 and 6 per cent in 1984. (Rotstein, 1984, 16) However, these were combined with the high rates of unemployment noted above and equally high interest rates. Normally Canada has had a high interest rate policy to assure the inflow of capital from the U.S.A. With two exceptions (e.g., 1973 and 1975), high interest rates were maintained during the recession (Table 2). As a consequence, the unemployment rate tended to be higher than most OECD countries and Canadian mortgage prices were high relative to those in the U.S.A.

Prior to the 1973-84 period of restraint, monetary policies were offset, to some degree, by fiscal initiatives. Since 1973, that practice

TABLE 1

Recent Economic Trends:

Canada, United States and the OECD Countries

	Average 1966-1973	Average 1974-1980	Recession 1981-1982	Recovery 1983-1984
Growth in Real GNP/GDP				
Canada	5.5 %	2.9 %	-0.6 %	3.8 %
United States	3.6	2.4	0.2	5.3
OECD	4.7	2.5	0.8	1.9
Unemployment				
Canada	5.1	7.2	9.3	11.7
United States	4.5	6.8	8.7	8.6
OECD	3.4	5.4	7.7	8.8
Consumer Price Inflation				
Canada	4.3	9.4	11.7	5.1
United States	4.4	9.3	8.3	3.8
OECD	4.9	10.4	9.2	5.3
Productivity				
Canada	2.6	0.0	-0.4	2.2
United States	1.6	0.1	0.1	2.5
OECD	3.7	1.5	0.8	2.8

SOURCE: Canada, Department of Finance, 1985a, p.4.

TABLE 2

Interest Rates, Canada and U.S.

1973 - 1983

(Treasury Bills, 90 Days)

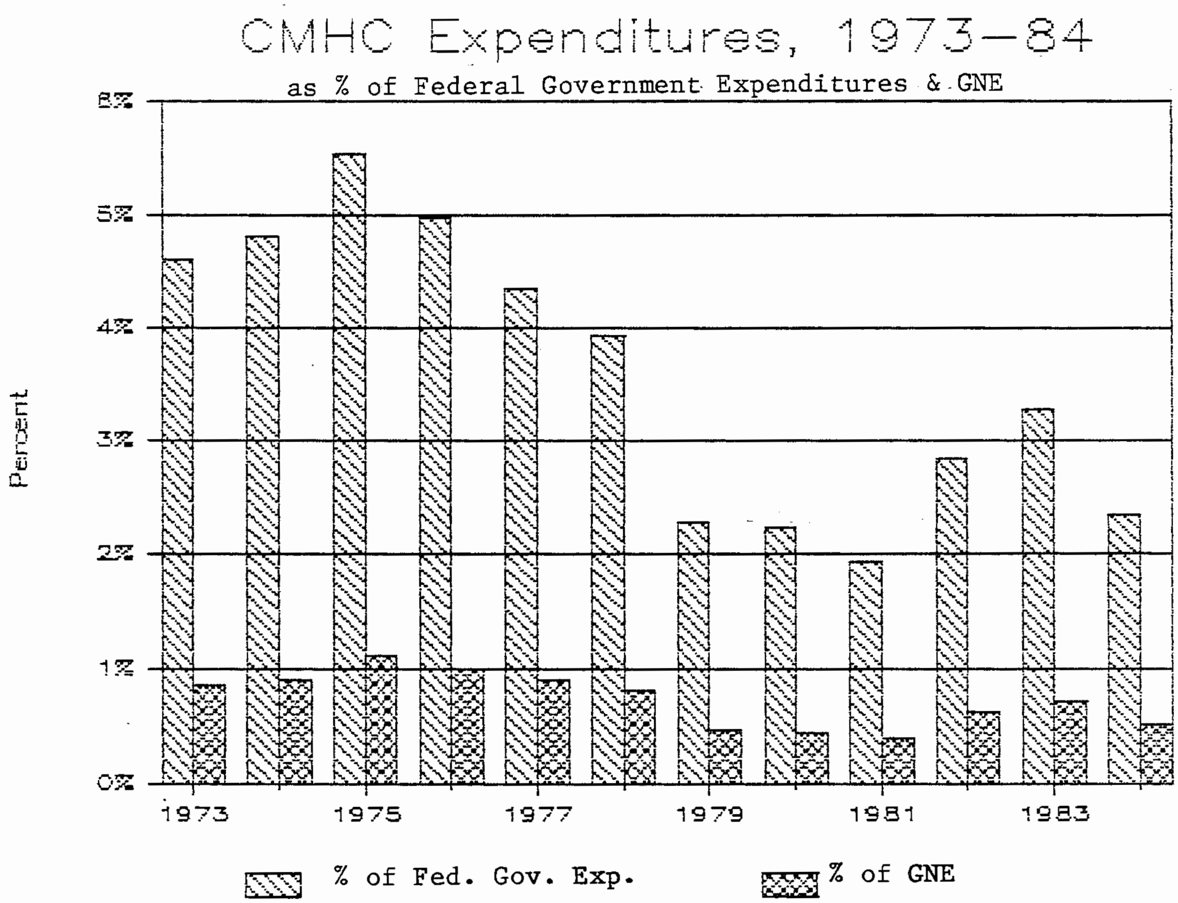
INTEREST RATE		
Year	Canada	U.S.
1973	5.47	7.02
1974	7.82	7.87
1975	7.40	5.82
1976	8.87	5.00
1977	7.33	5.26
1978	8.68	7.22
1979	11.69	10.04
1980	12.79	11.61
1981	17.72	14.08
1982	13.96	10.69
1983	9.27	8.14

SOURCE: C.D.Howe Institute, 1983.

