



The Right to Buy public housing in Britain: A welfare analysis[☆]



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ABSTRACT

We investigate the impact on social welfare of the United Kingdom (UK) policy introduced in 1980 by which public housing tenants (council housing in UK parlance) had the right to purchase their houses at heavily discounted prices. This was known as the Right to Buy (RTB) policy. Although this internationally-unique policy was the largest source of public privatization revenue in the UK and raised home ownership as a share of housing tenure by around 15%, the policy has been little analyzed by economists. We investigate the equilibrium housing policy of the public authority in terms of quality and quantity of publicly-provided housing both in the absence and presence of a RTB policy. We find that RTB can improve the aggregate welfare of low-income households only if the council housing quality is sufficiently low such that middle-wealth households have no incentive to exercise RTB. We also explore the welfare effects of various adjustments to the policy, in particular (i) to reduce discounts on RTB sales; (ii) to loosen restrictions on resale; (iii) to return the proceeds from RTB sales to local authorities to construct new public properties; and (iv) to replace RTB with rent subsidies in cash.

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1. Introduction

This paper undertakes what we believe to be the first welfare analysis of the Right to Buy (RTB) policy for publicly-owned housing that was developed in the late 1970s in the United Kingdom (UK) and became a flagship policy of the Thatcher govern-

ment. RTB allowed tenants in publicly-owned council housing to buy their rented accommodation at a heavily subsidized price (albeit with subsidies that varied both over time and geographically across local jurisdictions). Overall, RTB was largely responsible for an increase in the share of home ownership among householders in the UK from 55% in 1979 to over 70% in the early 2000s, thereby inducing a large-scale change in asset ownership among UK households in a relatively short period. Despite being an innovative and internationally-unique policy, RTB has been little analyzed by economists in Britain and elsewhere.

In the paper we examine the incentives implied by the RTB policy in the context of a model of heterogeneous households choosing between private ownership, private renting, and public renting. We describe the policy background to the provision of public housing in the UK and the development of the RTB policy in the remainder of Section 1. The remaining sections of the paper construct a theoretical argument on RTB which reflects these stylized historical facts, a brief description of which is as follows.

Household heterogeneity arises because households have different prospective life-cycle wealth profiles and, within any period, differing probabilities of high income 'draws'. Given the significant fixed cost of purchasing a house, a household needs sufficient high

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income ‘draws’ to be in a position to purchase.¹ Moreover, the demand for housing units (in terms of quantity and quality) is increasing in income and wealth. Hence the supply of private housing reflects the financial position and preferences of households with more frequent high income ‘draws’. Since, in the long run, private rents must reflect the annuitized price of private housing units, the private rental market also caters for the preferences of the same segment of households (Section 2.1).

The rationale for public sector housing is that it supplies lower quality units of housing that may not be provided by the private sector. These can be rented by households with few high income ‘draws’, so long as public housing is provided at similar cost-per-unit for given quality to private housing. We show evidence that public housing in the UK is indeed of lower quality but can find no robust evidence of the public cost inefficiencies frequently described in the literature in the United States. Indeed, since local authorities are budget-constrained, constructing higher quality units would lead to greater demand for public housing and hence rationing (queueing). We derive an equilibrium quality of public housing which reflects this trade-off (Section 2.2).

The ‘Right to Buy’ (RTB) policy, by subsidizing purchase price and reducing fixed costs of purchase (e.g. by allowing higher loan-to-value ratios and cheaper credit terms), allows households with fewer high income ‘draws’ to purchase their public housing. But not every household which is eligible for RTB will necessarily purchase because public housing rents are subsidized and maintenance costs are generally borne by the public authority. A household considering RTB will trade-off these costs against their preference (if any) for home ownership over renting. Over time, two key effects of the RTB policy are to reduce the stock of public housing relative to private housing, but also to change the distribution of ‘quality’ of housing units within the private sector (Section 3). In Section 3.1 we provide some new empirical evidence on the distribution of housing units and also on the characteristics of council tenants and of those who opt to purchase their public housing under the ‘Right to Buy’ policy.

