



## Using Path Dependence Theory to Explain Housing Regime Change: The Traps of Super-Homeownership

Martin Lux (corresponding author)

Institute of Sociology of the Czech Academy of Sciences, Prague, Czech Republic  
Faculty of Arts, Palacký University Olomouc, Czech Republic  
[martin.lux@soc.cas.cz](mailto:martin.lux@soc.cas.cz)

Petr Sunega

Institute of Sociology of the Czech Academy of Sciences, Prague, Czech Republic  
[petr.sunega@soc.cas.cz](mailto:petr.sunega@soc.cas.cz)

**Abstract:** *The goal of this paper is to demonstrate the usefulness of path dependence theory to explain the convergence of housing regimes among post-socialist countries, both at the beginning and in the later phases of housing-regime transformation. We especially seek to show the selected common traps that were recently created by the legacy of giveaway privatisation and the super-homeownership regime, traps that increase intergenerational inequality, which to now has been effectively mitigated by within-family financial transfers.*

**Keywords:** housing regime; path-dependence; home-ownership; post-socialist.



## Introduction

In the so-called transition countries, housing policies and institutions changed radically after 1990. The CEE region became a natural laboratory of housing-regime change. In this paper, we discuss selected findings from our decades of research on housing-regime change in reference to path dependence theory. We define its different strands and show that each of them is relevant in a different period of institutional transformation. We use path dependence to explain the traps and boundaries that people in the region face today.

Referring to the findings from our research, we show how the giveaway privatisation of public housing and the establishment of a super-homeownership regime significantly constrained alternative housing-regime trends, and how these traps and boundaries created ‘insider-outsider’ (also intergenerational) tensions. Finally, we argue that this tension has until now been effectively mitigated by growing intergenerational within-family financial and wealth transfers. When these transfers are interrupted, these tensions may lead to conflict and a public demand for a change in the housing regime. Any deviation from the traps, norms and limits of the super-homeownership regime is thus probably conditional upon some future change in the provision of financial transfers by parents towards helping their adult children to acquire their own housing.

## A brief overview of previous research

After 1990 the political, social, and economic systems of the post-socialist states underwent profound reform; this is the process that we are accustomed to calling ‘transition’. Bruszt and Stark (1998), however, instead favour the term ‘transformation’, which more aptly captures the effort to *innovate* old institutions in a new economic environment and stresses the importance of *path dependence*, the significance of historical social norms and specific institutional patterns that lead to divergent directions of policy and regime development among countries.

Path dependence(y) assumes that any action or policy decision is limited by past decisions and experience and is thus embedded into a unique normative, value, traditional, and institutional context. Consequently, it assumes that a particular goal can be fulfilled by means of different approaches, and, similarly, one and the same policy may have different outcomes in different contexts. When applied to the housing transformation in CEE countries, this theoretical framing can successfully explain, for example:

- (1) why rent deregulation was passed quickly in Hungary (where the government passed general right-to-buy legislation and refused to make any property restitution), while, by contrast, conservative rent controls were maintained for a long time in the Czech Republic (where right-to-buy legislation was not passed and the scale of housing property restitution was the highest among the post-socialist states) (Lux (ed.) 2003);
- (2) why the scale of housing property restitution was greater in the Czech Republic, Poland, and East Germany (where there was no pre-1989 sale of public housing and the government plans for a giveaway sale to public tenants were modest) than in Hungary, Slovenia, or Estonia, where giveaway privatisation started very early and the plans for privatisation were more extensive (Lux et al. 2017);



- (3) why the housing market in Hungary (where there was limited tenure choice, and relatively high rate of inflation before 2007 made FX-loans popular) was much more significantly affected by GFC than the housing market in the Czech Republic, where tenure choice was less constrained, inflation was lower, and FX-loans were marginal (Hegedüs et al. 2011).

## Path dependence – a useful or tautological theoretical frame?

In contrast to the common view that in the discussion about the convergence or divergence of housing regimes path dependence theory tends more to highlight signs of divergence (Kleinman 1996), we will show that the path dependence concept can be viewed as pointing to trends of both convergence and divergence. Secondly, we will show that path dependence is also a good tool for providing a better understanding of radical regime changes, such as the move away from communism towards democracy. Thus, path dependence may serve as a suitable theoretical framing with which to explain both regimes' convergence and divergence and to shed light on both gradual institutional development and radical institutional change.

