

Niemietz, Kristian

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## Abundance of land, shortage of housing

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# Abundance of land, shortage of housing

IEA Discussion Paper No. 38



by

**Kristian Niemietz**

**April 2012**

iea

**Institute of Economic Affairs  
2 Lord North Street  
London  
SW1P 3LB**

**[www.iea.org.uk](http://www.iea.org.uk)**

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## Introduction

Runaway housing costs have become one of the most pressing issues for low-income households in the UK. House prices have doubled in real terms since the mid-1990s alone, from an already very high level<sup>1</sup>. No other developed country except Australia<sup>2</sup> has experienced a price explosion of such a magnitude. Not even Spain, with its notorious house price bubble, has quite paralleled the British experience. In nominal terms, house prices in the UK have increased by a factor of nearly forty over the last forty years (see Table 1). Rent levels have followed suit, since the ratio of house prices to rent levels shows no systematic trend over time (The Economist house price indicators, 2012).

**Table 1: Mix-adjusted house-price index, selected years, 100 = 1971-level**

	House price
index	
1971	100
1981	472
1991	1,262
2001	2,133
2011	3,875

Based on data from DCLG (2011)

More important than house prices per se are measures of housing affordability, such as the 'Median Multiple' (MM). This is the ratio of median house prices to median annual gross income, i.e. it shows how many annual gross salaries a family in the middle of the income range requires to purchase a house in the middle of the price range. Demographia (2010) provide data on regional MMs, and show that as a historical longer-term average, MMs in developed English-speaking countries have clustered just below a value of 3.0. A family on average incomes could thus afford an average-priced house with three gross annual salaries. Demographia takes this 3.0 value as the critical threshold, and classifies housing markets with a MM at or below this level as 'affordable'.

Of the 33 UK regions included, not a single one counts as affordable according to this definition, and perhaps more worryingly, not a single one comes even close (see Table 2).

**Table 2: Median Multiples in UK regions**

Median Multiple	
4.0 – 4.9	Falkirk, Dundee, Belfast, Leeds & West Yorkshire, Perth, Derby & Derbyshire, Middlesbrough & Durham, Nottingham & Nottinghamshire, Sheffield & South Yorkshire, Hull & Humber
5.0 – 5.9	Glasgow, Greater Manchester, Blackpool & Lancashire, Leicester & Leicestershire, Stoke on Trent & Staffordshire, Swansea, Birmingham & West Midlands, Cardiff, Northampton & Northamptonshire, Aberdeen, Liverpool & Merseyside, Newcastle & Tyneside, Newport, Warwickshire, Edinburgh, Bristol & Bath
6.0 – 6.9	Warrington & Cheshire, Telford & Shropshire, Exurbs of London, Swindon & Wiltshire
>7.0	Greater London, Plymouth & Devon, Bournemouth & Dorset

<sup>1</sup> See The Economist house price indicators (2012). The moderate decline since 2008 is already included.

<sup>2</sup> The fact that it is Australia, of all countries, which parallels the British experience, already hints at an argument which will be elaborated on later in this paper: increases in housing costs have next to nothing to do with scarcity of land or other housing-related inputs. Australia has one of the lowest population densities in the world, but has adopted an approach to planning not too different from the British one (see Hartwich and Gill, 2011, pp. 10-14).

Gathered from Demographia (2010), pp. 29-31

Even some highly sought-after North American markets such as Washington DC and Chicago are cheaper, relative to earnings levels, than any region in the UK. Only Australia shows a similar lack of inexpensive housing. If these figures were adjusted for dwelling size or age, the position of UK housing markets would surely look even bleaker.

So unsurprisingly, housing has become a focus for the Liberal-Conservative coalition. In July 2011, Planning Minister Greg Clark announced a moderate reform of the land-use planning system, which would simplify the decision-making process and tilt it more in favour of development. The 'National Planning Policy Framework' (NPPF) would leave Green Belts, Areas of Outstanding Natural Beauty and other protected areas untouched, but facilitate residential construction outside of these.

Despite the urgency of reform, and despite the many ifs and buts in the NPPF, a broad anti-development lobby was soon up in arms against the proposals. The Campaign to Protect Rural England (CPRE), the National Trust, English Heritage, the Woodland Trust, as well as Greenpeace and Friends of the Earth launched a series of attacks against them. The Guardian and The Daily Telegraph newspapers openly supported this lobby; the latter even set up the initiative 'Hands off our Land!' to provide them with an effective platform. It is not unusual, of course, to see vested interests trying to derail a reform which they perceive as a threat. What was surprising, though, was how easily the media and the coalition itself let those vested interests get away with arguments that were quite obviously flawed.

