Student Economic Review, Vol. 17, 2003, pp. 67-75

ACCOMODATING A CRISIS:
A CRITIQUE OF IRISH HOUSING POLICY

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In this essay, Nick Hodsman and David Comerford review the effectiveness of Irish housing policy in tackling the problems of house price inflation, homelessness and an underdeveloped rental sector. They consider policymakers to be idle & ignorant at their best. More often than not, they claim, government policies are complicit in house price inflation. In response, they recommend a publicly funded and privately administered cost-price rental scheme.

The Plot

It is a testament to the fact that there exists in Ireland a housing crisis that over the course of the past decade housing has been catapulted up the political agenda. This is not the only place where housing has been hastily put up, as a quick peripatetic of Dublin's peripheries will reveal. This is a problem more fully dealt with in Laura Watts' essay in this very review. For our part, Nick and myself first seek to account for the housing crisis as we perceive it. Next, current housing policy is examined, along with the repercussions this has had for those who demand housing. Finally, we propose what other, and in our opinion better, policies might be considered. It is worth noting at this stage that we are all counted among those who demand housing, insofar as we *need* housing. We therefore have little compunction in defining housing as a merit good, that is a good which is deemed to have sufficient social benefits to warrant production beyond that level which the market advocates.

Foundations

Despite the fact that every indicator shows the Irish people to be enjoying an unprecedented level of material well-being, the number of homeless people in Ireland is over twice the 1996 level[1]. In the same period, national income has risen by on average 10%. Most economists will have noticed a causal link between the

[1] Focus Ireland, 2003.

first sentence and the second. Income growth such as that which we enjoyed throughout the nineties leads to inflation. Inflation is of no great concern to those people who earn inflation-adjusted wages, but those on fixed incomes, or no incomes, are relegated out of the market by housing price increases.

A core problem here is that housing is treated as a marketable good. Indeed, it is an especially lucrative one given the reliably predictable demand booms consistent with population increase, rising incomes and an ever diminishing supply of land. By way of indication, the average price of a new house in 1996 was €76,439. Today the very same house costs €180,000.[2]

This absurd increase can only be referred to as a market failure. The question that arises then is how to set about rectifying this failure. The first thing to do is lay bare its source. Punch and Drudy show us that house building costs have risen by under 20% since 1991, while house prices have risen by over 120%.[3] Policymakers perceive this as a boon to the 80% of householders who are categorised as owner occupants (and tacitly as victims of price illusion) by the Department of the Environment. However, as the homeless figure would suggest, this is a problem which permeates the housing sector and not merely the market for house purchases.

House prices are traditionally gauged by economists as investments. Hence, net present evaluation takes rents accruing over the duration of the tenure, which, given the resilience of bricks and mortar, can be a very long time indeed. These rents are then discounted by the real interest rate (the opportunity cost or cost of borrowing) and taxes. One might also add servicing and maintenance costs. What is noteworthy in the Irish case, however, is that real interest rates have been negative since Ireland ceded monetary control to the European Central Bank. Moreover, and this is something on which a considerable portion of our policy discussion will be devoted, Ireland offers tax incentives to home owners, regardless of whether they are owner-occupiers, speculators or that rarest of breeds, magnanimous landlords.

The point here is that people must live somewhere. If house prices are pushed up, so too are rents, due to substitution effects. Given the more flexible nature of rental tenure, real price increases frequently manifest themselves in lax provision of housing services and maintenance rather than through the nominal price. Anecdotally, complaints regarding plumbing, heating and other such perfunctory issues are on the increase. In a bid to keep costs down, landlords discriminate against potential tenants who they perceive as imposing higher maintenance costs. These include students, a group who are vocal and active in the housing sector.

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[2] Department of the Environment, *Annual housing statistics bulletin 2000*; Property section, *The Irish Times*, 13-3-03.

[3] Rich and Poor, Cantillon et al.

