

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

John Muellbauer

'The Broken Housing market'

13 November, 2018

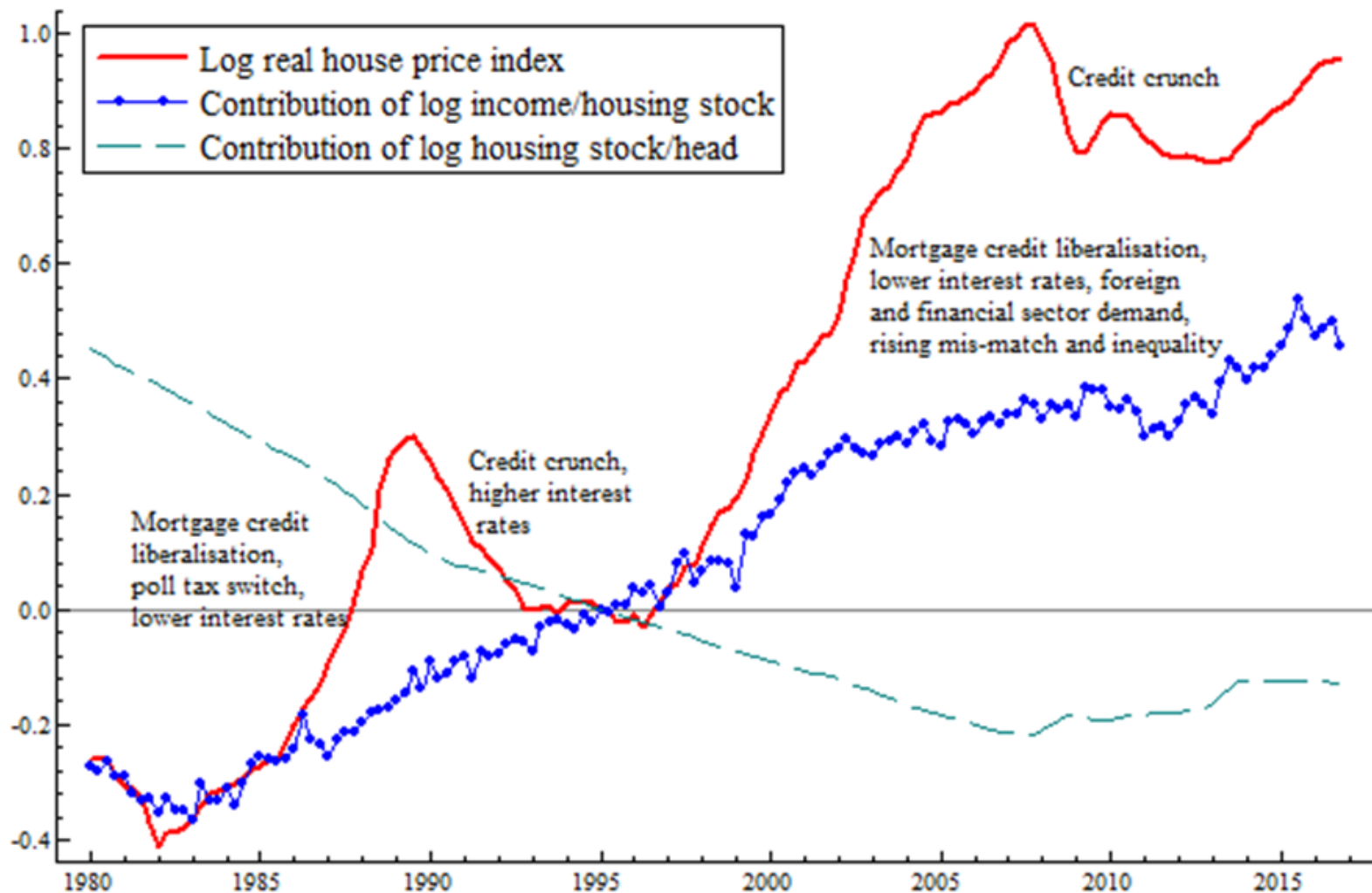
Bath Royal Literary and Scientific Institution