has continued with one major difference. With restraint, high interest rates and a tight money supply has been associated with a loss in government revenue and increased tax expenditures. Hence, there was a rapid increase in the government debt. In 1974, at the beginning of the recession, the federal debt was less than $25 billion (17% of GNP; $1,100 per person). By 1984, it reached $190 billion (45% of GNP; $7,500 per person). The public debt charges during this period increased from 1% of GNP and 5% of federal revenues to over 4% of GNP and 27% of budgetary revenues. The increase was particularly dramatic in the past four years. (Canada, Department of Finance [1985]). Social housing expenditures were restrained during the period but restraint in direct expenditures was offset by tax expenditures for private sector housing. One reason for the difference in treatment was the necessity, as already suggested, to offset the rising problem of affordability for the middle classes in the context of recessionary pressures. Still another was the degree of freedom allowed by the relatively low level of overall public expenditure in the Canadian housing market. Throughout the recessionary period, direct housing expenditures, that is, the annual budget of CMHC, accounted for less than 1% of GNE and only 2% to 5% of total government expenditures. As Figure 1 indicates, the peak in direct housing expenditures occurred in 1975, the year the program was initiated in response to the economic instability of 1973/74. After 1975, however, government restraint measures came into play, limiting the size of direct housing expenditures relative to the rest of the budget.

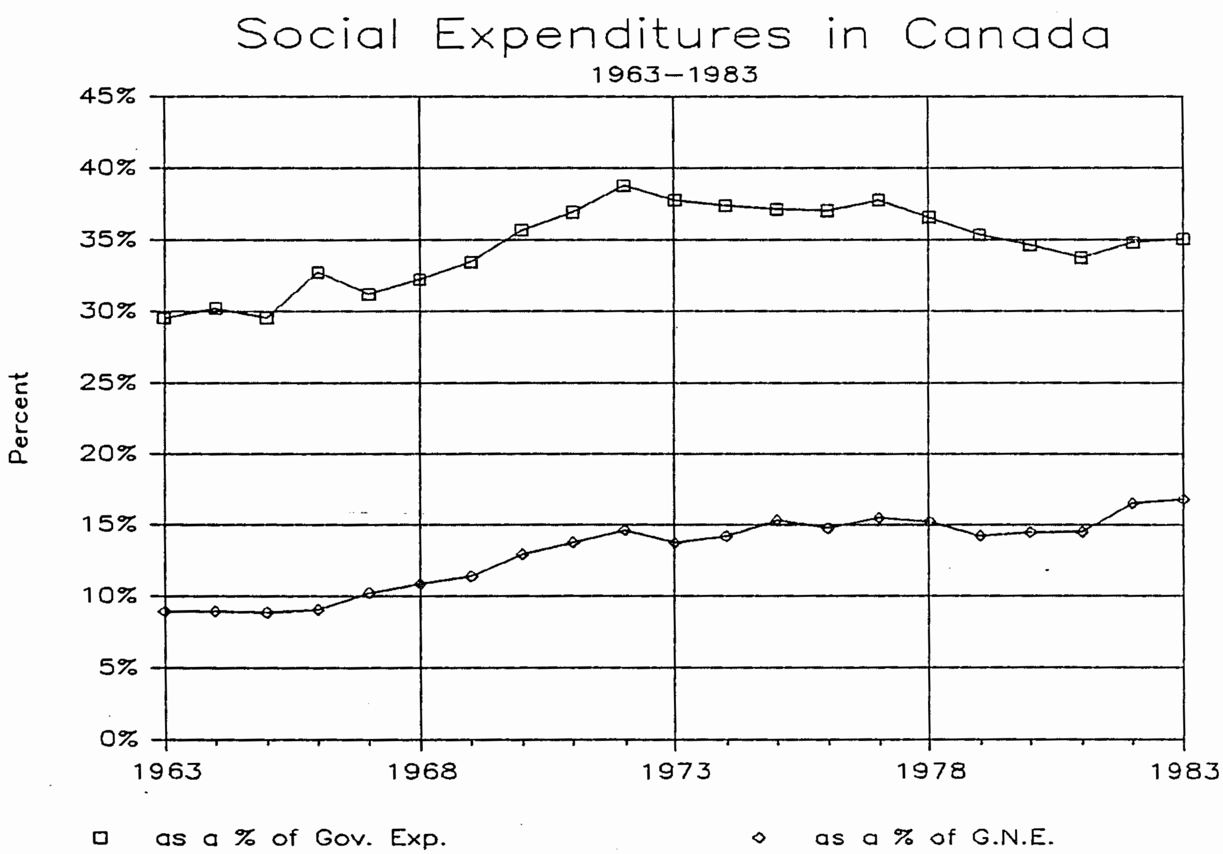
Overall social expenditures of government were not primarily responsible for growth in the deficit during the restraint period as can be appreciated by reference to Figure 2. Social expenditures include all transfer payments (unemployment insurance, pensions, assistance, and workers' compensation) as well as social services (health, education and welfare). From 1973 to 1983 (latest available data), social expenditures actually declined as a percentage of government expenditures

FIGURE 1



SOURCE: CMHC, <u>Annual Report</u> and <u>Canadian Housing Statistics</u>, various years.

FIGURE 2



SOURCE: Calculated from Bergeron, 1979 (for 1963-1975) and Statistics Canada, 1984 (for 1976-1983).

while increasing only marginally in relation to Gross National Expenditure. In fact, from 1974 to 1981, expenditures as a percentage of GNE remained constant. Canada, in comparison to most OECD countries, was a modest social spender. Comparative data show that from 1973 to 1984, Canada spent less than all the countries of continental northern Europe except Switzerland. Expenditures exceeded only those of the U.S.A. and Britain. (OECD, 1984)

The modesty of the Canadian Welfare State is important to keep in perspective as we turn to an examination of housing subsidies. Unlike social welfare states in Europe, which already had been initiated prior to World War II, Canadian welfare measures were not consolidated until the 1960s. Prior to that period, only unemployment insurance, old age security and family allowances had been introduced. The wartime apparatus which gave the Canadian state extensive involvement in most aspects of the economic sphere was systematically dismantled after 1945 to be replaced by private enterprise. Rent control, price and supply controls and social programs were transferred from the federal government to provincial jurisdictions or ended. Wartime Housing, a major state developer and landlord during the war, was replaced by the Central Mortgage and Housing Corporation, a mortgage bank primarily for financial institutions. The large stock of public housing during and immediately after the war was sold off. (Wade, 1984) The period from 1945 to 1963 saw few changes in the social welfare apparatus. A change of government in 1963 established five years of minority rule. Subsequently, social reform movements combined with economic expansion to create pressure for major amendments to the National Housing Act (1964), along with other social measures.

