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The strange world of housing finance

By MARK BOLEAT

IT is generally agreed that the housing market in Britain operates in an unfair way but there is no consensus as to which sectors are the most privileged. Partly this reflects the paucity of academic and informed journalistic comment on housing which has allowed politicians to continue making statements which cannot be justified by the facts and to advocate policies which cannot achieve their objectives. Fortunately the position is now improving and the facts are gradually being disentangled from the myths.

The consumers of housing who are most unfairly treated are private tenants who, for the most part, receive no subsidies. Indeed, because of rent restrictions and security of tenure, the supply of privately rented accommodation has been reduced to such an extent that the rent for those dwellings that do come on to the market is often far in excess of that which would obtain in a free market.

The 1974 Rent Act has further worsened the position of those who are unable to obtain council accommodation yet cannot or do not wish to buy a house. This is particularly true of young single people and married couples whose incomes have not yet risen sufficiently to enable them to buy and those whose jobs require them to move at frequent intervals.

It is symptomatic of British society that people ask what building societies and local authorities can do to mitigate the effects of the unnecessary decline in the privately rented sector—when the appropriate remedy is to change those parts of public policy responsible for the problem.

Council tenants are undoubtedly the most privileged consumers of housing. In 1974-75 the average subsidy to council tenants, on an historic cost basis, was £169; in the current financial year the figure is expected to be in excess of £220. The extent of the subsidy varies between areas. In London, council tenants pay less than one-third of the costs of providing their accommodation, in other metropolitan areas the proportion is just under half and in non-metropolitan areas it is slightly more than half.

Within the council sector preferential treatment is also given to those who occupy the larger units of accommodation because little attempt is made to make rents correspond with the quality of the accommodation being provided; thus in May 1973 the average rent for a two-bedroom flat was £3.62 a week while that for a four-bedroom house was little higher, in absolute terms, at £4.35.

There is far less unfairness within the owner-occupation sector—because market forces are allowed to operate more freely. Thus people who choose to live in the capital city are obliged to pay more for their housing; house prices in London are 30 per cent. higher than the national average and more than 70 per cent. higher than, for example, in Yorkshire and Humberside. Similarly, if one wants better housing one has to pay for it! Detached houses cost 60 per cent. more than terraced houses.

subsidies received by council tenants and owner-occupiers. Unfortunately there are considerable conceptual problems in determining the level of subsidy received by owner-occupiers. There are grounds for saying that tax relief on mortgage interest is a subsidy in that such relief is not (although it was until recently) available for interest charges other than for the purchase or improvement of owner-occupied housing. In 1974/75 tax relief on mortgage interest totalled £700 million. As there are 10.3 million owner-occupied dwellings this means an average of £68. The increase in the basic rate of income tax means that the figure is likely to rise to about £88 in the current financial year. These figures compare with the average subsidy to council tenants of £169 in 1974/75 and more than £220 now.

It should be noted that it is not valid to compare the average subsidy on all council houses (i.e. including those no longer being subsidised) with the average subsidy on mortgaged houses (i.e. excluding those owner-occupied houses no longer being subsidised). This is simply not comparing like with like.

True cost of subsidy

Owner-occupiers also benefit through not being obliged to pay capital gains tax. It is difficult to quantify the effect of this because the imposition of the tax would itself affect capital values and also because the tax is illogical in that it is levied on paper, rather than real, capital gains. Contrary to popular belief, house prices have risen by only a few per cent. a year more than the general level of prices, so real capital gains on housing have been small. Also, of course, houses must eventually be replaced.

To an economic theoretician, subsidies should not be measured according to tax relief or historic costs but rather by reference to current market values. Thus the subsidy to council tenants would be equal to the difference between the hypothetical market rent and actual rent.

It should be noted, of course, that market rents would not be the £1,200 a year or so that is often quoted on the basis of the house costing £10,000, interest charges being 12 per cent. a year and so on. Such reasoning is naïve and could be valid only if rents were never increased. John Odling-Smee, the economist at the London School of Economics who has done so much to raise the quality of debate in this matter*, suggests that an appropriate market rent is

equal to 4 per cent. of the current market value of a dwelling. This would suggest an average council rent (including charges for repairs and management) of £600 a year compared with the current £200.

Similarly the subsidy to owner-occupiers could be said to be equal to the notional income tax levied on the hypothetical market rent of a dwelling with, of course, interest charges and expenditure on repairs and maintenance being an allowable deduction. If subsidies are calculated in this way then the average per owner-occupier is still only half that received by council tenants.

It is sometimes argued that it is right that council tenants should be subsidised more than owner-occupiers because they are, on average, poorer. As a statement of fact this is true, but averages are always misleading. The richest one-third of council tenants, in terms of household income, have incomes in excess of one-third of owner-occupiers with mortgages, and no less than half of those who own their homes outright. This tremendous overlap between the various tenure groups casts doubt on the validity of measures such as holding down council rents (as was done as part of the counter-inflation policy) to help the poor. Redistributing income can easily be done through the tax and social security systems; to attempt to subsidise those items which the poor are thought to consume is not only an extraordinary round-about method of doing a simple task—it is also arbitrary, distortionary and probably ineffective.

In developing a fairer housing policy a primary objective must be to reduce the discrimination against the "have nots" in the privately rented sector who not only are not subsidised but are forced, through rates and taxes, to subsidise those who are able to enjoy a far better standard of housing. Another objective must be to equalise the subsidies between owner-occupiers and council tenants and to remove the council sector anomalies.

The obstacles to adopting a more rational housing policy are, of course, political rather than social or economic.

The review of housing finance currently being undertaken at the Department of the Environment presents the opportunity for the emergence of a rational bipartisan policy which will ensure equality between the tenure sectors. This opportunity should be taken.

* In particular in "The Impact of the Fiscal System of Differing Tenure Sectors" in IFS Publication No. 12.