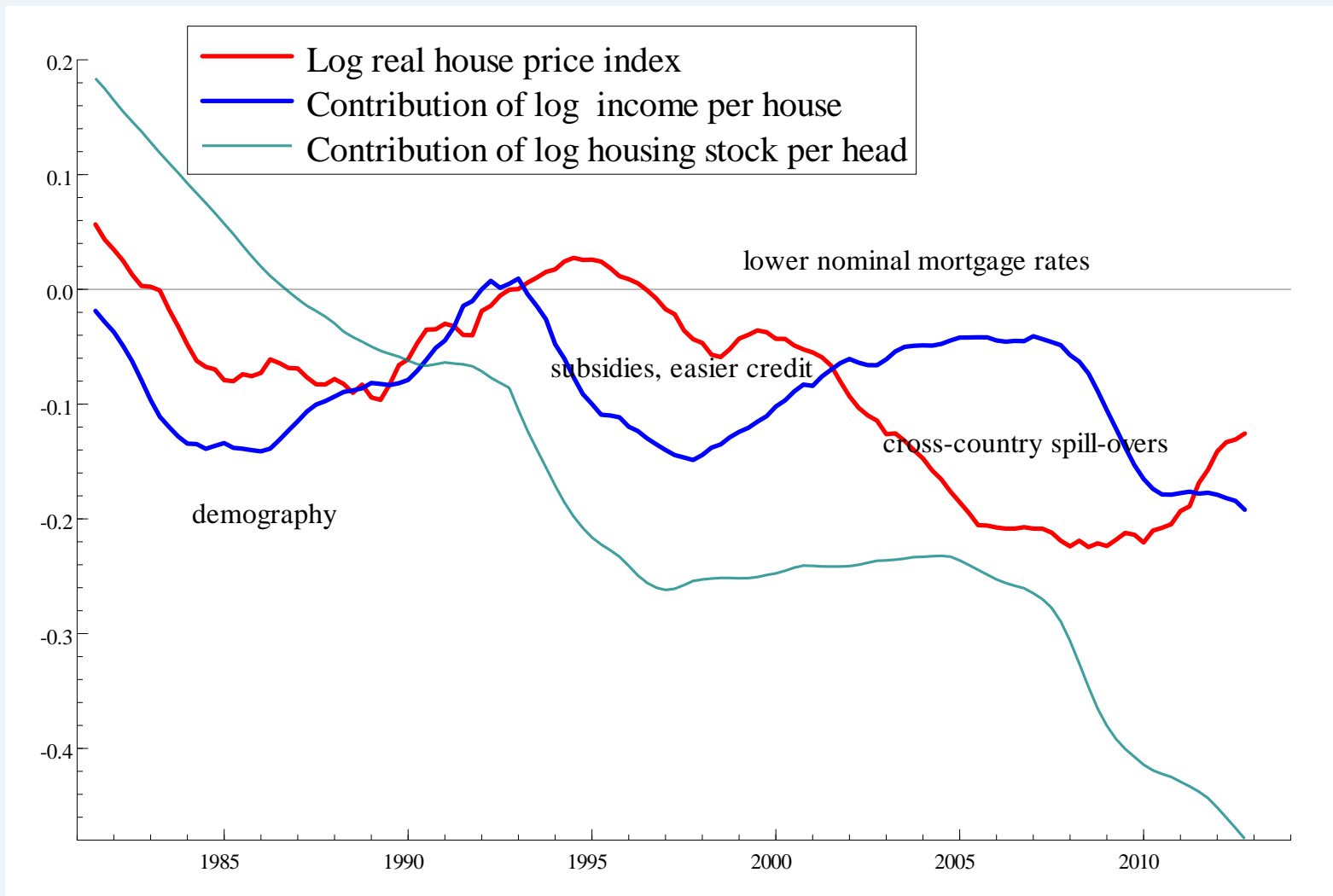
- Housing White Paper 2017, Mrs. May’s foreword: “*Our broken housing market is one of the greatest barriers to progress*”.
- Among the G7, the UK had the largest rise in house prices relative to average disposable income since 1970, esp’y since 1997.
- The consequent housing affordability problem is 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.

- 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.

- 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.**

- 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.