However, it may then be perceived as a theoretical frame that is too broad, tautological and not very illuminating; it may lead to the accusation that we can hide any explanation under the umbrella of the argument that 'history matters'. In this paper we want to demonstrate that if path dependence theory is appropriately conceptualised and applied, it can retain its broad scope and be very useful in uncovering the different traps and limits during the development of housing regimes in post-socialist countries after 1990.

In general, we can distinguish two types of path dependence according to the fact of whether we are analysing gradual or sudden regime change. In the first case, existing (and previous) formal and informal institutions limit the possible directions that a future path can take, while in the second case it is the past way of thinking among people (or their past patterns of problem-solving) that limit future possibilities. In each category, we can also distinguish two intensities: deterministic (strong) or open-ended (weak) path dependence. In the case of the gradual development of a regime (such as what exists in Western countries), we talk especially about the *inertia of institutions* and may see two theoretical ideal types of path dependence:

- *institutional open-ended (weak) type* – this means that if we go one way, we cannot easily change direction, because the specific institutions are already in place and they prevent trends from changing (this may also be referred to as being 'locked-in by the system' or 'path dependence in evolution');
- *institutional deterministic (strong) type* – this means that if we go one way, there are only a few (or one) possible ways in which we can go in the future (this may be also referred to as being 'locked-in by progress' or 'path dependence in progress').

In the case of radical regime change (such as what occurred after 1990 in CEE countries), we talk especially about *inertia in the way of thinking* (as old institutions no longer exist), and again we may see two theoretical ideal types of path dependence:

- *conceptual open-ended (weak) type* – this means that people continue to rely on their past life experience and strive to stick to past patterns of problem-solving; and



politicians, facing information asymmetry and uncertainty (while knowing that, in an extreme case, their failure may lead to a counter-change), partially maintain these conservative sentiments and suspend selected reforms (this may also be referred to as being ‘locked-in by experience’ or ‘path dependence in reforms’);

- *conceptual/ideological deterministic (strong) type* – this means that ideology is the means by which the selfish interests of the social classes are asserted; people will necessarily follow the specific interest of their social class (strata) and advocate for a system based on this interest (this may also be referred to as being ‘locked-in by economic interest’ or ‘path dependence in revolution’).

The strong subtypes of path dependence lost much of their relevance and creditability a few decades ago, especially when confronted with the many victims of communism and Nazism, whose ideologies were based on deterministic evolutionism and historicism. Therefore, we will only work with the weak subtypes of path dependence and apply them to housing-regime change after 1990 in CEE countries. In the first period of transformation (radical system change), it was the conceptual form of path dependence that played the primary role, while later, when new institutions had been established, the institutional form of path dependence gradually became more important (gradual system change). This typology of forms of path dependence, combined with the appropriate application of each form to a specific period in the course of housing-regime change (radical or gradual), is a viable theoretical extension of this theory.

## **Conceptual path dependence and the convergence of regimes towards super-homeownership**

As well as extending path dependence theory to apply to radical regime change, our second argument is that we can use both the conceptual and the institutional form of path dependence to explain also the convergence of regimes, i.e. not just the divergences briefly outlined in the Introduction. In this section of the paper, we apply a conceptual type of path dependence to radical regime change (an earlier phase of housing transformation) and show that governments (central or local) in all the post-socialist countries deliberately used the giveaway privatisation of public housing as a shock absorber. In the next section, we apply the institutional form of path dependence to gradual regime change (a later phase of housing transformation) in CEE countries in order to reveal the main common traps created by the legacy of this housing privatisation and the institution of super-homeownership.

In the early 1990s, with several exceptions, such as Poland and the Czech Republic, CEE governments opted to follow a strategy involving the quick and mass sale of existing public housing to sitting tenants at very advantageous prices and under favourable payment terms (or even handed it over for free in some countries, like Estonia, Lithuania, Russia, Moldavia, Romania, Albania, and others). In Poland and the Czech Republic right-to-buy legislation was not passed and public housing privatisation was left to the municipalities as an option (Lowe, Tsenkova (eds.) 2003), but these states decided to keep the original pre-1989 type of non-targeted centrally directed rent control in both municipal and restituted private rental housing (while also retaining most of the pre-1989 tenure protections) and to allow only small and very gradual rent increases.