The 1964 amendments to the National Housing Act (NHA) introduced, for the first time, an effective public housing construction program and a non-profit housing program for the elderly. Between 1949, when public housing was first introduced, and the 1964 NHA, only 12,140 public housing units had been built. In contrast, about 40,000 private sector rental units were subsidized as of 1964. The entire emphasis of Canada's National Housing Act was on increasing access to mortgages for individual home ownership and on subsidizing private sector rental starts. By the mid-1960s, this attempt to leave housing totally within the private sector had failed. However, the social housing programs introduced in 1964 were carefully designed to supplement, not replace, private sector housing activities and subsidies. The new non-market housing programs were designed to be very narrowly targetted and relatively small in scale so as not to compete with the private sector. As a result, the federal and provincial governments began jointly financing non-market housing for certain categories of "worthy poor," generally single parent families on welfare and the elderly. About 170,000 public housing and about 19,000 senior citizen housing units were built under the 1964 NHA. (Dennis and Fish, 1972; Rose, 1980)

The election of a majority Liberal government in 1968, combined with economic prosperity and growing demands for social reform to create major new government initiatives in the seventies. These included regional economic expansion, improved unemployment insurance, and the establishment of the first federal urban affairs department. Another minority government following the 1972 election, with a social democratic third party holding the balance of power, resulted in further improvements to Canada's welfare state including tax reforms, revised family allowances, and major amendments to the National Housing Act (1973). Significantly, the 1973 NHA (approved just before the 1974 recession) introduced public, private and co-operative non-profit housing programs, a rural and native housing program, and a public land banking program for assisted housing. These expanded the potential scope of Canada's non-market housing programs. The targetted group was expanded to include low and moderate income households so as to achieve a broader social mix within housing projects. The co-operative housing program was a major innovation for Canada, allowing the residents to jointly co-own and manage their housing on a non-profit, non-equity basis. Funding for these programs, however, was never very substantial and they have continually been under attack from the housing industry lobby. About 180,000 non-profit and co-operative housing units have been built since 1973. The total size of Canada's non-market housing sector is, nonetheless, still very small. The public housing and non-profit housing programs have resulted in about 380,000 new or rehabilitated units, representing only about 4% of Canada's housing stock. (CMHC, Canadian Housing Statistics, various years)

The years of restraint from 1973 to 1984 were essentially a period of conflict over the spoils of the newly created welfare state. More specifically, they were a struggle over state expenditures to promote private capital accumulation and federal social initiatives. Prior to 1963, the post-war compromise between capital and labour, extracted at a high cost in Europe, required little of the Canadian government than a few transfer programs. From 1963 to 1973, the expansion of federal social programs was a principal factor in the rapid growth of state expenditures. After 1973, pressures to support private capital accumulation again took the ascendancy. The new political ideology stressed that capital accumulation was the basis of society. "For the economy to grow, capital must grow. For capital to grow there must be profits. For profits to be large there must be fewer wage demands, higher productivity, and fewer social welfare programs to drain off profits and capital." (Drover & Moscovitch, 1981, 19) Wage controls, cut-backs in public expenditures, changes in unemployment insurance, the erosion of health insurance, the expansion of the prison system, the promotion of private sector housing, and the stimulation of tax expenditures were all fostered to right the imbalances of the previous decade. Housing was also singled out as a cause for concern.

3.0 HOUSING SUBSIDIES 1973-84: FAVOURING PROFITABILITY

The years following 1973 were the most volatile ever in the history of Canada's housing subsidy programs owing to the highly unfavourable macro-economic conditions already noted, combined with rapid increases in the cost of housing and the failure of the private rental supply sector. Hence, there were dramatic swings in housing expenditures and rapid turnover in the establishment and abandonment of housing subsidies. Virtually all the activity has focused on the private housing market because of pressure from developers to stimulate housing production through tax expenditures. The non-profit and co-operative housing programs, which had been poised for take-off after the 1973 NHA revisions, depended extensively on direct public expenditures. They increased initially, as a result of the new legislation, but social housing expenditures contrary to earlier expectations, continued to comprise a very small portion of Canada's housing subsidies.

