Housing, Debt and the Economy: a Tale of Two Countries

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‘The Broken Housing market’
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Bath Royal Literary and Scientific Institution
It is now official: “the UK housing market is broken”.

- Housing White Paper 2017, Mrs. May’s foreword: “Our broken housing market is one of the greatest barriers to progress”.

- Among the G7, the UK had the largest rise in house prices relative to average disposable income since 1970, esp’y since 1997.

- The consequent housing affordability problem is revealed by a rise in ‘concealed households’, or family units without their own home.

- It rose by 50 percent in the past decade, from 1.6m in 1996, to 2.5m households in 2016.
It is now official: “the UK housing market is broken”.

• 65% of 25-34 year olds with middle incomes owned their own homes in 1995-6; 27% in 2015-6 (IFS data).

• The Housing Benefit bill rose in real terms between 1997-98 and 2011-12 by 67 percent in London, by 61 percent in the rest of the South East, and by 51 percent in Great Britain.

• Since then, severe cuts in the generosity of Housing Benefit reduced the expense to the taxpayer but increased financial stress for many tenants.
Consequences of rising house prices and of institutional differences

- Rise in inequality between generations in the UK:
  - ‘lost generation’ born after Mrs Thatcher came to power in 1979
  - privileged opportunities for children of wealthy
  - Local house prices now reflect more heavily access to good transport, education and a healthy environment

- Macro-consequences:
  - instability for the UK financial system and for households
  - lower growth
  - Germany has benefitted from the converse.
Learning from international experience

- The UK’s housing crisis was not inevitable.
- It results from multiple policy failings.
- Problems both on the supply side and the demand side.
- Contrasts with Germany: despite major institutional differences, many lessons.
- Learn from S Korea: land-banking and land-value capture.
- Learn from Denmark: stabilising property tax.
Key drivers of UK real house prices

- Log real house price index
- Contribution of log income/housing stock
- Contribution of log housing stock/head

Credit crunch, mortgage credit liberalisation, lower interest rates, foreign and financial sector demand, rising mis-match and inequality.
Key drivers of German house prices

- Lower nominal mortgage rates
- Subsidies, easier credit
- Cross-country spill-overs
- Demography
• In the UK, housing and debt contributed to economic and financial instability (though US and Ireland were even more extreme)

• **Amplifying feedback loops** of the financial accelerator include

  o consumer spending rises with house prices *(but not in Germany)*

  o residential construction rises with house prices *(but hardly responded in the UK)*

  o The opposite when house prices fall when the bad loans of banks restrict credit flows, worsening the down-turn.

  o These mechanisms were missing in the fashionable academic theory and models used by central banks.

  o German mortgage lending is more conservative: tighter loan to value and loan to income ratios; hardly any home equity withdrawal.
Other UK – German differences

- UK owner-occupation 65% but declining; German 46% and stable.

- Regulated rental market, long contracts, security in Germany, see below.

- Mostly adjustable rate mortgages in the UK; fixed rate in Germany. Linked to contrasts in inflation history.

- Funded pensions plus public back-stop for the less privileged in the UK; mainly pay-as-you-go pensions in Germany (post 2003 reforms increasing funded share).

- Stock market participation higher in the UK.
• The private rental sector in Germany over 2x as large as the UK’s.

• Age structure balanced in Germany, disproportionately young in UK.

• Small-scale landlords dominate ownership in both countries (a bit more so in UK).

• UK rental contracts are mostly ‘assured short-hold tenancies’- security of tenure for min\textsuperscript{m} of 6 months, more usually 12 months. Average duration 2.5 years, less in London.

• German contracts underpin indefinite tenancies: average duration in Germany is 11 years. Supports social cohesion and stability.