Rent regulation, like the massive sale of public housing, distributed a hidden economic subsidy, computed as the difference between the market and actual price/rent; this hidden economic subsidy was by far the biggest housing subsidy in all the CEE countries in the 1990s and thus represents the clear first sign of the convergence of regimes. Municipalities in Poland and the Czech Republic, though not obliged to sell their newly acquired housing, were unable to introduce any way of managing this housing stock that could save them from subsidising it. Later, they saw the sale of public housing to tenants as a good way of getting rid of this gift. In the end, in all post-socialist states, sooner or later, the stock of public housing dramatically decreased, and homeownership became the supra-dominant form of housing tenure. This is the second clear sign of convergence among CEE housing regimes and, similarly, an outcome of the distribution of extensive economic subsidies in 1990s.

There is a vast body of literature that has tried to explain why governments pursue these policies, instead of introducing real market-oriented housing reform, such as rent deregulation and the market sale of public housing to tenants or third parties. Scholars have employed multiple theories, the best overview of which is provided by Hegedüs (2013) and the conceptualisation offered by Stephens et al. (2015). However, the most relevant explanation probably lies in conceptual path dependence (Struyk 1996; Lux et al. 2014): the purpose of allocating huge economic subsidies was to help households absorb the shocks caused by the other economic reforms and to promote some sense of security during the otherwise uncertain period of system transformation.

Housing became a sphere in which governments conceptually re-confirmed the ‘old privileges’ that tenants of public housing had obtained under the previous regime. It is well-known that public renting in socialism was much closer to homeownership tenure than it was in the West: tenants obtained unlimited and very secure occupancy rights through the possession of a ‘deed’ to the flat (that could be passed on and inherited and could be exchanged with other tenants) and paid very low rent – later, these specific tenure attributes led to public renting under socialism being labelled ‘quasi-homeownership’. In other words, tenants mentally perceived occupied rental flats as their own property and behaved according to that assumption; and governments did not want to break this deeply rooted way of thinking. Specifically, in the early 1990s, central governments were reluctant to surrender control over the main levers that decisively influence the form of housing system. Despite claims about decentralising, central governments preserved the housing privileges of the existing occupants of public housing that they obtained during communism – either by selling them flats at ‘giveaway’ prices (i.e. shifting quasi-homeownership into homeownership) or by keeping their rents low and retaining conservative tenant protections.

Finally, these interventions left those without housing (especially young households) outside the scope of any effective governmental assistance: the old system of public housing construction was abolished and the new market system only evolved gradually – and even if it had already evolved, newcomers necessarily had to pay several times more for their housing than previous housing occupants. These state interventions thus gave rise to significant ‘insider-outsider tensions’, where existing owners and sitting tenants enjoy legislative privileges and low housing costs, while ‘outsiders’ were excluded from these privileges and faced either access difficulties or very high housing costs. Both regime change (moving towards the predominance of outright homeownership) and stratification implications (the insider-outsider inequality this structural change produced) are outcomes of conceptual path dependence and are also clear



signs of the convergence of the post-socialist regimes because they were observed across all post-socialist states.

## Institutional path dependence and the convergence of regimes in the traps of super-homeownership

Later, the institutional rather than the conceptual type of path dependence became more relevant for explaining further housing transformations. This does not mean that ideology ceases to be relevant, but when new formal and informal institutions are in place and regime change is more or less over, the impact of institutions on the behaviour of all the actors in a society becomes stronger. The main housing institution we want to focus on in this paper is the restricted tenure choice that results from super-homeownership, i.e. the legacy of giveaway privatisation. The housing system has come to be dominated by one form of housing tenure and this has created important traps and barriers to alternative developments.

## Housing wealth inequality and the trap of low-equity homeownership

In one of our previous studies we found – though only in the case of the Czech Republic – that giveaway privatisation significantly changed the nature of housing inequality. Although it was not a comparative study, owing to the lack of comparative quantitative data, we think that a very similar situation also occurred in other CEE countries.