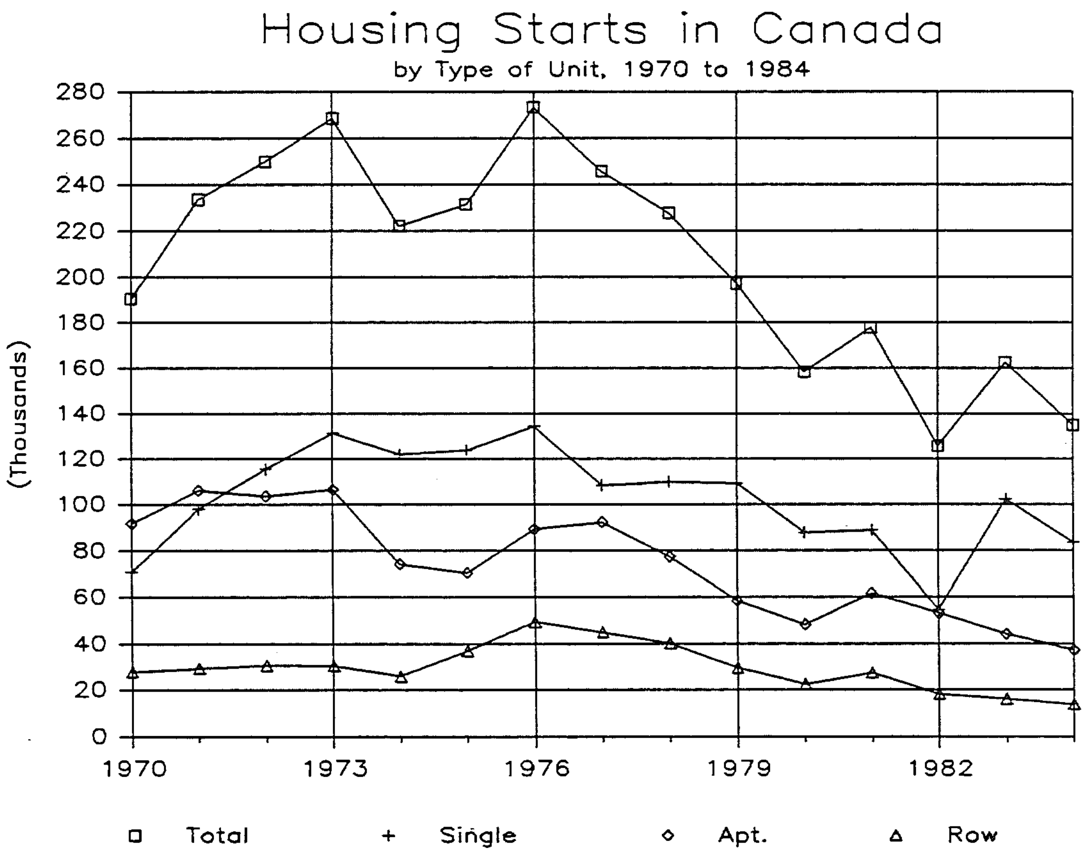
In response to political pressure, and economic necessity, the government introduced a range of subsidies to meet rapid changes in the housing market. Social housing subsidies (non-profit and co-operative) usually involved direct subsidies and loans. The entrepreneurial programs were more variable. In addition to direct subsidies and loans, home ownership and private rental housing was subsidized by tax expenditures, such as the Registered Home Ownership Savings Plan (RHOSP) and the Multiple Unit Residential Building (MURB) program. The RHOSP was continued throughout the period of restraint while the much more expensive MURB program was turned on and off. The MURB program allowed wealthy individuals to shelter income from other sources by investing in apartment projects. The initial attempts by restraint minded finance ministers to discontinue MURB's brought protest from the investment and development lobbies. Direct subsidy programs, such as the Assisted Home Ownership Program (AHOP) and the Assisted Rental Program (ARP), accounted for a smaller portion of these expenditures. Both direct and indirect approaches to stimulating private sector housing investments also spawned additional subsidy initiatives particularly in the dramatic downturn of economic activity after 1981, which shall be discussed later. (Hulchanski and Grieve, 1984) In general, subsidies were modified in response to three policy initiatives during the 1973-84 period: Keynesianism (1973-78); Keynesianism in retreat (1978-1981); and Keynesianism in disguise (1981-1984).

3.1 The Keynesian Response, 1974 to 1978

The period from 1973 to 1978 was a period of dramatic expansion in government housing subsidies. It was a response to the political pressures caused by rapid increases in the cost of housing and to the economic pressures caused by a significant fall in housing starts. Housing starts, both ownership and apartment, dropped dramatically in 1973 when several programs aimed at stimulating housing investment came on stream. (Figure 3) Job maintenance and job creation became important considerations when the unemployment rate began to rise in 1974 and continued to rise each year until levelling off in 1978. In response to the rising inflation rate, wage and price controls were introduced in 1975. The housing sector was dramatically affected by these initial years of economic instability. The rules of the housing investment game, which worked so well during the prosperous 1960s and early 1970s, no longer applied. Canada's largest development corporations, responsible for the 1960s apartment construction boom, had all made the same investment decision by the mid-1970s: to abandon the residential sector. It was no longer as profitable and the risks were much greater. The impact of this decision was mainly felt in the rental sector. The single family housing sector continued to be dominated by smaller builders.

The federal response to this situation was essentially Keynesian,

FIGURE 3



SOURCE: CMHC, Canadian Housing Statistics, various years.

to have government spend its way out on the assumption that the problem was only temporary. Though restraint measures were introduced in most key sectors with the imposition of national wage and price controls, and social expenditures were contained, as noted previously, the federal government could not allow housing starts to fall even further. The middle class was increasingly vocal about house prices and tenants about rising rents and the residential construction firms were increasingly vocal about their survival. In his May 1974 Budget Speech, the Finance Minister made special mention of the impact of inflation on housing and his commitment to introduce new spending programs:

> An important aspect of the recent inflationary experience in Canada has been its impact on the cost of housing and the ability of the average Canadian, particularly young people and people of modest incomes, to meet their housing needs. The government has put into place a number of important programs and measures to ease both the supply and cost aspects of the problem. These measures are reflected in the expansion of the budget of Central Mortgage and Housing Corporation to $1.2 billion per year. (Canada, Department of Finance, 1974a)

A few months later, in another budget speech, the Finance Minister admitted that the "weakness in this sector of our economy troubles me a good deal," because it "threatens to reduce employment, raise production costs and increase housing prices and rents." "Even more important," he continued, "a reduction in the supply of new housing could lead to a lower standard of accommodation than Canadians deserve." (Canada, Department of Finance, 1974c) A quick response, therefore, was necessary for reasons of legitimation and accumulation. As a result, an unprecedented range of federal housing activity was initiated, expanding existing programs and introducing several new home ownership and rental supply programs. Virtually all the new expenditures were directed to the private housing market. On the other hand, the government had no intention of expanding its role in social housing. It was seeking a temporary "quick fix" for the slump in private housing investment.