These selecting mechanisms, monetary and otherwise, create a caste who cannot afford appropriate housing. The government has long been aware of the existence of such people. Indeed, in 1961, 18.4% of Irish households lived in accommodation owned by the local authority.[4] Despite the all too apparent need for social housing in a society where in excess of 5,000 people are homeless and over 48,000 are on waiting lists for local authority housing,[5] fewer than 8% of the Irish population are currently housed in such schemes. This compares with a figure of 36% for Holland.[6]

Culturally, such a discrepancy may be explained by Ireland's history. Having been raised to believe that an English man's home is his castle, framers of the Irish constitution enshrined protection of the dwelling of every citizen as "inviolable".[7] Moreover, the fact that the independence movement arose out of one for land rights has rendered the Irish population more attuned to property possession than may be the case elsewhere. These initial conditions have been compounded by government policies that have favoured owner-occupancy ever since. This stance has in turn stigmatised social and, to a lesser extent, rented housing.

The Walled Constructs of Irish Policy

There are organic developments at work that boost the costs of housing in Ireland. The invisible hand is adept at moulding these natural undulations but not the sheer rise in house prices we have experienced of late. It is government policy that has made a mountain out of this molehill. If we refer to the equation for net present value of a house (P), we see that government has adopted policies that will spur demand for housing rather than quench it:

$$P = \frac{\text{Rents accruing over lifespan of house}}{\text{(interest rates + marginal taxes)}}$$

Costs of ownership are reduced by the remission of rates, the repeal of residential property tax and the repeal of the stamp duty on new housing for owner occupation. Demand for owner-occupied housing was further stimulated by mortgage interest relief and cash subsidies for first time buyers. Matters are further exacerbated by policies which favour speculation, such as the abolition of capital

4 Statistics from the Department of the Environment and Local Government.
5 Focus Ireland quoting Department of the Environment figures for March 2002.
6 Drudy, P.J., (2000; 2)
7 Bunreacht na hEireann, art. 40.5

gains tax on the sale of the principal residence, the abolition of rent controls and section 23 and section 27 income tax relief for rental accomodation. All of these policies coincide to make marginal taxes to the property owners, the divisor in the equation above negative. Since real interest rates are negative, we can see that property prices are higher than the rents accruing from them over the lifespan of a property. This fact in turn makes property an excellent investment, and people are keen to take advantage of it. 25% of houses bought in 2000 were bought as a speculative property by current owner occupiers.[8]

These pro-cyclical policies could not have come at a worse time. Unprecedented economic growth in the 1990s did not vent itself through inflation in consumer goods as the European Common market ensures a ready supply of tradeable imports are available. Moreover, real negative interest rates since the launch of EMU have rendered saving a mug's game. South-East Asian, Latin American crises, Brown Monday and the bursting of the technology bubble have made Irish investors wary of international speculation. Hence, excess liquidity was mopped up by the housing market.

A roof to cap it off

The results of these inappropriate policies are those outlined in the opening paragraph: embarrassing blights on Irish society such as homelessness, unsatisfactory housing conditions and an embarrassment of riches for the wealthiest members of society. Given that property is the form of collateral favoured by banks, it is those in possession of a house already who are best placed to take advantage of the housing boom through remortgaging a first property with a view to purchasing a second. The disparity between rich and poor is hence compounded, as the ivory compounds of the rich become an increasingly remote dream for those not on the property ladder.

Since property has become the investment of choice, those responsible for it have seen their political stock grow. With that power comes corruption and as the planning and payments tribunal reveals every day, such corruption is rife. It is not entirely true to say that the market failed because a brown envelope was spirited into the invisible hand, but it undoubtedly contributed. Where are the solutions then? Housing policy remains as wrongheaded as ever. The Irish government continues to sell off local authority housing on the grounds of efficiency, but such concerns fly in the face of equity considerations.