• Flexible rent controls in Germany: restrict scale of rent increases during a tenancy. Landlord can set rent for new tenancies.
Household balance sheets: more debt in the UK
Germans have housing; Brits have high house prices

- Ratios to household income of illiquid financial assets and housing wealth
German households save far more

Contrasts in the household saving ratios
Housing supply issues

- UK builders are more monopolistic - basically land speculators.
- Small and medium sized builders build around 25% of UK homes; around 50% in Germany.
- Volatile and high building land prices in the UK make building risky; hard for small builders to access credit.
- Slow UK build-out rates to exploit local monopoly power and control risk.
- Big differences in land value capture and planning.
Contrasts in use of planning gain

• Germany
  o Local authority caps land values at pre-permission prices at the time planning permission is given.
  o Hence acquires land for infrastructure at reasonable cost.
  o Captures part of ‘planning gain’ to fund infrastructure.
  o Planning gain can be 10-fold.

• UK
  o The land-owner receives the planning gain.
  o Planning gain on UK greenfield land can be 200-fold.
  o Has cumbersome procedure to try to claw back a bit of the planning gain to help fund social housing and infrastructure (slow negotiations under ‘Section 106’).

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<th>2014</th>
<th>Homes receiving permission</th>
<th>Homes built</th>
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<tbody>
<tr>
<td>Germany</td>
<td>285,000</td>
<td>245,000 (86%)</td>
<td></td>
</tr>
<tr>
<td>England</td>
<td>261,000</td>
<td>125,000 (48%)</td>
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• **UK Council Tax based on 1991 valuations:**
  - The highest tax rates are paid on the poorest housing; most expensive housing paying no more than moderately expensive.
  - Council Tax Relief for poor families: poverty trap problems.
  - Discounts for second homes and for single people.
  - Results in inefficient use of space; encourages conversion of multi-family dwellings into single luxury mansions, reducing supply.
  - Poorest local authorities tend to set highest rates.
  - Raised 4.8% of total UK tax revenue in 2015.
  - **In the UK:** Stamp Duty Land Tax progressive rate: 2-12% on homes above £125,000; since 2015, an extra 3% on second homes and buy-to-let.
  - Discourages labour mobility, matching of supply and demand e.g. down-sizing.
• **Redistribution of wealth to the older ‘haves’**.

• **Financial crisis worse** than it need have been and **vulnerability** continues.

• **Possessions and arrears crisis** only averted by the most dramatic monetary and fiscal interventions in history.

• Falling owner occupation, **lowest fraction of FTBs under 30** since records began in 1968.

• Effective further tightening of planning controls under New Labour.

• **Lowest house-building levels in 2010-2014** since 1920s.

• Property tax reform and supply side reforms are needed.
• 1. Fix planning system and property law (1961 Land Compensation Act) so that much more of planning gain - *land value capture* - accrues to *society* to fund infrastructure, schools and social housing. *(now in Labour manifesto).*

• 2. Reform fiscal rule so that marketable public assets such as land are netted off gross debt: makes public land banks affordable.

• 3. Greatly expand social housing supply.

• 4. Financial incentives for councils for greater land release.

• 5a. Remove inequity and inefficiency of Council Tax, cut Stamp Duty.

• 5b. Ensure foreign investors are taxed properly.
5. Property tax reform

- Simplest: return to pre-1989 Domestic Rates (like property taxes in most countries, owners pay, no single person or second home discounts) BUT with **regular revaluation** and **deferral** option.
- Deferral means that every year of non-payment increases society’s stake at the Land Registry: with 0.5% of value tax, 5% after 10 years. Settled when ownership is transferred.
- Destroys use by the wealthy of the ‘cash-poor widow in expensive home’ argument against property taxes.
- Super-tax to catch ‘trophy homes’ of foreign residents, discounted for domestic income and social security tax payers and pension recipients.
- More radical: land value taxation but would have to offer green discount to avoid ‘garden tax’ jibe.
A green land value tax

- The green LVT would consist of a standard charge on the land value per square metre, plus a surcharge on the building depending on its energy usage, zero for an energy-neutral building.
- Such a GLVT would encourage efficient use of land and energy, encourage home insulation and higher environmental standards, helping the UK to meet its climate obligations.
- An energy-efficient block of flats would typically have a far lower property tax rate per flat compared with an energy-inefficient mansion on the same sized plot.
- Incentive for the building industry to build higher density energy-efficient flats.
- Labour Party promises to look at land value tax.
Like LVT-based residential property taxes, raises revenue for public sector investments that boost local property values.