For the ownership sector, the Assisted Home Ownership Program was expanded and the Registered Home Ownership Savings Program (RHOSP) was introduced "in order to assist young people in accumulating the capital required for a down payment on a house" and as a means of providing "an important new source of mortgage funds to finance the construction of the new housing we require." (Canada, Department of Finance 1974c, 18) For the private rental sector the Assisted Rental Program was initiated and the Multiple Unit Residential Building (MURB) tax provision introduced, creating a tax shelter for wealthy investors by permitting capital allowances on new rental projects to be written off against other income. In addition, because of tenant concerns over rising rents and as part of wage and price controls, all provinces adopted rent controls by 1976. No new social housing programs were introduced and funding levels for the 1973 NHA's non-profit and co-operative housing programs remained very low. The changing macro-economic conditions brought about by the 1973 recession focused federal housing activity solely on the private housing market. The problem was, according to the Minister of Finance, "the decline in new housing starts - especially in rental housing, where construction was curtailed by the increasing squeeze of costs against real income." (Canada, Department of Finance 1974c, 5)

This action by the federal government did have its impact on housing expenditures and housing starts. Housing expenditures increased sharply. As Table 3 indicates, total CMHC expenditures, which includes all the federal government's direct housing subsidies and loans, increased from \$1 billion in 1973 to \$1.85 billion in 1975. CMHC expenditures remained close to the \$2.0 billion level until 1978. Not included in CMHC's budget are the housing subsidies provided through the tax system. RHOSP and MURB, for example, cost the federal government an average of \$60 million and \$110 million annually during this period. (Dowler, 1983)

It is important to note that these annual federal housing expenditure

TABLE 3

CMHC Social Housing and Market Housing Expenditures,

1973-1984

(millions of Canadian dollars)

	Total CMHC Expenditures	Total Social Housing	Social Housing as a % of Total CMHC Expenditures	Total Market Housing	Market Housing as a % of Total CMHC Expenditures
1973	1,062.6	477.8	45.0%	175.8	16.5%
1974	1,339.9	498.9	37.2%	484.2	36.1%
1975	1,846.0	937.5	50.8%	526.2	28.5%
1976	1,907.9	930.1	48.7%	351.1	18.4%
1977	1,889.8	678.4	35.9%	511.3	27.1%
1978	1,879.3	696.8	37.1%	276.2	14.7%
1979	1,190.3	458.2	38.5%	113.7	9.6%
1980	1,323.6	476.8	36.0%	82.1	6.2%
1981	1,333.2	557.9	41.8%	101.1	7.6%
1982	2,214.4	747.7	33.8%	885.8	40.0%
1983	2,767.8	920.8	33.3%	1,029.4	37.2%
1984	2,140.1	1,107.3	51.7%	178.2	8.3%
Total	20,894.9	8,488.2	40.6%	4,715.1	22.6%
Annual Avg.	1,741.2	707.4	40.6%	392.9	22.6%

SOURCE: CMHC, 1982, 1984.

levels do not reflect total new spending commitments. Many housing programs were structured in such a way so as to pass the costs onto future budgets. The stream of subsidies was dispensed over a number of years and federal accounting methods did not provide an estimate of the total being committed in each year. The Assisted Rental Program, for example, subsidized 122,600 units between 1975 and 1978 but cost CMHC only $31.7 million in those four years. From 1979 to 1984, however, another $184.2 million in ARP subsidies were paid out by CMHC. (CMHC, 1984) This type of subsidy will continue for many years. Furthermore, rental investors were permitted to stack the ARP subsidy with the MURB tax incentive. The MURB subsidy is also dispersed over a number of years, with only a small portion of the cost of the program delivered in the year the project was built.

The Keynesian response did have an impact on housing starts. As Figure 3 indicates, both single family and apartment starts increased in 1976 though they began to fall thereafter. There would have been no increase and the fall would have been much more dramatic if government had not intervened. Most purchasers of new single family houses received one or more forms of subsidies. Virtually all the rental starts after 1974 were subsidized, only a minority of these subsidized starts were in the non-market social housing sector. The majority of the rental subsidies were investment incentives to private developers. This helped maintain the fiction that there was indeed a viable private rental sector. This rental sector, however, was no longer responding to supply and demand signals in the marketplace. It was responding to the very lucrative government subsidy programs. Government was, in effect, bribing private rental investors. If the bribe offered was substantial enough, rental investment would take place. Once the Assisted Rental Program ended in 1978, apartment starts slumped to the lowest levels in 20 years in spite of tremendous demand and even though a major private rental tax subsidy program continued to exist (MURB's). Vacancy rates across the country were at their lowest levels in the post war period. With a growing federal deficit and the growing realization among policy makers that the slump was not a temporary aberration, the Keynesian response was abandoned and restraint, or at least the appearance of restraint, was introduced.

3.2 Keynesianism in Retreat, 1978 to 1981

The second period, represents an attempt by the federal government to further restrain its spending. The need for restraint in the growth of government expenditures was discussed in the March 1977 budget and became a major theme thereafter. In terms of total housing expenditures, however, the restraint was limited and largely cosmetic. The reason for this was the relatively small size of housing expenditures. Though direct housing expenditures and the indirect housing related tax expenditures had increased significantly since 1983, housing still comprised one of the relatively small categories of government spending. Because of this and because of the continuing need to play a role in both legitimation and accumulation with respect to housing, the impact of federal restraint on housing was both small and temporary.

By examining CMHC's budget, it would appear that significant cuts were made in housing programs because the total budget fell to $1.2 billion from $1.9 billion the year before, a 37% decrease in just one year. A number of programs were indeed cut, but they only accounted for part of the decline in CMHC's budget. In 1978, as part of its restraint program, the federal government also decided to minimize its direct mortgage lending activity. Prior to that, the social housing programs, as well as some of the market housing programs, had been receiving full or partial mortgages directly from CMHC. After 1978, a new formula required these programs to obtain their mortgages from private lenders, thereby permitting the government's role in direct lending to decline while increasing the role of the private sector - a major objective of restraint.