Dublin saw a net growth in local authority housing of 1,527 between 1995 and 1999. In the same period they sold 2,755 houses.[9] Bearing in mind that there are

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[8] Drudy; 2000: 6

[9] Dept. of Environment, 2000

currently 48,000 people waiting to be housed, and Dublin is the most intensely desired area in which to live, the lack of logic here is plain to see, yet the local authorities still offer very favourable terms on house sales and mortgages.

Room for Improvement

Having established that there is indeed a housing problem in section one, and examined some of the government policies that may have exacerbated the problems in section two, it is necessary to offer alternative policy measures in order to cure the acute housing shortage in the Dublin area. Whilst levels of social housing may be a primary necessity for those on local authority waiting lists, it is our belief that these needs must be met by capital expenditure, and provision made to those who really need it. The only way to do this is to either allocate a larger section of the budget to social housing, or to raise taxes in order to pay for it. The justification for this comes from having established housing as a "need" in section one and it therefore must be regarded in the same light as health or education. Therefore, in the same way that if there are not enough schools for children to be educated in or enough hospital facilities to cope with those suffering from heart attacks, there should be enough housing space to put roofs over peoples' heads, whatever their problem. However, providing more social housing is not going to solve the problem for thousands of people who cannot afford to live in a house. As a result, policies need to be implemented not just to take people off the streets, but to allow people to live in affordable and acceptable accommodation. Consequently, the main focus of this section is to attempt to find solutions for the whole of Dublin and not just the marginalised.

The "Rip-off" effect of private housing investors

Until 1995, the cost of a new house rose at the same rate as inflation as measured by the CPI. It also rose at the same rate as the average earnings of adult workers and house building costs. By 1998, building costs, wages and consumer prices had continued to increase at a similar rate; however, new house prices had increased at rates of more than 30% a year, compared to the 5% to 7% increases in the CPI.[10] As a result, it can only be concluded that supernormal profits are being made by incumbents. Supernormal profits imply market failure and it is for this reason that government intervention is justified. Supernormal profits also imply a degree of monopoly. Standard monopolistic theory reveals a welfare loss to society. This can easily be interpreted as larger proportions of income being spent on

[10] Drudy, 1999: 4

housing as opposed to consumption, or savings, and as a result a loss to the economy. Therefore, not only are people being ripped off by these price rises, but they are also having a damaging effect on the economy. These prices are also having an effect on second hand homes, which are also being raised through the substitution effect. As a result, the government needs to try to encourage a degree of extra competition in the housing market.

The case for government intervention

Baumol's theory of contestable markets states that in order for there to be any type of competition, there must be the threat of a new entrant.[11] When such large barriers to entry have to be overcome, it is almost impossible to see any new entrants. This can be applied to the Dublin housing market, where to be a new entrant requires access to vast amounts of capital. As a result, land investors are able to form cartels in order to suppress supply and dictate prices. No private party has access to sufficient capital to restore equilibrium; therefore, the government should step in to the breach. It is not our belief that this should be done through the use of rent ceilings, as basic supply and demand theory dictate that this might cause a further fall in the supply or, more likely, a black market. Rent controls would necessarily cause prices to accordion proportional to old levels, which prospective tenants would be rational to supplement with "gifts" in a bid to buy the best property.

The solution, using the same basic theory, is to attempt to shift the supply curve to the right, by increasing supply. This supply should come from the government, who buy land and build apartments in the same way that the private investors do. The only difference is that the government charge rents in order to cover costs, and not to make profit. The government have the access to capital in order to build these apartments, and as a result is potentially the only actor with the means and the inclination who can overcome this significant barrier to entry. With an increase in supply, and competitive rents, the equilibrium price of rented property could be expected to decrease. The central argument of this project would be that it creates a competitive environment in the housing market, as the private rental firms are forced to lower prices in order to keep tenants. It will also force them, without regulation, to provide a greater quality of service, and more secure tenancy agreements.