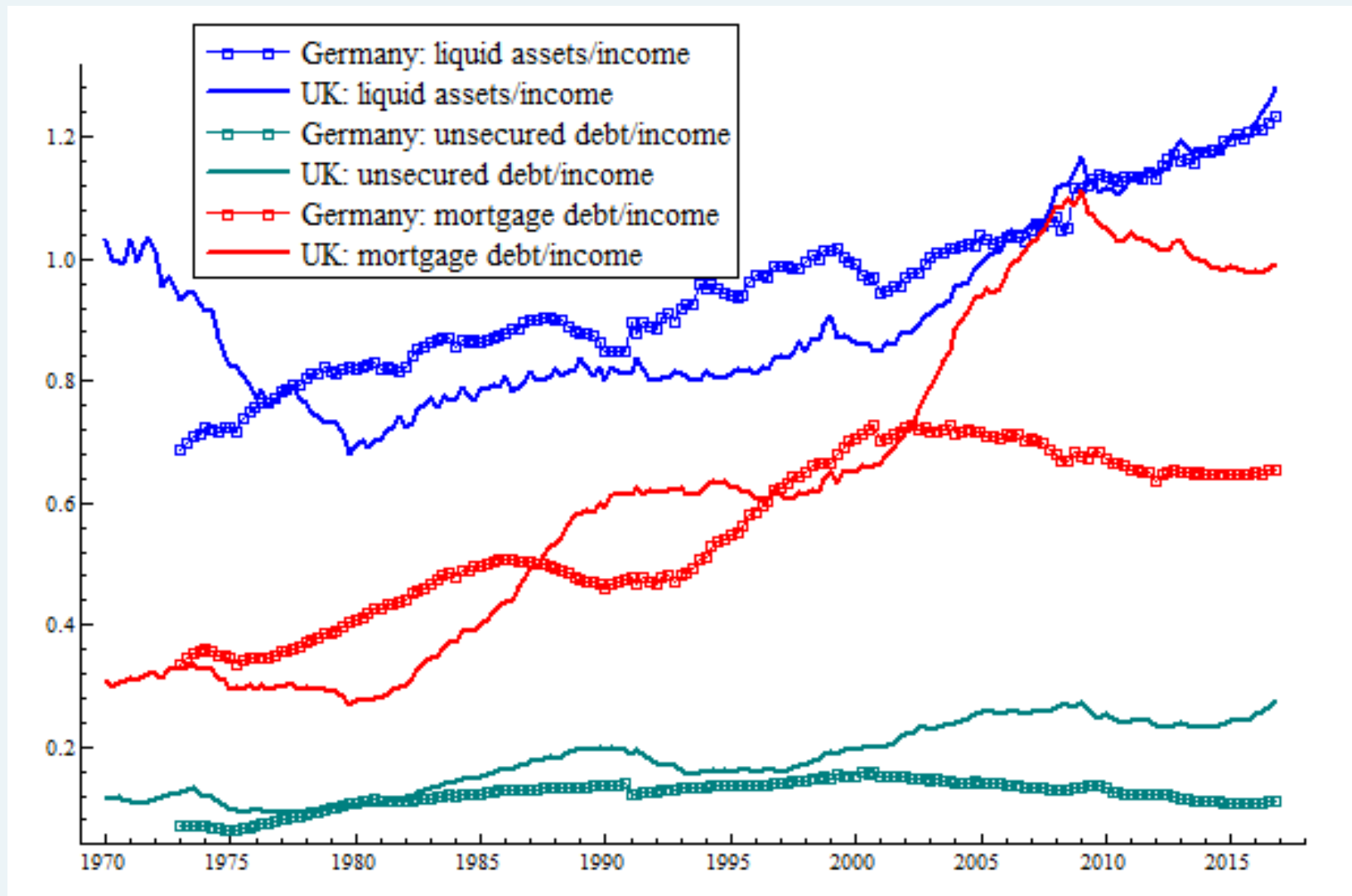


- In the UK, housing and debt contributed to economic and financial instability (though US and Ireland were even more extreme)
- Amplifying feedback loops of the financial accelerator include
 - consumer spending rises with house prices (but not in Germany)
 - residential construction rises with house prices (but hardly responded in the UK)
 - The opposite when house prices fall when the bad loans of banks restrict credit flows, worsening the down-turn.
 - These mechanisms were missing in the fashionable academic theory and models used by central banks.
 - German mortgage lending is more conservative: tighter loan to value and loan to income ratios; hardly any home equity withdrawal.

- 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.

