

The housing crisis: a briefing

By Dr Kristian Niemietz, Head of Health & Welfare, Institute of Economic Affairs

- Since 1970, average house prices have risen four and a half fold after inflation. No other OECD country's experience has even come close.
- The UK's housing stock is not just inadequate in total, but much of it is also in the 'wrong place', because what little development we have is skewed towards those parts of the country where the problem is least bad (and effective demand for housing the lowest).
- There is no specific shortage of social housing, or private rented accommodation, or homes for first-time buyers, but an overall shortage of inexpensive housing across all tenures.
- Government solutions, through interventions such as the Help to Buy scheme, changes to inheritance tax, and higher tax for buy-to-let landlords are all a step in the wrong direction.
- Greenbelts are not just outdated, but conceptually wrong. Protecting land from development should be done in a selective manner; a proximity of a plot of land to, for example, London or Oxford, is not in itself a valid reason for a presumption against development.
- Boosting homeownership should not be a policy aim in its own right. The government's aim should be to improve affordability in general.
- Sensible tax changes, such as fiscal devolution, would strengthen incentives to permit development by ensuring that local authorities gain from it.

An overview of the current housing crisis

Housing costs in the UK – both house prices and rents – are among the highest in the world, both in absolute terms and relative to average incomes.

Since 1970, average house prices have gone up four and half fold after inflation. In this, the UK is an extreme outlier. No other OECD country has experienced a price explosion of such a magnitude.ⁱ No other OECD country's experience comes even close.

A similar picture is obtained for median multiples (MM's), the ratio of median house prices to median annual incomes, a standard measure of housing affordability. 'Normal' MM values in developed countries are between 2 and 3, and until the 1990s, this was true for the UK as well. Most English regions record MMs around 5, and in much of the south of England, MMs are above 6.ⁱⁱ

Why do we have a housing crisis?

For over three decades, the UK has had *lower rates of housebuilding* (relative to population size) than any similar country for which comparable data is available.ⁱⁱⁱ This is why the UK's housing stock (when measured as the total residential floor space divided by the number of households) is now the smallest among comparable countries.^{iv}

The housing stock is not just inadequate in total, but much of it is also in the 'wrong' place, because what little development we have is skewed towards those parts of the country where the problem is least bad (and effective demand for housing is lowest).^v

There is an overall shortage of housing, and it is most pronounced in the areas where housing demand is highest. This is why we will not follow the distinction between tenures set out in the consultation document. There is no specific shortage of social housing, or private rented accommodation, or homes for first-time buyers, or housing of any other type, but an overall shortage of inexpensive housing across all tenures.

We do not need separate policy measures for this subsector or that subsector of the housing market, but a general increase in housing supply.

What differs across tenures is the manifestations of the lack of supply. These are as follows:

- In the social sector -> longer waiting lists primarily occur
- In the private rental sector -> soaring rents and higher numbers of rogue landlords
- For would be homeowners -> more difficult to raise a deposit and access housing finance

Whichever tenure you consider, *the cause of rising house prices is always the same: demand vastly outstrips supply.*

In a seminal paper in the *Economic Journal*, titled "The impact of supply constraints on house prices in England", Hilber and Vermeulen estimate that 35% of the average house price in the UK is directly attributable to planning constraints. (This is a national average. The share is far greater in London and the Southeast).

Hilber and Vermeulen's 35% figure must be seen as an absolute lower bound. In a number of ways, their study errs on the side of caution. The definition of 'natural obstacles' for example, is a very encompassing one, which probably means that in several instances, low housebuilding numbers are wrongly attributed to natural obstacles when they should really be attributed to planning constraints.

As Cheshire (2009, p. 11) explains in his international comparison of planning systems:

"In economic terms the distinctive difference between the English planning system and those of Germany, the Netherlands and the US is that the English system explicitly constrains the supply of land, and has done so over a long period. The German and Dutch systems, although they impose a strong regulatory framework, have imposed only a modest constraint on land supply (although as noted above the Dutch seem to have become more restrictive since about 1990)."^{vi}

Government solutions thus far & their effect

Help to Buy Scheme

According to Shelter's estimate, the Help to Buy programme has pushed up house prices by over £8,000.^{vii} That figure may not be the last word, but there can be no question about the direction of the effect. It is a priori clear that increasing demand in a market with highly inelastic supply must necessarily increase the price, whilst having only a trivial impact on quantity. This is not even an empirical question, it follows from economic theory.