In Section 4, we examine various reforms to the RTB program, including changing the discount rate on RTB sales (Section 4.1), loosening resale restrictions on housing purchased through RTB (Section 4.2), permitting local public authorities to retain receipts from RTB sales in order to construct new public housing of a particular quality (Section 4.3), and finally, replacing public housing with cash subsidies (Section 4.4). Section 5 provides a brief conclusion to the paper.²

1.1. Background: council housing and the development of Right to Buy

‘Council housing’ (the term for public housing constructed by local government authorities in the UK) was a policy developed from the early 1920s onwards in order to re-house low income families in subsidized, rented, accommodation. The need to re-house families arose from an ongoing policy of slum clearance in

the 1920s and 1930s coupled with a perceived shortage of affordable private rented housing; a need heightened from the 1940s onwards because 4 million houses in the UK were seriously damaged or destroyed by bombing between 1939 and 1945. Aided by the 1946 Land Acquisitions Act, which allowed local authorities to acquire land for construction, and by direct subsidies from central government, council house construction accelerated after 1945 and continued well into the 1970s. By 1979 around 32% of dwellings in Britain were council houses, totalling some 6.5 million properties – a far greater share of the total housing stock than that of public housing in, for example, the United States.³

It is reasonable to ask – at least from a North American viewpoint – why increased provision of public housing, rather than encouragement of private ownership and construction, played such a dominant role in UK housing policy for such a long period. But it should be remembered that the UK, over the century beginning in the late 1910s, moved from a nation of private renters to one of private owners as well as public renters. Chart 1 shows how, between 1918 and 1991, the share of private renting fell from 76% of housing tenures to only 9% of housing tenures. And Chart 2 shows that, although there were periods in which public housing construction matched or indeed exceeded private construction (such as the decade after 1945), in other periods – notably the 1930s and 1960s – private construction for homeowners dominated public construction by local public authorities. The important role of public construction (at least, relative to North America) seems to have stemmed from several factors: borrowing constraints both on the one hand on private builders and landlords seeking to renovate properties in the 1920s but also on working class tenants seeking to buy their own houses; a shortage of private land and a high degree of public regulation of planned private housebuilding through much of the 1940s and early 1950s; the ideology of ‘municipal socialism’ which reappeared in the UK at regular intervals between the 1880s and 1940s; and (given the large share of public housing) the apparent absence of the stigma and social externalities associated with public housing in the United States. Nevertheless, it is perhaps surprising to housing economists that, even in the late 1950s, the number of housing units constructed for local public authorities still exceeded the number of private dwellings constructed in the UK.

Because of the capacity of public authorities to construct relatively cheap lower quality housing units, council housing in the UK has been generally regarded as a solution to the major social problem of a shortage of affordable housing. Council housing is normally allocated to families by a simple queueing mechanism with priority given to families with special housing needs (homelessness, state of existing accommodation, severe health problems, eviction unrelated to personal behavior, etc.) but also more generally to those with low incomes and/or proxies for low income such as family size and employment status (or lack of it). For those without priority needs, waiting times could be as long as several years or indeed indefinite, although in the heyday of council housing a local authority could usually offer a property of some kind within a shorter period. For tenants, the attractiveness of council housing is that rents are usually significantly lower than those for equivalent private sector rental properties, and indeed private rentals had become increasingly scarce by the end of the 1970s. Maintenance costs of council housing are in general covered by local authorities. These implicit subsidies were in part made possible by direct subsidies for construction from central government (including allowing local authorities to borrow at lower interest rates than private housebuilders) and by the development of low-cost system construction methods which, however, subsequently some-

¹ We do not explicitly discuss the argument that individuals with more income volatility, for given expected wealth, would prefer to rent rather than buy (Ioannides, 1979; Rosen et al., 1984) – a result which finds some empirical support in Robst et al. (1999). Among a number of subsequent contributions, Ortalo-Magne and Rady (2002) argue that the standard result hinges on the nature of the covariance between income and asset price volatility.

² Although we discuss the redistributive implications of the RTB program, we do not explicitly examine public housing policy as an additional instrument for redistribution, providing in-kind rather than cash transfers, other than our brief discussion in Section 4.4. This argument for public housing is highly controversial in the United States though it provides an additional rationale for the development of public housing in the UK, at least until the 1950s. For further discussion in the context of housing, see Aaron and Von Furstenberg (1971); Thurow (1984) and Bruce and Waldman (1991).

³ Jones and Murie (2006) Table 2.2. and p.52.

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