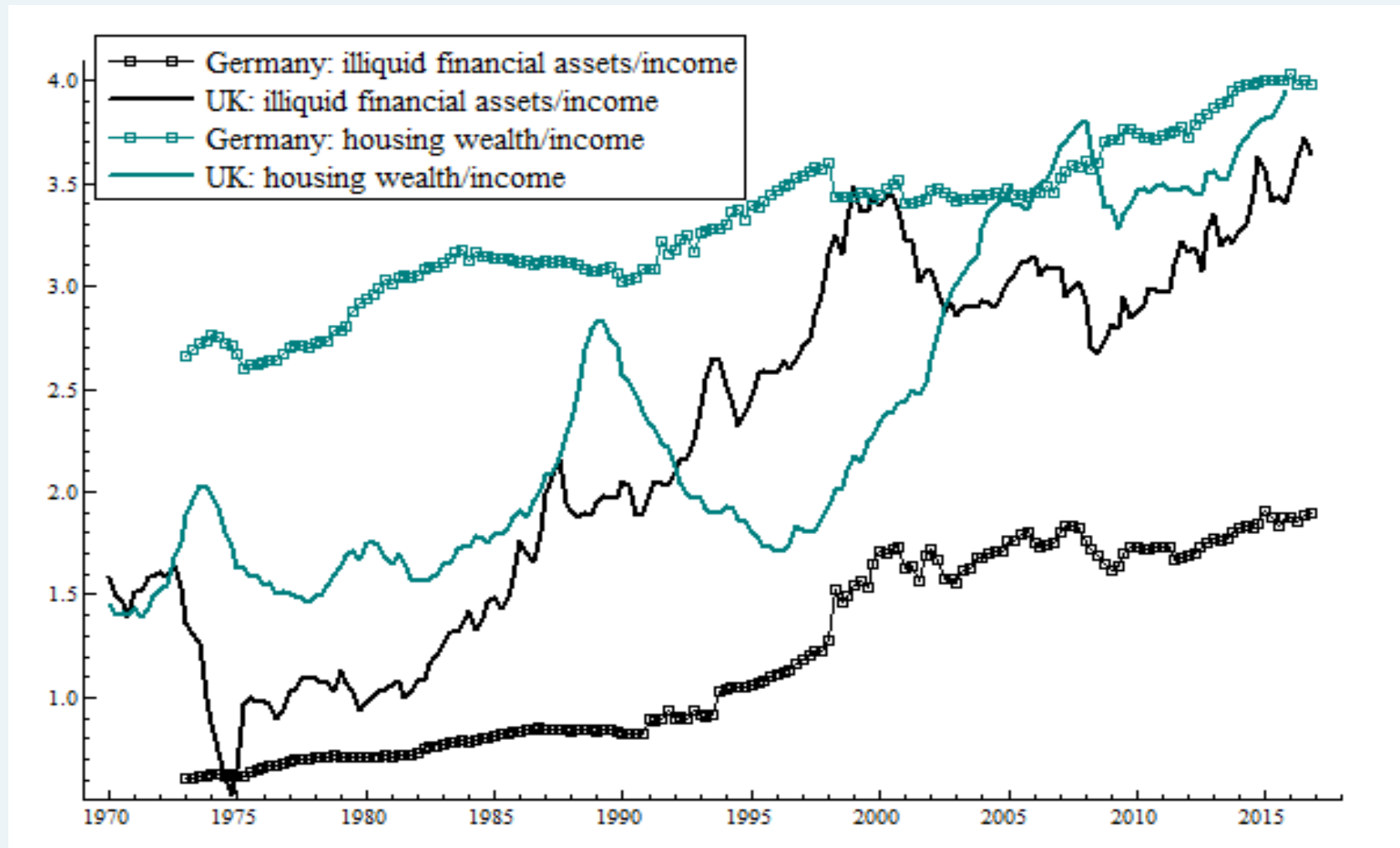
- The private rental sector in Germany over 2x as large as the UK's.
- Age structure balanced in Germany, disproportionately young in UK.
- Small-scale landlords dominate ownership in both countries (a bit more so in UK).
- UK rental contracts are mostly 'assured short-hold tenancies'- security of tenure for min^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