This shift from government to private lending accounted for a great deal of the "decline" in CMHC expenditures between 1979 and 1981. (See Table 3) But the decline was partly illusory. It allowed for the appearance that federal spending as well as the government's role in the housing sector was being cut in response to restraint measures when in fact it simply passed on even greater costs to future budgets. Because the government borrows money at a better interest rate than is obtainable by social housing agencies in the private mortgage market, the subsidies provided to social housing had to be increased to cover the difference. These additional subsidies, however, did not benefit low and moderate income groups since they were used to pay the additional costs involved in using private mortgage lenders. Financial institutions became the primary beneficiary of this budgetary manoeuvre.

Another way in which the impact of restraint on housing was more illusion than fact relates to the proportionate increase of housing related tax expenditures. The RHOSP was maintained and MURB, though discontinued for a year, was also reintroduced. It was Finance Minister Allen MacEachen who reintroduced MURBs in 1980 to "reduce shortages of rental accommodation and provide a needed stimulus for the construction industry." (Canada, Department of Finance, 1980, 104) The irony of this reintroduction of MURB tax incentives was that it was announced in the October 1980 budget in which the Finance Minister launched an attack on tax expenditures. He noted that tax expenditures can be very inefficient and expensive and "tend to pyramid with the result that a number of profitable corporations or wealthy individuals pay little or no tax." (Canada, Department of Finance, 1980) Yet, because of the continuing failure of the private rental sector to supply units on a non-subsidized basis, the government gave in to the tremendous pressure from the housing industry and the tax shelter investment industry and reintroduced the lucrative MURB tax incentives. By maintaining RHOSP and MURB, future middle class home owners and wealthy individuals in the 50% tax bracket retained their respective housing investment subsidies in spite of restraint. Since these did not show up in the federal budget they were easier to retain than the direct spending programs. The federal government thereby benefited politically by maintaining these programs and it assisted private accumulation in both the troubled ownership and rental sectors. RHOSP helped address the high cost of becoming a home owner and MURB addressed the lack of profitability in the private rental sector.

The housing measures introduced during this second period were totally in keeping with the growing neo-conservative approach to government budgets which was emerging under the Liberal government at the time. Measures were taken to reduce the growth in the size of direct expenditures and to increase the reliance on the private sector wherever possible. This political agenda, combined with the unstable macro-economic conditions, had its impact on the housing policy making process within CMHC. By the late 1970s, the national office of CMHC became a virtual lobby organization for the housing industry. The perennial struggle within the CMHC bureaucracy between the social housing people and the market oriented people was won by the advocates of the private market. CMHC's research activity and policy advocacy shifted to the promotion of measures aimed at promoting and assisting the "efficient" private housing supply sector and at attacking non-profit and co-operative housing programs as being "inefficient and poorly targetted."

By 1980, both CMHC and the housing industry lobby began advocating the replacement of social housing programs with a national shelter allowance scheme. In March 1981, the Federal Minister responsible for housing announced the time had come to "seriously consider the idea of a housing allowance" and at its 1982 annual meeting, the Canadian Home

Builders Association adopted a resolution urging "that the current Federal non-profit and co-operative housing programs be discontinued" and replaced by a shelter allowance. (Hulchanski, 1983; Clayton, 1984; Steele, 1985) Shelter allowances were favoured because they provided low income households a monthly check to help them obtain housing from the private sector, rather than rely on government social housing supply programs. The private commodity nature of the rental stock would thereby be maintained. The debate was no longer one of whether or not there would be large scale housing subsidy programs. The debate had become one of whether the housing subsidies would be provided on a market or non-market basis.

By the early 1980s the housing debate in Canada, which was generally phrased in terms of improving efficiency of government subsidies by targetting programs only at the "truly needy," became a surface manifestation of a much deeper clash, best characterized as the "market-welfare" and "social-welfare" housing options. Due to the inability of the private housing sector to supply moderate cost housing without substantial subsidies to investors, the fundamental policy issue was whether public funds should be used to maintain the private housing supply sector, the commodity form of housing, or whether government should improve and expand its non-market social housing supply programs. The series of ad hoc programs during the 1973-1978 period were largely based on the assumption that the problem was temporary and that the "market-welfare" programs would be temporary. When some of the key programs were withdrawn in 1978, however, housing supply slipped into further decline and prices in the existing stock dramatically increased. After a few years, it was more than apparent that something had to be done, and pressure was placed on the government to introduce new subsidy programs.

3.3 Keynesianism in Disguise, 1982 to 1984

The attempt to minimize housing expenditures did not last very long. Mortgage interest rates began to rise dramatically, moving from 11% in late 1979, to a peak of 21% in August and September of 1981, and levelling off in the 12% to 13% range during 1983. (CMHC, 1983, 65) A housing crisis of major proportions was created by the addition of these highest ever mortgage interest rates to the already troubled housing sector. In addition to the low vacancy rates, the lack of unsubsidized private rental construction, and the high cost of single family housing, many home owners were facing foreclosure when they renewed their mortgages. All the ownership subsidy programs of the previous eight years were aimed at inducing moderate income tenants to become home owners. The normal mortgage at that time was for a five year period. The five years came due when interest rates were at their highest in the early 1980s. Many simply could not afford to carry the new, much higher monthly cost of the mortgage.

The mortgage crisis became a political crisis for the government at a time when the ruling Liberals were already highly unpopular. Middle class home owners began forming organizations to resist foreclosure and to lobby for reductions in interest rates. The housing industry also became a very active lobby due to the impact of interest rates on housing starts. In spite of its restraint program, new housing initiatives were announced in both the November 1981 and the June 1982 federal budgets.