The most likely explanation for this phenomenon is that besides a lot of scaremongering and plain misinformation, these groups were able to revert to straw men, red herrings and blind alleys which have muddled the housing policy debate for far too long. In the housing debate, supply-side conditions are too often taken as given, and high housing costs, poor housing conditions and overcrowding are then erroneously treated as 'market outcomes'. This results in a counter-productive tendency to concentrate on what are at best side issues, and more often just non-issues. The latest British Social Attitudes Survey (BSA) provides a good summary of the state of the debate. It shows that a majority is aware of the problems in the housing market, but would like to see them resolved without additional development. When asked, 'if the government were going to do something to make homes more affordable, what do you think the most useful action would be?', 69% of respondents favoured demand-side measures, such as subsidies for home buyers (DCLG, 2011a).<sup>3</sup> Only 5% chose the rather straightforward option 'allow developers to build more homes'.

This paper will address a selection of the non-arguments often heard in the housing debate, and will show why none of them can explain more than a trivial share of the housing cost escalation. It will then go on to show why only a thorough liberalisation of the land use planning system can address the affordability crisis.

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<sup>3</sup> 63% thought the government should give financial assistance to selected groups of home buyers, or require banks to do so. Another 6% favoured a rationing measure: 'Make it more expensive to purchase second homes'.

## Population density: the myth of the overcrowded island

The focus on population density, sometimes linked to immigration, is an example of an oft-repeated non-issue<sup>4</sup>. With 247 inhabitants per square kilometre, the UK is not particularly densely populated. A number of developed countries record much higher figures, for example South Korea (484), the Netherlands (395), Belgium (341), Japan (339) and Israel (327). But since housing markets are regional rather than national phenomena, such figures are of limited use. Therefore, Table 3 shows population density figures for sub-national administrative entities<sup>5</sup> in the UK, the Netherlands, Belgium, Germany and Switzerland. This allows a comparison of population density across regions which approximate housing markets more closely. Entities that consist of a single city or conurbation have not been considered.<sup>6</sup>

**Table 3: Regional population density in the UK, the Netherlands, Belgium, Switzerland and Germany**

	Inhabitants per km <sup>2</sup>
South Holland (NL)	1,254
North Holland (NL)	1,008
Utrecht (NL)	887
Zug (CH)	535
Basel-Landschaft (CH)	527
North Rhine-Westphalia (DE)	524
Limburg (NL)	522
Noord-Brabant (NL)	499
Flanders (BE)	462
Aargau (CH)	430
South East (UK)	425
West Midlands (UK)	410
Saarland (DE)	398
Overijssel (NL)	341
Yorkshire and the Humber (UK)	327
Solothurn (CH)	320
Baden-Württemberg (DE)	301

Sources: ONS (2006), Centraal Bureau for de Statistiek (2011), Statistische Ämter des Bundes und der Länder (2011), Research Centre of the Flemish Government (2011), Bundesamt für Statistik (2009)

Compared with other relatively densely populated parts of Europe, there is nothing unusual at all about the density figures obtained for the South East, the West Midlands, or Yorkshire and the Humber, and these are the most densely populated regions in the UK. The constraints to residential development do not arise from 'overpopulation'. They are politically imposed. Developable land is available in plentiful abundance.

Organisations like the Campaign to Protect Rural England, the National Trust and Greenpeace routinely assert that the

<sup>4</sup> E.g. Daily Telegraph: 'England is most crowded country in Europe', 16 September 2008.

<sup>5</sup> Regions in the UK and Belgium, provinces in the Netherlands, Bundesländer in Germany and cantons in Switzerland

<sup>6</sup> This results in the exclusion of the city states of Berlin, Bremen and Hamburg, the cantons Basel-Stadt, Genf and Zürich, and London.

countryside is on the verge of disappearance. The CPRE (2006, p. 5), for example, claims that '[a]cross large parts of England, especially in the South East, the spread of urbanisation means there is little "deep" or "real" countryside left.' However, data from the Land Use Database show that only one tenth of the English surface area is developed at all. The rest mostly consists of woodland, grassland and farmland. Even within the developed tenth, the single biggest item is gardens (see Table 4). Land which is literally 'concreted over', i.e. covered with buildings, industrial structures, streets, roads, parking sites, rail tracks etc. accounts for a mere one twentieth of the whole English surface area. These figures are not fundamentally different even when looking at the UK's most densely populated regions, the South East and the West Midlands, in isolation.<sup>7</sup> In England, and much more so in the UK as a whole, overdevelopment is not a significant risk.