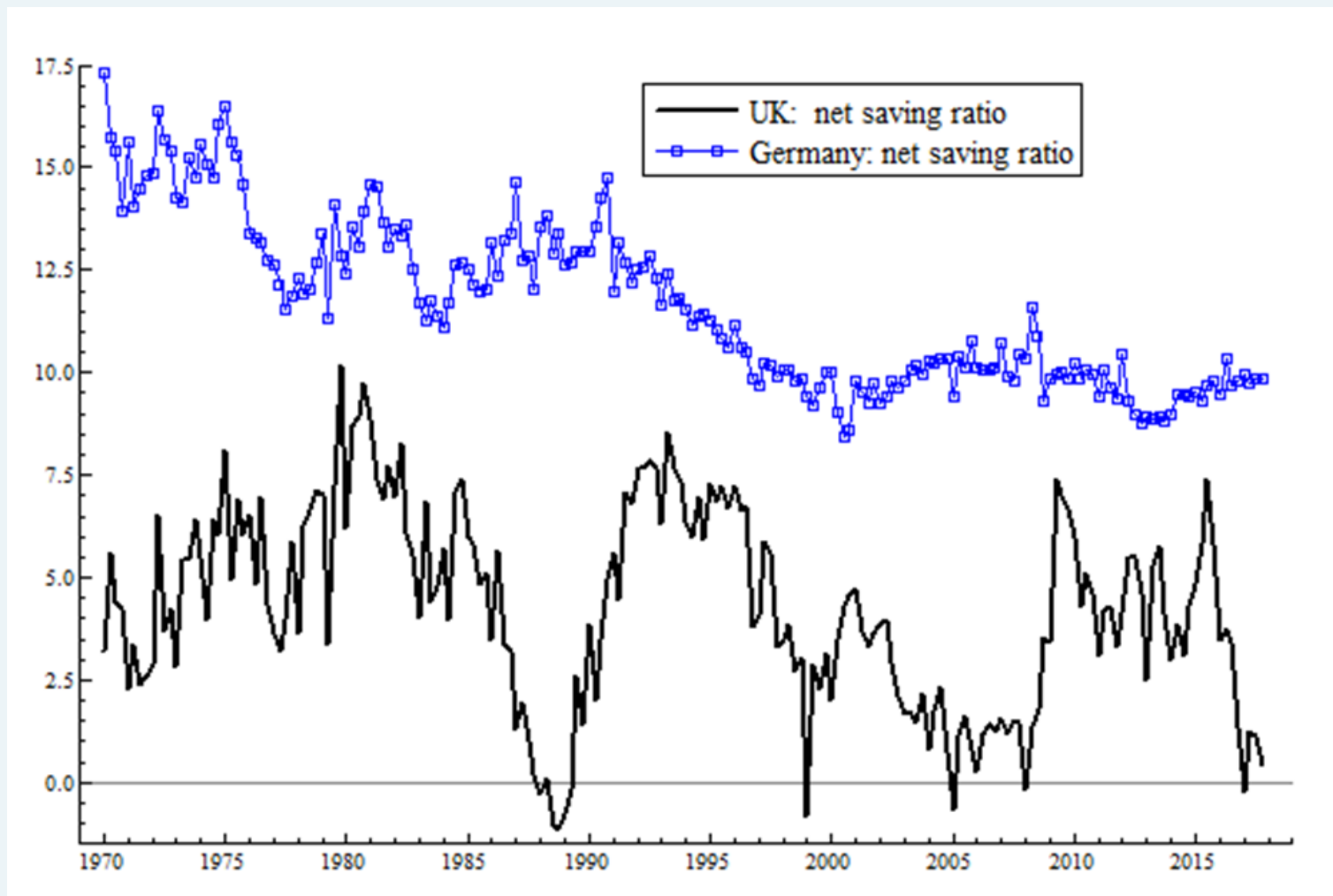


Germans have housing; Brits have high house prices

- Ratios to household income of illiquid financial assets and housing wealth



Contrasts in the household saving ratios



- 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.

- Germany
 - Local authority caps land values at pre-permission prices at the time planning permission is given.
 - Hence acquires land for infrastructure at reasonable cost.
 - Captures part of ‘planning gain’ to fund infrastructure.
 - Planning gain can be 10-fold.
- UK
 - The land-owner receives the planning gain.
 - Planning gain on UK greenfield land can be 200-fold.
 - 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’).

