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The Case for a Healthier Rental Sector in the UK

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Our housing market is a pain. Prices are too prone to large speculative swings; buying and selling is overly difficult; house-sale chains make life a misery; workers find it impossible to move quickly as new jobs open up. Yet nothing gets done.

At bottom the problem is that the United Kingdom's citizens are fixated on owning. Two thirds of us are now owner-occupiers; only one in ten people rent from the private sector. The young, especially, cannot imagine any other world.

Yet as a nation we do not have to live this way, and once did not. After the end of World War Two most of the UK's inhabitants went to their beds in privately rented accommodation. We could reclaim this renting culture if we tried.

As with most addictions, the nation is reluctant to admit to a weakness and has persuaded itself that owning is intrinsically good. Over the years, fostered by remarkable tax breaks, property has shot up in value, and what has been merely fortuitously profitable has acquired an almost moral sheen. Renting, somehow, is not thought of as what decent British people do -- at least for long.

Yet take a short flight eastwards. Arguably the world's most prosperous nation, Switzerland, has the highest proportion of renting in the western world. Two thirds of Swiss are private renters. Their country disproves the common presumption that wealth and owning your home must go together. Moreover, renting is high in Switzerland not for arcane reasons but simply because there has not been preferential tax treatment given to owning.

The citizens of the UK, by contrast, treat a house as though it were both a place to sleep and a giant piggy bank into which to pour

savings. Two things thus get mixed together: living and investing. This conflation has undesirable effects.

First, the British borrow as much as they can, and sink it into their home. People typically do not want to put money in a business and pay tax on the profit if they can get a tax-free gain merely by buying a bigger house. This, in turn, creates distortions. It pushes money away from the real, productive things going on inside an economy. That makes the economy prone to house-price swings, because we all become tiny speculators. And it creates armies of individuals who do up houses as a hobby or, worse, to make a covert living. And it makes us obsessed with local house prices. And it fills up our countryside with garden centres. And it clogs our TV channels with programmes about house improvement. Obsessions show.

If the UK were bold enough to set the rate of capital gains tax at the same level on homes as on business investment, the economy would very probably grow faster and tick more smoothly. People would start thinking seriously about being renters. They would choose a house because it suited their family, not because it was an investment. They would no longer be mini property speculators.

Second, renting is beneficial for the deep-down flexibility of a country. Economies need to be adaptable. In the 1950s the number of UK homes occupied by their owners was low, and we had tiny unemployment. The USA, on the other hand, had a high owner occupation rate of 60%. At that time the USA had the highest unemployment rate in the Western World. There seems to be some deep connection between the housing and the labour market. Economists have a lot to understand here but there is evidence that economies thrive better when they have large rental markets.

Because home ownership tends to ossify things, it can have bad effects on unemployment. Selling a home and moving is expensive. Hence owner-occupiers are less mobile than renters, and therefore more vulnerable to economic downturns in their region. This is why West Virginia in the United States has historically tended to be the state with the greatest unemployment and home-ownership levels. There is recent research showing that those states of the US with the

fastest growth in owner-occupation went on later to have the fastest growth in unemployment.

High home-ownership levels block young workers' ability to enter an area to find a job: if we look at countries like Spain, with its 80% home ownership rate, a key part of the problem is young jobless people living at home, unable to move out because the rental sector hardly exists any more. Here the difficulty is not that unemployed people are home owners; it is that unemployed men and women cannot move to the appropriate areas.

Inefficiencies caused by high home-ownership rates impair the creation of jobs in more subtle ways.

In an economy in which people are immobile, workers do jobs for which they are not ideally suited. Triangular-shaped workers cannot move around to drop into new triangular-shaped job slots; they have to force themselves into round holes close to where they currently live. Immobility makes for an imperfect match of people and job openings. The resulting inefficiency is harmful: it raises the costs of production and lowers real incomes. Prices of goods thus tend to be higher, and real wages lower, than in a more fluid society.

Moreover, a Not in My Back Yard mentality works more strongly among owners than renters. Although we lack good data, it is likely that areas with high home-ownership levels act to prevent entrepreneurs from setting up new operations. Planning laws and restrictions on land development, enforced by the local political power of groups of home-owners, can hold back the growth of new businesses.

We know too that home-owners commute more often than renters, and over longer distances, and this raises transport congestion that is bad for business and makes getting to work more costly for all of us. The link between the immobility caused by owner-occupation and greater traffic jams needs greater research. It is not renters who are on the M40 into London at 7am.

Third, most owners need mortgages. Variable-rate mortgages have to take part of the blame for our past housing market problems. If we

had had the American style of mortgage, even in the late 1980s we could have staved off the worst of the tearful repossessions. In the US, it is commonplace to have a 20-30 year fix-rate mortgage. It then does not matter whether interest rates are pushed up by policy-makers.

Fourth, stamp duty worsens the effects of high home ownership rates. There is no good justification for such a tax: it hampers mobility. We need to encourage fluidity, not impair it.

Finally, continuing trouble is caused in England and Wales by having a system where, when I agree to buy your house, the contract is not legally binding. We should adopt throughout the British Isles the sensible Scottish system where an agreement and a firm price mean exactly that.

These three steps – long fix-rate mortgages, getting rid of stamp duty and reforming the selling system – would reduce the intrinsic tendency for high levels of owner occupation to tend to ossify an economy.

For the sake of the economy, as well as our citizens' peace of mind, we need a housing market that works better. A larger and healthier market for rented homes would be an important step forward.