In the study of social stratification, it is generally assumed that as wage inequalities increase, so, too, will housing inequalities. The results of housing inequality research presented in Lux et al. (2013) demonstrate that (1) the traditional relationship between housing tenure and social stratification (based on the concept of housing classes) was relatively weak in the post-socialist Czech Republic (logically, in a super-homeownership society most poor families are also homeowners), but (2) the housing inequalities that are traditionally present in tenure differences have been replaced by residential wealth inequalities, i.e. there is a much stronger and significantly increasing association between general social stratification (measured using the ISEI scale) and housing wealth/equity (housing value). In other words, these are residential wealth inequalities that emerged as the main axis of housing and general social inequality. Tenure inequality in the Czech Republic has been transformed into residential wealth inequality, a factor that has been shown to have a very strong link to social stratification. Increasing residential wealth inequality in the Czech Republic was confirmed in our later study (Sunega and Lux 2018).<sup>1</sup> Some Czech households are trapped in low-value homeownership in

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<sup>1</sup> We showed that capital gains realised between 2010 and 2016 by homeowners that fall within the first quintile of income distribution are lower than the capital gains of homeowners that fall within the fifth quintile. Because wealthier households attain bigger capital gains over time from their investment into homeownership than do households with lower incomes, wealth inequalities among homeowners become significantly bigger over time. We also showed that if we were to include all households in the evaluation, i.e. even households living in rental flats, the differences between the poorest and wealthiest households would be even greater: if the capital gain of the lowest-income households (1<sup>st</sup> quintile) was originally equal to 47% of the capital gain of the highest-income households (5<sup>th</sup> quintile), after including tenant households the average capital gain of the lowest-income households would be equal to just 26% of the average capital gain of the highest-income households.



declining regions, where capital gains are uncertain and a future crisis could easily lead to negative equity.<sup>2</sup>

Further, the recent young generation of Czechs is facing sharp decreases in the affordability of owner-occupied housing. This process further intensified the insider-outsider tensions that had already formed in the early transformation years. Stephens et al. (2015) conceptualised this situation for the whole CEE region and have termed it a ‘housing welfare regime by default – in that no conscious decision beyond privatization has been taken – and their distinctive characteristics will remain a peculiar marriage of *state legacy welfare*, very high levels of intergenerational support and (at least in some countries) *anti-state welfare*’ (Stephens et al. 2015: 1230). They focus on the fact that it is outright homeownership that characterises the post-socialist states. ‘With weak markets, the scope for the *household* to become a source of housing welfare (by default) has become more pronounced’ (Stephens et al. 2015: 1230).

## The trap of housing market volatility

In our research on housing markets we found that in societies where homeownership is the dominant housing tenure (and thus substitution between renting and homeownership is significantly constrained), the end of any economic crisis and the ensuing rise in household incomes is necessarily accompanied by shock growth in housing demand ('as all want to become homeowners'), while in societies with a more balanced housing system a similar rise in household incomes will not necessarily translate into a shock increase in the demand for owner-occupied housing. Using the OECD price and wage series we demonstrated that the higher the homeownership rate, the higher the probability that changes in house prices will closely mimic changes in household incomes (Lux et al. 2019). Assuming that the responsiveness of the housing supply is poor, the main implication is that in societies with a high homeownership rate we find higher house-price volatility and thus a bigger chance of price bubbles appearing than in societies with a more balanced housing system (Egert and Mihaljek 2007; Lux, Sunega *in review*).

## The trap of an ineffective and unsustainable social housing policy

Another trap arising from the super-homeownership regime concerns the sustainability and effectiveness of social housing strategies. Based on research in 12 post-socialist countries (Hegedüs et al. 2013), we found that giveaway public housing privatisation, originally intended as a temporary, *ad hoc* public intervention at the beginning of the transition, proved to have strong staying power and had a long-term impact on post-socialist housing policies: it indirectly became one of the barriers to the introduction of a new, sustainable social housing policy. All the social housing strategies we analysed (with the exception of Slovakia) that were applied in CEE countries between 1995 and 2012, regardless of the ideology behind the strategy and regardless of the amount of new social/public housing construction since 1995, proved to be

<sup>2</sup> Similarly, international research has confirmed that in many other (OECD) countries household wealth inequalities are increasing (Niimi & Horioka, 2016; Saez & Zucman, 2016); and it was the spatial differentiation of house price appreciation specifically that caused increasing household wealth inequality (Piketty 2014; Allegre & Timbeau, 2015; Arundel, 2017; Bonnet et al., 2014).



unsustainable in the long term and did not lead to any decisive growth in in the stock of social rental housing.