2014	<i>Homes receiving permission</i>	<i>Homes built</i>
Germany	285,000	245,000 (86%)
England	261,000	125,000 (48%)

- 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.

- 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.

- 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.**

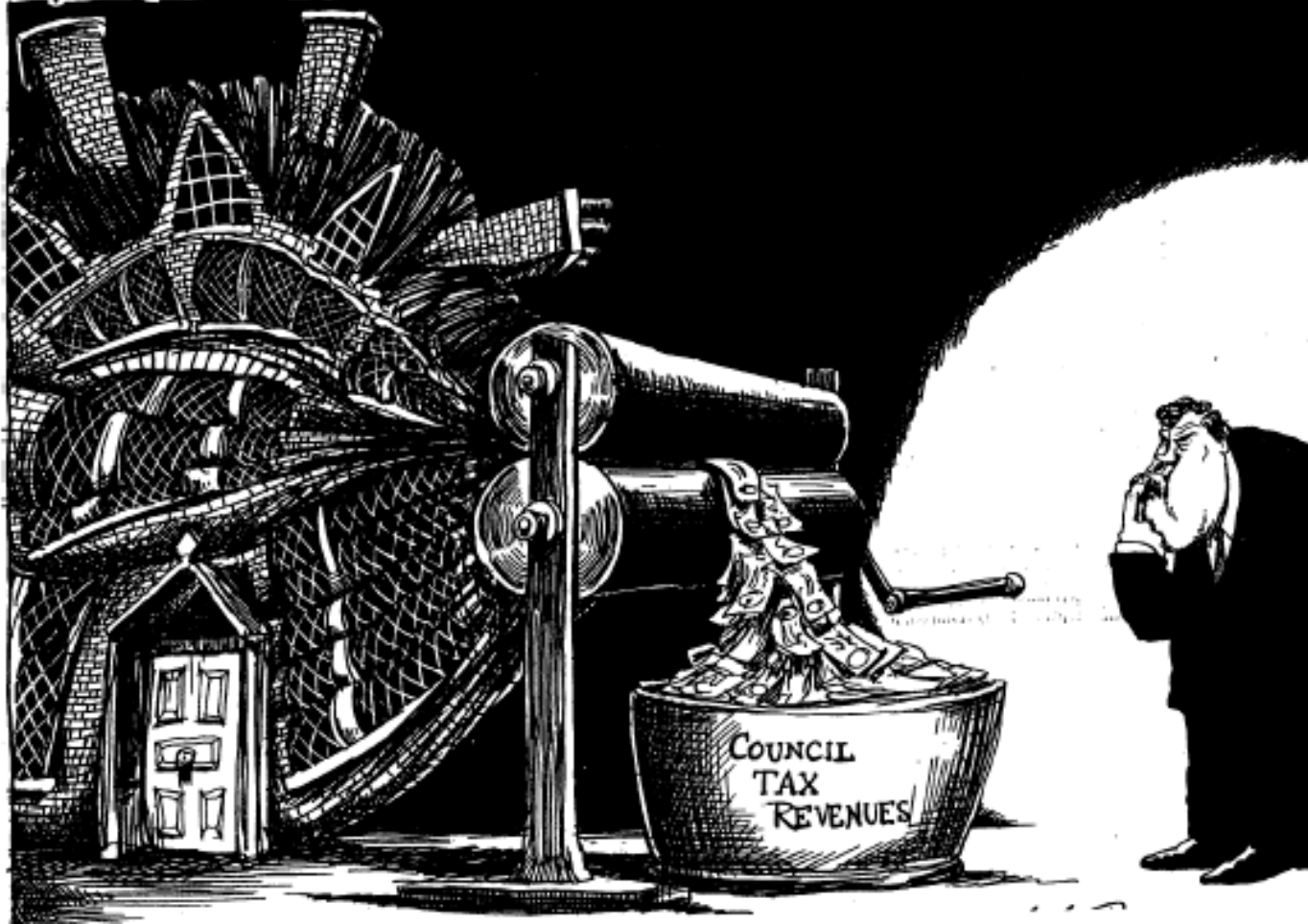
- Like LVT-based residential property taxes, raises revenue for public sector investments that boost local property values.
- Incentive for developers to bring their private land banks into development more rapidly.
- Incentive to locate business investment in cheaper locations where unemployment rates 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.