In the November 1981 budget, the Finance Minister stated that he was "greatly concerned over the distress of homeowners having to renew their mortgages at higher interest rates, and over the shortage of rental accommodation." (Canada, Department of Finance, 1981a, 5) For homeowners he announced the Canada Mortgage Renewal Plan (CMRP) and for rental investors he announced the Canada Rental Supply Program (CRSP). CMRP allowed homeowners to defer part of the higher interest rates. "The government is prepared to guarantee the interest deferred, within limits," the Minister announced, "when mortgage payments exceed 30% of gross income." (Canada, Department of Finance, 1981a, 5) CRSP was a revival of the Assisted Rental Program, under a different funding formula. "In order to encourage the construction of rental housing," announced the Minister, "the government will provide interest-free loans of up to $7,500 per unit for 15,000 units allocated to tight markets across Canada." (Canada, Department of Finance, 1981a, 5) After the housing industry argued that $7,500 was not enough, this limit was removed, resulting in interest-free loans of $12,000 to $15,000 per unit. Only seven months later another federal budget was announced with even more housing subsidies.

In a period when Keynesian fiscal policy was supposed to have been discarded, the federal government went on a spending spree. A new program, the Canada Home Ownership Stimulation Plan (CHOSP), gave $3,000 grants to all purchasers of new housing and to first-time home buyers who purchased an existing house. Spending on the Canada Home Renovation Plan was doubled as were the number of units subsidized by the Canada Mortgage Renewal Plan which was expanded to include a larger number of households. Funding for 2,500 more social housing units was also provided. This was the first time since the 1973 introduction of the social housing programs that the federal budget made a special additional allocation to non-market housing. Each of these program categories was justified on the basis of job creation. For example, the increased social housing allocation, according to the Minister, would "generate an additional 4,500 jobs, largely in 1983." (Canada, Department of Finance, 1982, 21) The doubling of CRSP would result in an estimated 54,000 new jobs and the doubling of the Home Renovation Plan would produce about 10,000 new jobs. Similar home ownership initiatives were reintroduced in the 1983 and 1984 budgets with the latter adding a mortgage rate protection plan.

In short, the problem was deeper than just housing. In a fashion similar to the previous thirty years, government used spending on the housing sector in a counter cyclical fashion even though the economic circumstances were totally different from the 1950s and 1960s. A Keynesian policy was being implemented in a non-Keynesian period. The housing programs resulting from the recession of 1973 mainly addressed the failure of private housing supply. Though the housing sector still faced the same problems, broader economic and political dynamics ten years later led to the use of the housing sector for its job creation potential. None of the new housing programs represented an attempt to stabilize or improve the operation of the housing market, in fact they resulted in the opposite. Nor were they designed to help the housing situation of low and moderate income Canadians. They were simply an immediate response to an immediate economic and political crisis. The sectors with the most political clout gained the most. Middle class home owners and real estate investors were the primary beneficiaries. Some 250,000 home owners received the $3,000 CHOSP grants and rental investors received CRSP subsidies for construction of 33,000 rental units in addition to the on-going MURB tax incentive which was subsidizing about 20,000 rental units per year. In comparison, there was only an additional allocation of 2,500 social housing units.

4.0 IMPACT: POLARIZATION BY TENURE AND REGRESSIVE DISTRIBUTION OF SUBSIDIES

One impact of housing subsidies during a period of restraint was the polarization of households by tenure. In addition, the system of housing subsidies and incentives has been one of the more regressive categories of social expenditure in Canada in terms of assistance to lower income individuals. Expenditures on social housing programs, in particular, have been one of the smaller spending items in the system of direct and indirect housing subsidies. Larger benefits to middle and high income Canadians have been extended through housing related tax expenditures. The $125 million annual cost of RHOSP, for example, has been available only to those who could afford to defer expenditures of $1,000 a year. The MURB program, in similar fashion, led to over $1.5 billion in foregone revenue in eight of the past eleven years. MURB, like RHOSP, benefited higher income groups.

Table 4, from the Department of Finance, provides a summary of who benefited from housing related tax expenditures. In his 1984 report to the House of Commons, Auditor General Kenneth Dye referred to the "massive impact" of tax expenditures which were "a huge hidden budget in the financial affairs of Canada." (Canada, Auditor General, 1984, Section 1, 23) For every $100 spent directly, Dye estimated $30 to $50 was spent indirectly by way of tax expenditures. Tax expenditures in general, and housing tax expenditures in particular, mainly benefit the highest income households. As the figures in Table 4 from the 1979 Department of Finance tax expenditures accounts indicate, the greater one's income, the greater the housing tax expenditure benefits received. (Canada, Department of Finance, 1981b)

Unfortunately we were not able to provide recent estimates of tax expenditures because the Canadian government has refused to compile and publish up-dated tax expenditure accounts. Moreover, it is not only the regressive nature of housing tax expenditures which is at issue, but their size relative to direct housing expenditures. Housing tax expenditures are two to three times greater than direct spending programs on housing. In most other budgetary categories, the relationship between the two types of spending is just the opposite - tax expenditures are less, between 30% and 50% according to the Auditor General, than the direct expenditures. This means that in housing, for every $100 in direct total expenditures, some $200 to $300 is spent in tax expenditures.

Another indicator of the distributional impact of housing subsidy programs was obtained by examining trends in the distribution of home

TABLE 4

Average Dollar Benefits Per Tax Filer

From Federal Housing Tax Expenditures, 1979

Total Income Group	Average $ Benefit from Housing Tax Expenditures
Under $ 5,000	$ 32
5,000 - 10,000	171
10,000 - 15,000	314
15,000 - 20,000	619
20,000 - 25,000	964
25,000 - 30,000	1,312
30,000 - 50,000	1,994
50,000 -100,000	3,670
$100,000 & over	6,753

SOURCE: Canada, Department of Finance, 1981b.

ownership among income groups. Table 5 demonstrates that there were gains among the top two quintiles and declines in the bottom two. The percentage of households owning their own units remained virtually the same during the period (an overall change of 0.6% more home owners). What was dramatic was the change in who were home owners. During a period in which a great deal of direct and indirect subsidies were provided to the ownership sector and to first time home buyers, households in the highest two income quintiles made substantial gains in home ownership rates (up to 10% each) whereas the households in the two lowest quintiles increasingly became tenants. The middle quintile household remained about the same, with a small increase of 4% in the rate of home ownership during the entire period since 1967. Since 1973, however, the home ownership rate of the second quintile also declined, from 53.3% to 52.4%. In short, fewer households in the lower 60% of the income range are home owners today than they were back in 1967. The temporary programs introduced since that time have not, it would appear, been able to out pace the tide of rising house prices and mortgage interest rates. This trend of course, was not due solely to the regressive nature of housing program subsidies. Macro-economic trends continued to work against lower income households. The 1967 data are included to allow for comparison after the onslaught of recession in the mid-seventies.