**Table 4: Surface area of England by land use**

	England (% of area)	South East (% of area)	West Midlands (% of area)
Green space and water	90.1%	84.7%	88.8%
Domestic gardens	4.3%	6.3%	4.9%
Transport routes	2.5%	2.7%	2.7%
Buildings	1.8%	2.0%	2.1%
Other/unclassified	1.4%	1.6%	1.5%
Total	100%	100%	100%

Based on data from the DCLG (2007)

<sup>7</sup> The area of Greater London, of course, is a very different matter.



## Housing Benefit: unfit, even as a treatment of symptoms

It is sometimes suggested that the problem of high housing costs can be attenuated through extended use of the Housing Benefit (HB) system. A report by the Child Poverty Action Group (CPAG, 2009) advocates maximising HB take-up rates, removing upper limits and less stringent targeting. In a Fabian Society report, Horton and Gregory (2009, p.146) argue: 'Part of the residualisation of housing provision has been the residualisation of financial support for housing provision, especially Housing Benefit, with its narrow coverage, inflexibility, and steep withdrawal rate. So part of our "de-residualising" agenda has to be to extend this system of financial support.'

Characteristically, neither report addresses the question why there has actually been an escalation of housing costs. Ignoring the causes of the housing cost escalation, and attempting to insulate low-income groups from the consequences via the HB system, would amount to mere symptom treatment even under the best of circumstances. But crucially, the HB system is not even a viable means of treating the symptoms anymore. The HB system has clearly failed to insulate low-income households from the impact of rising housing costs, as can be seen by the increasing share of housing costs in these groups' budgets. But this is not for a lack of spending or a lack of comprehensiveness. The 'residualisation' of HB which the Fabian Society report bemoans has never happened. On the contrary, the HB system has been hugely expanded over time. In 2009, nearly one in five households in Britain (18.3%) were in receipt of HB payments (DWP and ONS, 2010), a staggeringly high proportion when keeping in mind that HB is not the government's only type of housing-cost support.<sup>8</sup>

Consequently, total HB spending has more than doubled in real terms over the past two decades (see Table 5). This does not reflect a deliberate policy choice, but is a consequence of rising housing costs. The HB formula pegs rates directly to local rent levels, so if rents increase, HB rates follow suit. Just as importantly, if local rent levels rise at a faster rate than local wages, more households become eligible for HB to begin with. Both factors act to increase the HB bill, and an end to this is not in sight, despite all the controversy over HB and benefit caps.

**Table 5: Real-terms spending on Housing Benefit**

	1991	2001	2008	2015forecast
Total spending on HB (constant 2008 prices)	£9.8bn	£14.0bn	£17.1bn	£18.9bn

Source: DWP Statistics (2011)

Why has HB not insulated low income groups from the housing cost escalation, if so many households qualify for this transfer? Part of the answer is that HB is not well targeted, and indeed could not be. Just over half of total HB spending goes to households in the bottom third of the income distribution (based on data from ONS, 2010). This is a consequence of the tight link between local rent levels and HB rates: HB favours people living in expensive areas rather than people with low incomes. To some extent, this situation could be changed by moving towards a more streamlined HB system with fewer rates (see Niemietz, 2011, pp. 199-201). This would incentivise people to avoid the most expensive pockets of the country, thus leading to a more cost-effective HB system. But there are limits to how far this can be taken, because it is clearly reasonable for the HB system to reflect regional differences in rent levels.

There is a second reason why the HB system could not become a substitute for a functioning housing market: enrolling more people into the HB system inevitably means undermining work incentives, because it exposes more people to the HB withdrawal rate, which acts like an implicit tax on work.<sup>9</sup> In this way, the HB system has become a major part of the

<sup>8</sup>A large share of housing cost support is still provided in kind, in the form of below-market, subsidised rents, which will be covered below. Other cash benefits designed to help with housing costs include Support for Mortgage Interest and Discretionary Housing Payments.