The main (though not exclusive) cause that we identified was a phenomenon we call the privatisation trap (Lux and Sunega 2014): this means that when social rental housing is built, sooner or later there is a demand for it to be privatised into the hands of its new social/public tenants; or it is transformed in practice into de facto homeownership support. In other words, giveaway privatisation suffers from a much greater degree of inertia than was previously thought ('once you start, you cannot simply say that you stop now'). The consequence of the lack of a sustainable and effective (well-targeted) social housing policy is that there is a growing number of homeless households throughout the region (Féhér and Teller 2016), which further exacerbates insider-outsider tensions in CEE societies.

### **The trap of within-family financial transfers**

We confirmed (Lux et al. 2018) that intergenerational financial transfers are the most important factor in the reproduction of homeownership in the Czech Republic (and probably also in other CEE countries). The provision of a transfer or the lack of one largely determines the housing tenure of Czech young adults. Without transfers, the children of homeowners are significantly less likely to also become homeowners. The amount of transfers has significantly increased among recent parents compared to the previous generation of parents. We found especially that the motive of indirect reciprocity is of growing significance in intergenerational transfer behaviour, i.e. the probability that an adult child will receive a transfer is closely linked to the fact of whether the parents had also received a transfer from their parents in the past. Consequently, intergenerational financial transfers are the main mechanism by which homeownership is transmitted across Czech generations.

### **Discussion**

Although several of the findings presented above from our research are not the outcome of international comparative research (in particular the findings on residential wealth inequality and transfer-giving) because there is a lack of appropriate comparative data, there is a growing body of research that, using mainly qualitative methodology, has reached similar results in a wider range of countries (for example, Druta and Ronald 2017; Soaita 2013). Therefore, we strongly believe that the traps of super-homeownership outlined above are signs of the convergence of CEE housing regimes.

We showed that when appropriately applied, we can use path dependence theory to explain both radical and gradual regime change and also to demonstrate both convergence and divergence trends among regimes. In this paper we focused on the convergence of regimes. Referring to the conceptual form of path dependence, we explained how CEE governments extended common and huge economic subsidies that were intended to maintain the status quo during the earlier years of regime transformation and the ensuing convergence of CEE housing regimes towards homeownership as the dominant tenure. Referring to the institutional form of path dependence, we revealed what are probably some common traps that have been created by this new institutional context of super-homeownership.



Homeownership is associated with many well-known positive outcomes, such as providing people with the desired sense of having a home, security, and freedom, and thus satisfying their preferences. It provides them with household wealth and the possibility to obtain capital gains and it strengthens within-family solidarity through inheritance and financial transfers. In this paper, however, we focused mainly on the traps associated with this that are less commonly mentioned. In a wider societal perspective, housing regimes that are based on the dominance of homeownership replace traditional tenure inequality with housing wealth inequality, while preserving and intensifying tenure inequality especially between the young and old generation (insiders and outsiders). They generate an affordability problem for the young generation and thus create an increasing need for within-family transfers. Consequently, housing wealth becomes to some extent an artificial form of wealth because it is subject to intergenerational solidarity and is not subject to the consumption of the homeowners themselves. Moreover, many homeowners are trapped in low-value homeownership, either due to their property's location or its quality. Super-homeownership regimes are affected by house price volatility and market instability significantly more than balanced housing regimes are, and this makes capital gains uncertain and the financial security offered by homeownership to some extent only a virtual form of security. Finally, we showed that this regime also places political constraints on establishing sustainable and effective policies in the social rental segment; this fact factually decreases choice and freedom among those who are searching for their first housing.

The main convergence aspect that runs through this whole paper concerns the insider-outsider tension between those who are housed and those who want to find proper housing. This tension began in the earlier phases of transformation, when new households were effectively excluded from huge economic subsidies distributed through giveaway privatisation or rent control. Despite the later development of market-based housing finance and the extension of several new subsidies, this tension further intensified as a result of the decreasing affordability of homeownership among the young generation. Despite of increasing housing wealth inequality and strengthening the link between social stratification and housing wealth that has been proved by our research, the main mechanism that kept the insider-outsider tension more latent than open in the political battle is the chain of intergenerational financial transfers from parents to their adult children to help them acquire housing, a phenomenon that intensified after 1990. In a more general way, this is the mechanism that keeps super-homeownership alive. Any future change in intergenerational solidarity may thus significantly alter the future path of housing-regime development in CEE countries.

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