Original in G/R.

G/R PPS

Housing

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

10th March 1980

Dear Nick,

MORTGAGE SUBSIDIES

You wrote to me on 18th February, enclosing a letter to the Prime Minister from Sir John Eden. I attach a copy of the letter the Chancellor has sent to Sir John, commenting on his letter and that of his constituent, Mr. C.C. Kennedy.

You also asked for a draft reply for the Prime Minister to send to Sir John. We doubt, on reflection, whether there is anything substantive which the Prime Minister could usefully add on those aspects of Mr. Kennedy's letter which are particularly the concern of the Treasury. Perhaps she might express appreciation to Sir John for bringing the letter to her attention, and say that she had noted the careful and sympathetic comments the Chancellor [and other Ministers] had already made.

You also mentioned that it might be possible to introduce a mortgage subsidy scheme at the beginning of a financial year. The Chancellor sees overwhelming objection to this, or indeed to any attempt to hold mortgage rates too far below other interest rates.

The main reason is that the Government cannot afford to exempt any large section of the population, however deserving, from the effects of monetary policy. There is no getting away from the fact that tight money means high interest rates so long as there is a high PSBR and that high interest rates work partly by squeezing mortgage and other borrowers. This is a disagreeable truth, but a truth nonetheless. If we were to prevent the policy from having its full effects, we should only drag out the pain of getting inflation out of the system. We should also have to load the burden still more heavily onto others, including small businesses as well as the general body of income tax payers without mortgages. Something like a

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quarter of all households have building society mortgages, so we are talking about shielding so very major a part of the population from our policies, that the policies themselves would necessarily be affected.

Any such attempt would thus undermine the market's confidence in our determination to stick to our guns. That is the last thing we want.

These general objections apply to all schemes for enlarging the protection which is already given to mortgage borrowers by tax relief and by the fact that gross mortgage rates are still below other interest rates and also below the rate of inflation. In addition, there are of course specific objections to specific schemes.

A straight subsidy, for instance, would be very expensive. Each 1 per cent off gross mortgage rates would add about £360 million a year to public expenditure. After allowing for an offsetting reduction in mortgage tax relief, it would add about £240 million to the PSBR. This would run clean counter to the Government's policies on spending and borrowing.

A loan would be less awkward if repaid within a financial year. But we could not be sure that it would be repaid so quickly. Nor could we be sure that the building societies would accept it. And of course the impact effect of making a loan would be to increase Government borrowing and so to add immediately to the upward pressure on other interest rates. Again, that is the last thing the Government would want.

The Chancellor hopes very much, therefore, that we can discourage any talk of a mortgage subsidy, or loan, or any other means of holding the mortgage rate too far below the market. He realises full well the hardship caused by high mortgage rates, especially to those who took out mortgages two years ago at $8\frac{1}{2}$ per cent. But as Ministers have said consistently in their speeches, the only real alternative to high interest rates is to get down public expenditure and the pressures caused by Government borrowing, and so, in time, reduce inflation.

I am sending copies of this letter, and of the Chancellor's to Sir John Eden, to Ian Fair and Don Brereton.

Yours sincerely

John Wiggins

A.J. WIGGINS
(Private Secretary)