<sup>9</sup>Suppose HB rates were raised across the board, for example by pegging them to a higher percentile in the rent distribution. Amongst those who do not work at all, this raises the replacement rate. The ratio of the income they receive without work to the income they would receive in a realistically attainable job rises: The former is increased by the full amount of the HB rise; the latter is only increased by the tapered amount. Amongst those who worked before and received HB, the 'income effect' acts to reduce work levels (they could now reach the same living standard as before with fewer working hours) while the substitution effect is unchanged. Amongst those who worked before and now start to qualify for HB, both the income and the substitution effect act to decrease work hours. They could reach the same living standard as before with fewer working hours, while work also pays less at the margin, since they are now on the HB taper rate.

poverty trap – but as long as housing costs are anywhere near their present level, this is almost inevitable. CPAG and the Fabian Society have suggested the HB taper rate should simply be lowered. But a simple numerical example can show that there are tight limits to how far this can be taken. As soon as an individual starts earning above the Personal Allowance, the HB rate combines with income tax and national insurance contributions, typically resulting in a combined effective marginal tax rate (EMTR) of 76% of gross income.<sup>10</sup>

With a monthly HB rate of £785, which is the rate of a two-bedroom flat in Oxford, a net income of about £1,230 is required for HB to be fully tapered away. If the HB taper rate was cut by ten percentage points to 55% of net income, HB would be extended to households with a net income of up to £1,450 per month. For those already receiving HB, the EMTR would fall from 76% to a still very high 69%, but more households would be added to the HB rolls and thus see their EMTR rise. With housing costs at their current levels, there is no way out of this dilemma. Even if the HB taper was cut in half, the corresponding EMTR would still be higher than the higher rate of income tax, and the income range over which it applies would have doubled. Note, also, that this will remain exactly the same under the new Universal Credit (UC) system to be phased in from 2014 on. HB will become a component of the UC, but the rates will be set in the same way as today, and the combined EMTR of UC, income tax and national insurance will also be 76%.

**Table 6: Effect of changing the Housing Benefit taper.  
Example: HB rate for a two-bedroom flat in Oxford**

HB taper	EMTR	'Break-even point', HB rate = £785 per month
65%	76%	£1,230
55%	69%	£1,450
45%	63%	£1,770
32.5%	54%	£2,460

Expensive housing makes detrimental anti-work incentives unavoidable. But the same also holds in reverse. If, for example, rents in Oxford were to fall by one third, a net income of £830 would be sufficient for HB to be fully tapered away, taking those with net incomes between £830 and £1,230 off the taper. This would lead to a drop in their EMTR from 76% to 32%, i.e. a dramatic improvement in work incentives.

The issue of runaway housing costs must be dealt with directly and at source, not through the HB system, which cannot act as a replacement for a properly functioning housing market.

<sup>10</sup> The present the HB taper rate is 65% of net income, while the standard rates of income tax and National Insurance are 20% and 12% of gross income respectively. Thus, the EMTR is  $20\% + 11\% + (0.65 \times (100\% - 20\% - 11\%)) = 76\%$ .

## Social housing: stop blaming the Right to Buy

It is often suggested that the housing problem is best solved through an expansion of social housing, i.e. housing provided by the public sector and/or by registered social landlords. If the market fails to provide low-income families with decent housing, the argument goes, the state or state-regulated providers must step in and fill the gap. 'The root problem of rising housing benefit costs is the failure to maintain sufficient supplies of social housing', argues CPAG (2012), and according to the British Social Attitudes Survey, one in five respondents believe this is the best way to reduce housing costs for low-income groups (DCLG, 2011).

It is not difficult to see why this view is widespread. Demand for social housing vastly outstrips supply. In England alone, 1.84m households are currently on waiting lists (ONS and DCLG, 2011). But what is true for the HB system is also true for the social housing system: neither of the two can act as a substitute for a functioning housing market. Even when ignoring the possibility that social housing may simply crowd out private low-cost housing – Sinai and Waldfogel (2005) show that this does indeed happen to some extent – social housing comes with downsides of its own. Two of the main problems associated with social housing are low levels of labour market attachment among tenants, and low levels of educational attainment among their children, even after controlling for other factors. A social housing tenant is only half as likely to be in employment as somebody with similar socio-economic characteristics living in a different tenure. Meanwhile, their children are twice as likely to drop out of school without a qualification, compared to children from otherwise similar backgrounds. A similar gap emerges for long-term and intergenerational indicators (Leunig, 2009, p. 20). Social housing has itself become part of the poverty trap, so proposals to expand this sector even further and use it as a surrogate for the regular housing market should be received with caution.

It is quite unnecessary to discuss the failures of social housing in greater detail here, because that would be a pushing at an open door: advocates of a social housing expansion often concede readily that social housing in its present form entrenches poverty. Indeed, in criticising the status quo, supporters and critics of social housing make surprisingly similar points. Horton and Gregory (2009, pp. 36-39) provide a literature review documenting how social housing has led to a separation of residents from mainstream society and the formation of adverse peer-group effects. More tangibly, social housing has also locked many residents into neighbourhoods with poor job prospects and limited educational opportunities. It contributes to long-term worklessness and educational underachievement, rather than just being a correlate. Hills (2007, p. 111) provides a more nuanced analysis which also finds some positive outcomes, but which documents extensively that '[e]ven controlling for a very wide range of personal characteristics, the likelihood of someone in social housing being employed appears significantly lower than those in other tenures'.