Inheritance tax

The changes to inheritance tax are a step in the wrong direction. By treating housing wealth preferentially relative to non-housing wealth, these changes will introduce further distortions, and further inflate demand without adding anything to supply.

Higher tax for buy-to-let landlords

The higher tax burden on buy-to-let landlords is also a step in the wrong direction. Letting a property is business like any other, and the cost of servicing the mortgage is a business cost like any other. Thus, the tax system should treat it as such.

Changes to Stamp Duty

The changes to Stamp Duty, which have abolished 'cliff edges' in the old tax structure, have been a step in the right direction. However, taxing housing transactions is the wrong approach per se. It reduces labour mobility and impedes downsizing.

Greenbelts

Greenbelts are not just outdated, but conceptually wrong. The greenbelt should not be 'reformed' or have its boundaries redrawn, it should be abolished in its entirety. Protecting land from development should be done in a selective manner, on the basis of the environmental and amenity value of that land. The mere proximity of a plot of land to e.g. London, Oxford, Cambridge, Bristol or Bath is not, in itself, a valid reason for a presumption against development. The idea that cities sprawl outwards endlessly unless locked into a straightjacket has no factual basis whatsoever, and even if this were a legitimate concern, there are much more intelligent ways of encouraging higher-density development than blanket development bans.

What should the government be doing?

Boosting homeownership should not be a policy aim in its own right. *The government's aim should be to improve affordability in general: to allow construction levels that are high enough to lead to house prices and rents falling across the board.*

This may well result – and is indeed likely to result – in higher levels of homeownership, which one might see as a desirable side effect, but it should not itself be the aim. *Housing policy should be tenure-neutral.* The tenure mix should reflect people's preferences and market conditions.

Sensible tax changes would strengthen incentives to permit development by ensuring that local authorities gain from it. Broadly speaking, *tax revenue ensuing from housing (and commercial) development should remain in the area in which it is generated.*

This could be achieved by, for example, the introduction of a local income tax, with local authorities setting the rate and retaining the revenue. Attracting residents would then become a way for local authorities to increase the local tax base, and permitting development would be a relatively easy and straightforward way to attract residents.

A complementary option would be to *replace council tax with a local Land Value Tax (LVT).*

Conclusions

The reason for the government's failure in tackling the housing crisis is its unwillingness to confront organised 'Nimbyism'. This is, to say a least, a short-sighted strategy, because rising housing costs cause far more widespread political discontent than a few Nimby groups could. In the short term, of course, the latter are far noisier than the people who are negatively affected by rising housing costs.

It has become almost a cliché to point out that everybody agrees in principle that the UK needs more housing, but that nobody wants those houses near them. But this is where political leadership is required. Repeating that cliché, like an unfortunate fact of life that nothing can be done about, is not enough. Public attitudes to housing are not immutable, and resistance to development can be overcome – but not if it is never publicly challenged.

This Briefing is based on a response to the House of Lords Select Committee on Economic Affairs' inquiry into ***The Economics of the UK Housing Market.***

ⁱ Niemietz, K. (2015) 'Reducing poverty through policies to cut the cost of living', Report, York/London: Joseph Rowntree Foundation, p. 8.

ⁱⁱ Ibid. p. 9.

ⁱⁱⁱ Niemietz, K. (2012) 'Redefining the poverty debate. Why a war on markets is no substitute for a war on poverty', Research Monograph 67, London: Institute of Economic Affairs, pp. 85-86.

^{iv} Niemietz, K. (2015) 'Reducing poverty through policies to cut the cost of living', Report, York/London: Joseph Rowntree Foundation, pp. 8-10.

^v Cheshire, P. (2014) 'Turning houses into gold – the failure of British planning', CentrePiece, Centre for Economic Performance, pp. 15-18.

^{vi} Cheshire, P. (2009) 'Urban containment, housing affordability and price stability – irreconcilable goals', SERC Policy Papers No. 4, Spatial Economics Research Centre, The London School of Economics and Political Science, London, UK.

^{vii} Van Lohuizen, A (2015) 'How much help is Help to Buy? Help to Buy and the impact on house prices', London: Shelter.