The increasing rates of home ownership among the upper income groups also indicates an equally significant and very troubling trend for the rental housing sector. The rental sector was becoming an increasingly residual one, containing virtually all lower income Canadians and very few higher income Canadians. This had not always been the case. Table 6 indicates that as recently as 1967 the tenant population was divided almost equally between each of the income quintiles. The only exception was the highest quintile. By 1982, however, the number of higher income tenants (tenants with incomes in the fourth and fifth quintiles) declined while the number of lower income tenants (tenants with incomes in the

TABLE 5

Changes in Home Ownership Rates Within and Between Income Quintiles

1967, 1973, 1977, 1981

	% of Households Owning Their Unit				Change
	1967	1973	1977	1981	1967-1981
Lowest Quintile	62.0 %	50.0 %	47.4 %	43.0 %	- 19 %
Second Quintile	55.5	53.6	53.3	52.4	- 3 %
Middle Quintile	58.6	57.5	63.2	62.7	+ 4 %
Fourth Quintile	64.2	69.8	73.2	75.0	+ 11 %
Highest Quintile	73.4	81.2	82.3	83.5	+ 10 %
Total	62.7	62.4	63.9	63.3	+ 0.6 %

SOURCE: Statistics Canada, 1983.

TABLE 6

Renter Households by Income Quintile

Canada, 1967, 1973, 1977, 1981

Income Quintile	1967	1973	1977	1981	Change 1967-1981
Lowest Quintile	20.4	26.6	29.1	31.1	+10.7
Second Quintile	23.9	24.7	25.9	26.0	+ 2.1
Middle Quintile	22.2	22.6	20.4	20.3	- 1.9
Fourth Quintile	19.2	16.1	14.8	13.6	- 5.6
Highest Quintile	14.3	10.0	9.8	9.0	- 5.3
Total	100.0	100.0	100.0	100.0	

SOURCE: Statistics Canada, 1983.

first and second quintiles) increased, both by significant amounts for such a short period of time. This means that those households able to take advantage of the home ownership option did so leaving virtually all those who had no choice in the rental sector. In general, then, the private sector programs were supply incentives without providing direct benefits to lower income households. By contrast about 80% of the residents in non-profit and co-operative housing projects were low and moderate income households. Nevertheless, through the period of restraint, the private sector subsidies were much larger than the non-profit and co-operative subsidies. The MURB tax benefits were especially costly.

More analysis needs to be done on the effectiveness of these past programs. The federal government, in the period since 1973, appeared to have taken the easy way out by assuming that housing problems were temporary and that minor, temporary programs would help improve the situation. This was much easier than attempting to develop a longer term policy framework. It also appears that these programs did not really address the affordability problem. Only the small-scale non-profit and co-operative housing programs contributed to increasing the stock of affordable housing. The units subsidized by ARP, MURB, CRSP, AHOP and the CHOSP were subject to inflation in the speculative real estate markets in which they were located.

As for the immediate future, there appears to be a relatively clean slate. Most of the housing programs introduced by federal budgets since 1973 had been discontinued by mid 1984. The election of a Conservative government in September 1984 has resulted in the elimination of even more housing programs and significant budget cuts in others. In the new government's November 1984 "economic statement" spending on the social housing and housing rehabilitation programs was cut significantly and the last phase of the private rental supply program (CRSP) was cut entirely.

(Canada, Department of Finance 1984c) In its May 1985 Budget the Conservative government eliminated one home ownership tax expenditure program, the Registered Home Owner Savings Plan. However, the Budget provided individuals with an exemption from capital gains taxes to a lifetime maximum of $500,000. This is in addition to the already existing exemption of capital gains taxes on the sale of the primary residence. Though the intent is to stimulate new job creating investment, no distinction was made between capital gains accumulated from past investments versus new investments. One result may be that long term owners of the existing rental stock will begin cashing in on their buildings and for wealthy individuals to begin buying second and third houses as speculative investments. The new capital gain exemption, therefore, is likely to have serious ramifications on the affordability of both rental and ownership housing in Canada.

It appears, therefore, that a period of rather severe restraint on government housing expenditures began in 1984. This restraint is not only due to the market housing orientation of the new government, but also, and probably mainly, due to the relatively low and stable mortgage interest rates. Whether, however, the new government pursues the same line of policy as its Liberal predecessors remains to be seen. A sharp drop in housing starts or an increase in interest rates causing housing costs and rents to jump suddenly will likely force the new government to behave very much like its predecessor. The economic impact and political consequences of doing otherwise is simply too high. The alternative, planning and implementing a comprehensive national housing policy and a set of coordinated national programs based on the lessons of the past is not yet on the new government's agenda. In fact, as explained earlier, many of the key variables - interest rates, unemployment levels, changes in real income - are largely determined south of the border. Canada needs to first confront this much larger problem before more independent housing policy initiatives can be undertaken. For the foreseeable future, it appears that the inequities of the current housing expenditure system will continue, that Canadians will continue to be even further polarized by tenure based on their income and that Canada's rental sector will increasingly become a residual one, the domain of the bottom forty or fifty per cent of the income scale.

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