Incentive for developers to bring their private land banks into development more rapidly.

Incentive to locate business investment in cheaper locations where unemployment rates are often higher.

Given annual or biannual revaluations, relieves financial pressure on businesses.

Any radical change in the tax system needs to be phased in slowly to give people time to adapt.
Benefits of reforms 1 to 5

• Higher growth prospects, and more sustainable and inclusive.
• Intergenerational inequality and gap between wealthy and poor will fall.
• More sustainable public finances.
• More housing and more efficient use of housing stock will improve living standards and choices over where people want to live.
• Lower Stamp Duty will increase mobility, allow people to live closer to work, reduce commuting costs, improve labour market flexibility.
• Financial stability will improve as house price volatility is reduced – lesson from Denmark.
• 6. Reform rental contracts and regulation to encourage long-term tenures. *All major parties now considering this.*

• 7. Reform pension system to reduce the ‘take’ of the asset managers.

• *Which political party will take up the cause of the increasing post-Thatcher cohort and the elderly who care about their offspring?*
• Older and more affluent voters turn out in elections.
• NIMBYism has wide support.
• Marginal seats –most in S East- are key to electoral success.
• Many in the ‘middle class’ i.e. the top 25%, like their privileged access, via high house prices, to good schools etc.
• Mortgage lenders prefer house prices to stay high.
• The press tends to reflect the interests of very affluent owners and fairly affluent journalists. Whips up hysteria for threats to house prices.
• Even the ‘liberal’ press...next slide (thank you, Will Hutton).
Squeezing the richly appointed 5 recs, 6 bds, 3000 sq. ft. Home until the pips squeak...

Council Tax Revenues
Declining Nimbyism – Brit. Social Attitudes Survey

Would you support or oppose more homes being built in your local area?

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<tr>
<th>Year</th>
<th>Support</th>
<th>Oppose</th>
<th>Neither/don’t know</th>
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<tbody>
<tr>
<td>2010</td>
<td>28%</td>
<td>46%</td>
<td>26%</td>
</tr>
<tr>
<td>2013</td>
<td>47%</td>
<td>31%</td>
<td>23%</td>
</tr>
<tr>
<td>2014</td>
<td>56%</td>
<td>21%</td>
<td>23%</td>
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• https://www.intergencommission.org/

• Analyses the poor life chances of the post-1980 generations: worse labour market prospects, far higher housing costs, larger government debt burden and rising costs of health care of older generations to finance.

• Climate change adds another layer.

• Lord Willets argues that higher property taxes are a fairer way of sharing these burdens, as earlier generations own most of the property, now worth twice more compared to income.

• https://www.economics.ox.ac.uk/materials/working_papers/4660/housing-debt-and-the-economy-a-tale-of-two-countries.pdf
http://blogs.lse.ac.uk/politicsandpolicy/turning-houses-into-gold-the-failure-of-british-planning/
• Climate scientists fear that the world is hurtling towards a catastrophic *tipping point* in the global climate.

• **Amplifying feedback loops** threaten mass species extinction, major sea-level rises and other disasters:
  - *Melting polar ice caps*: reduce reflection of sun’s rays, increasing global warming.
  - *Melting permafrost in the Arctic tundra*: releases trapped methane, about 30 times more potent a greenhouse gas than CO₂ (in the SR)
  - *Tundra soil*: warming will release large amounts of buried carbon over a longer time scale.
  - *Rain forests*: when stressed by drought they reverse the carbon cycle and release CO₂ instead of absorbing it.
  - *Oceans*: major absorbers of CO₂, but their warming reduces this stabilising capacity.