People in glass houses …

It would be unrealistic to expect any government action of this sort. One of the principle reasons behind this is the power of the housing lobby. Their power was previously referred to in section two, where it was seen that they were even able to

[11] Baumol, 1982.

change government policy. This shows their rent seeking and lobbying abilities, perfectly demonstrating one of the key traits of monopolists or cartels. It is worth noting that the majority of TDs are home owners, if not land owners. A goodly proportion of them also work as, or in conjunction with, solicitors and developers. Government has in the past shown a willingness to face difficult and powerful opposition, as they did in the case of taxi drivers & Aer Lingus.

Another argument is that of efficiency. One of the key arguments to the expansion of the private sector is the increased efficiency that profit-seeking yields. Having established housing as a “need” and, therefore, categorised in the same light as health or education, we can use the U.S. health service as a stunning example of how privatisation exacerbates inefficiency in the market for necessities. The U.S. spends 14% of their GNP on healthcare every year. France spends 9% of their GNP on health every year, with a state-run health service. Simple arithmetic tells us that the U.S. spends 5% more of their GNP on healthcare than the French. As a result, people invest far more in the U.S. private health-care system (still leaving 40 million people uninsured) than in France on the State-run system. This wouldn’t be quite so alarming, if the French didn’t live longer than the Americans! Therefore, to use the argument of economic efficiency in this context is flawed.

Given our past experience in housing related corruption, it would be kept out of government hands. In Sweden, where this type of cost-rental system has operated for a number of years, housing is run by housing companies. These are tendered by the government, and put in charge of ensuring the upkeep of all the accommodation. Recently, the local authorities also gave them price-raising powers as well.[12] As a result, the scheme does not have to be subject to the reputations of extremely inefficient government departments.

Learning from our neighbours

Most continental European countries have a far more integrated housing policy than Ireland. Kemeny attributes this to political culture. Many continental countries enjoy more diverse input into policy formulation than do Britain and Ireland. Most continental governments are made up of coalitions dependent on post-materialist and special interest parties. In Ireland it has always been one of the larger parties which have dominated. As a result, Kemeny states that Ireland has a 'dualist' housing system, by which he means market oriented. This is evinced in the government's zeal to sell off local authority housing and ghettoisation of what little council housing remains and, more importantly, their inhabitants. He says that this is not the inevitable outcome, and that housing could be “socially constructed through

[12] Kemeny, 1985: 82

strategic policy making".[13] In the Netherlands, where land pressure is far greater than in Ireland, rent prices are half what they are in Dublin, and 40% of the accommodation is provided by the state, or through housing companies.[14] These housing companies have been able to continue to build more properties, as through the process of maturation, debts were paid off from previous buildings, and as a result, much of their older accommodation is now making an absolute rent. Here Kemeny asserts that the rental market starts to out-compete the owner-occupancy market. This happens because money is needed only once to pay for a housing company residence, whereas a second hand home can be sold three or four times over in a generation, which results in more debt being accrued. As a result, in many European countries, staying in rental accommodation for a lifetime can result in less money paid on accommodation than in the cost of a mortgage in Ireland.[15] Once the benefits are put forward in this way, especially in light of the current problems in Dublin, alternative policies such as these seem very tempting.

Home, James!

In conclusion, we have illustrated and elucidated an issue which affects everyone in society, insofar as housing is a need. The solutions to the problems of homelessness, unaffordable and inappropriate housing will come only when policymakers realise this fact. Current policies, by trying to guide the invisible hand, are themselves misguided. Only when the invisible hand is severed from the corpus of speculators that have corrupted the housing pool will a satisfactory level of housing provision be achieved. We consider government enterprise to be the best means of achieving this. As opposed to current piecemeal housing policies, public enterprise is a capital investment that will continue to have positive repercussions on into the future, and a state can do nothing more prudent than invest in its future.

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[13] *Ibid*. 38
[14] *Ibid.* 90
[15] *Ibid*. 42-49

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