- 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.

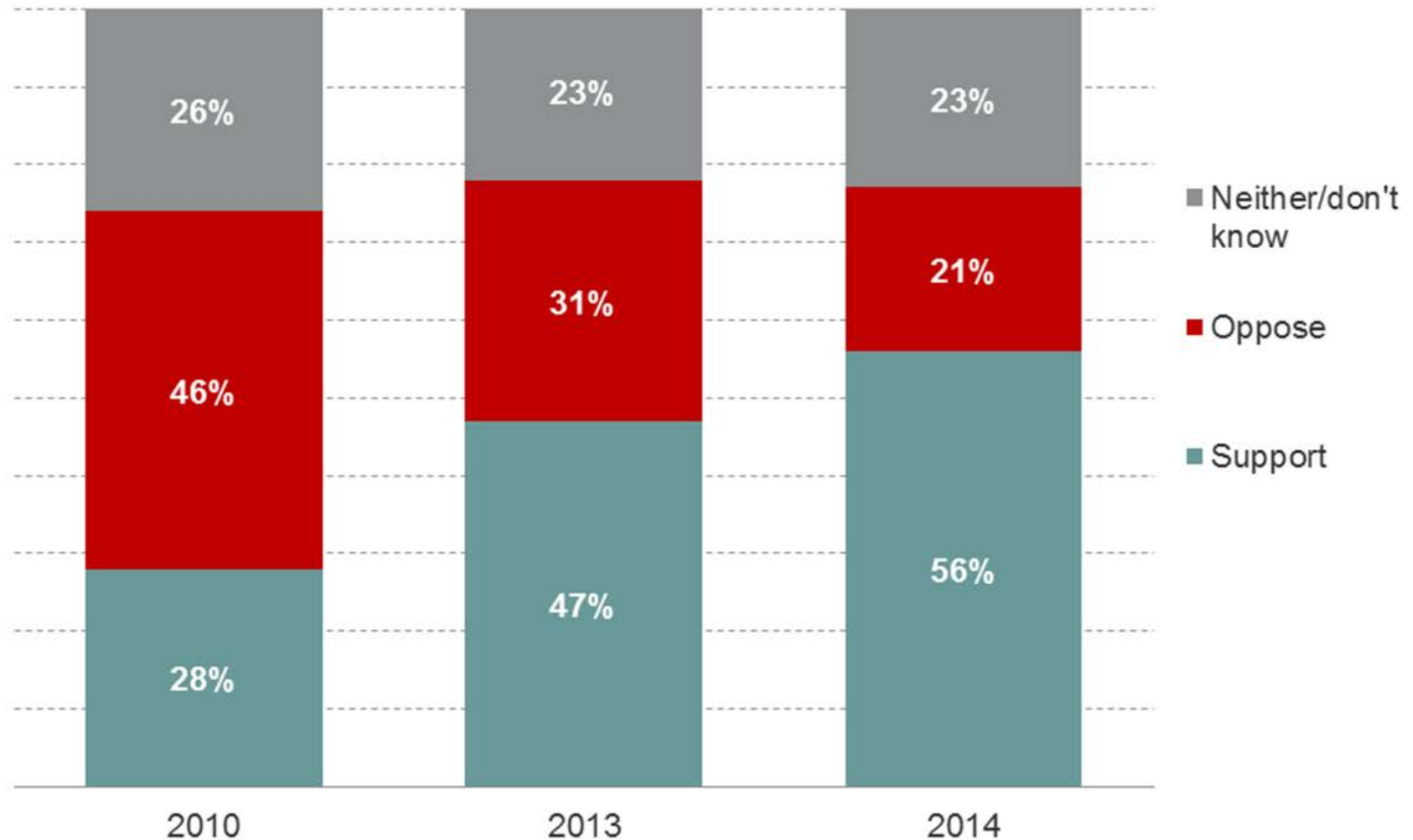
- 6. Reform rental contracts and regulation to encourage long-term tenures. **All major parties now considering this.**
- 7. Reform pension system to reduce the 'take' of the asset managers.
- **Which political party will take up the cause of the increasing post-Thatcher cohort and the elderly who care 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, 300ft² gen. des. res. until the pips squeak...



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



- <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.