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To: MR LANKESTER  
From: SIR KENNETH BERRILL

Public Expenditure: Housing

*cc Housing: May 79: Policy  
spoke to Berrill - 18  
agreed that Housing wrong.  
Berrill to consider this approach  
as part of 1980 Survey. R.*

The over-riding need to cut the PSBR faces Ministers with difficult choices. To achieve the targets required it may be necessary to consider policy changes which in other circumstances would be politically impracticable. If so, the CPRS believes that the greatest scope lies in the field of housing. In opposition the Government identified this as a major area where savings in public expenditure could be achieved and where the market should be given greater scope. This note sets out some of the considerations which the Prime Minister may wish to have re-examined.

2. Much has already been done. The housing budget was cut substantially in the Autumn and further cuts are now envisaged. The Housing Bill opens up the scope for market forces through council house sales and the introduction of shorthold. Substantial subsidies remain, however, and these distort the market and the demand for new investment. It is for consideration whether the Government should aim at setting a timetable - even if a long one - for eliminating indiscriminate subsidies and concentrating on those in need. The balance between subsidies to the public sector and the special tax reliefs for owner-occupiers would have to be examined.

3. The condition of British housing is good by international standards. There is a surplus of dwellings over households of over 1 million (5% of the total stock). The quality is better than that of a number of more prosperous countries. It can be argued that, in the post-war period, the UK gave a priority to housing which many of our competitors reserved for industry.

4. Paradoxically, housing problems are often perceived as getting worse. There are still many unfit and poor quality houses. Local housing shortages persist and waiting lists remain long. The young and mobile have difficulty in getting homes. We would argue that this is largely the consequence of market-distorting subsidies.

5. The Case Against Indiscriminate Subsidies

- (i) The cost of subsidies is over £3bn a year (£1.8bn for local authority housing and £1.5bn for tax relief to owner-occupiers). Withdrawal over, say, 10 years would make a substantial contribution to the PSBR - even allowing for retention of rent and rate rebates for the protection of the poor. £3bn is equivalent to 4-5p off the standard rate.
- (ii) At present demand is artificially stimulated. For example there is little inducement for people to move to smaller dwellings as families

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get older and children leave home. A move towards economic charging would reduce unnecessary investment. It would leave the market to determine the allocation of resources and would lead to a more efficient use of existing housing stock.

- (iii) The excess demand causes high prices in the owner-occupied market, creating barriers for first-time buyers and windfall gains for existing owners. Where the price cannot rise, as in the public sector, rationing takes place by queuing.
- (iv) The Government is not prepared to subsidise food, fuel and other necessities. Why should housing be treated differently?
- (v) Withdrawal of subsidy would release resources for investment in productive investment; would remove one obstacle to mobility; and lead to manpower savings in local authorities and tax offices.

6. Any radical reform of housing finance would need to involve all ~~the~~ forms of housing tenure. The object should be to face each household with the true costs of the resources it pre-empts. Clearly this would mean higher rents for both the public and private tenant. But it would also mean higher costs for the owner-occupier. Would this be compatible with the Government's commitment to encourage owner-occupation?

7. In our view it would. Demand for home ownership is high because at a personal level there is no better investment that an individual can make. No other investment offers:-

- (i) tax-free capital gains;
- (ii) inflation proofing - over the past decade the rise in house prices has outstripped the RPI and comprehensively outperformed the Stock Exchange indices;
- (iii) cheap finance through the building societies (even now a negative real interest rate);
- (iv) an asset which conveys visible social status and which allows one to live rent free.

8. Moreover, gradual withdrawal of subsidies from all three sectors would not damage the relative attraction of owner-occupation. Nor, of course, would it necessarily leave individuals worse off since they are currently paying part of their housing costs through taxation.

9. In the case of the owner-occupier there is a problem of what constitutes the existing subsidy. From an economic point of view the best way to treat houses for tax would be to charge income tax on the rent which the owner would have had to pay to a landlord for the same house (Schedule A). But this would be difficult to administer and to justify presentationally.

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It would therefore probably be necessary to fall back on the withdrawal of tax relief, though this is conceptually less satisfactory.

Distributional Effects

10. It is inevitable that any reform of the kind outlined above would make some people worse off and some better off. The obvious gainers would be those owner-occupiers who own their houses outright. They would benefit from general tax cuts while suffering no reduction in "subsidy". On the other hand new owner occupiers could suffer a marked fall in disposable income since the value of the tax relief they receive on the high outgoings of the early years of the mortgage would in most cases exceed the value of any general tax cut. So far as council tenants are concerned, some would be unaffected by the change since they would qualify for rent rebates. But council tenants as a whole would be worse off since they at present receive a greater subsidy per head than owner-occupiers, and would on average receive smaller tax cuts. The distribution effects should not be too severe if subsidies were withdrawn gradually.

Conclusion

11. The CPRS does not under-estimate the political sensitivity of housing subsidies. But we believe that it is the one area of policy which holds out some prospect of a substantial contribution to reducing the PSBR, while at the same time offering substantial longer-term benefits for the economy as a whole. If the Prime Minister agrees, she may feel that the Department of the Environment should be asked to review the possibilities quickly, in consultation with the Treasury and the CPRS. The groundwork has already been done over the past 3 or 4 years and the necessary material is readily available.

12. I am sending a copy of this minute to Sir Robert Armstrong.

KR

25 January 1980

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