There is a lot of common ground here with critics of social housing, such as King (2007) and Greenhalgh and Moss (2009). But unlike the latter, supporters of social housing believe the results are negative precisely because social housing was so tightly targeted to the weakest groups. This is, in their view, what creates the adverse peer-group effects and the negative perceptions of social housing residents. Social housing, in this view, acts like a medicine in reverse: poisonous when used in small quantities, beneficial when used copiously. The more social housing is provided, the less stringent is the targeting regime, and the more balanced is the residential composition.

There are a number of problems with this explanation, but let us accept it for the sake of argument. An elephant in the room still remains. Proponents of a social housing expansion often create the impression that targeting was so strict because the British social housing sector was exceptionally small. The privatisation of council housing that begun in 1980, it is argued, had decimated the stock to a meagre leftover (Horton and Gregory, 2009; Hills, 2007, p. 202). The reality is that Britain's social housing sector is still one of the largest in the developed world. Social housing still accounts for as much as one fifth of the total dwelling stock, which is hardly a 'residual', but a larger share than in many of those countries social housing supporters like to present as role models (Table 7).

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**Table 7: Social housing stock as % of the total housing stock, (2008 or latest available year)**

	Social housing as % of total housing
Netherlands	32%
Austria	23%
UK, Czech Republic	20%
Denmark	19%
Sweden	17%
France	17%
Finland	16%
Ireland	8%
Belgium	7%
Slovenia	6%
Germany	5%
Italy, Estonia, Hungary, Latvia, Slovakia, Greece	<5%

Source: Eurostat (2010, p. 67)

Yet this figure still does not capture the full scale of subsidised housing. The Right to Buy did decrease the size of the public housing stock, but this did not automatically mean a decrease in the level of housing cost support for low-income families. Critics of the Right to Buy sometimes use the term 'privatisation' as if it was a synonym for 'demolition', i.e. they treat the privatised stock as if it had simply disappeared. This is the rhetoric used, for example, by Polly Toynbee, who claims that '[s]ince 1980, when the Thatcher policy began, a net total of 750,000 council homes have been lost - the number sold without replacement'.<sup>11</sup> What Toynbee overlooks is that these 'lost' homes continued to house low-income families on a subsidised basis. Council house tenants receive an implicit subsidy in the form of the difference between the rent they pay and the market rent; council house buyers under the Right to Buy receive an implicit subsidy in the form of the difference between the price they paid and the market price. In a sense, this was not too different from converting a payment flow into a lump sum payment. To put it simply: suppose all council houses were given to their tenants free of charge today. That would obviously amount to a gigantic one-off subsidy, enabling them to live rent-free for the rest of their lives. But applying the Toynbee logic, one could then also argue that all council houses have been 'lost', and that no single household was receiving any subsidised rent.

If social housing in Britain is under strain – and it clearly is – it is because the housing market as a whole is under strain. There is no specific shortage of social housing, but a general shortage of low-cost housing across all tenures. If low-cost housing was more widely available in the private sector, the pressure on social housing would ease, and the

<sup>11</sup> Polly Toynbee: 'It's on the house', The Guardian, 11 October 2002.

counterproductive targeting regime could be relaxed. But as long as there are needy families on the waiting lists, giving council flats to people who could easily afford private rental is barely an option.

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## Speculation and property taxes

One of the red herrings that sometimes comes up in the housing debate is ‘speculation’, the idea that housing demand is driven up by people who buy in anticipation of future price increases. A case in point is the Liberal Democrats’ (2011) consultation paper on inequality. It correctly identifies the house price explosion as a driver of wealth inequality, and describes some of the benefits associated with widespread property ownership, including among low-earners. But then, the phenomenon is explained in the following terms:

‘At present, capital gains on primary residences are not taxed at all. This unfairly benefits those who already own a disproportionate share of national wealth, thereby significantly increasing inequalities. [...] [L]ow taxes on unearned wealth also create perverse incentives to invest in non-productive assets instead of productive enterprise. This, in turn, contributes to endless cycles of property price inflation, which squeeze low income groups out of markets for housing that could enhance their financial security.’

This description confuses transitory housing bubbles with lasting price increases. Of course there has been a housing bubble in the UK (see for example Garina and Sarno, 2004). But this does not explain why house price trajectories in the UK differ from those observed in Spain, the USA and Ireland, where house prices also shot up sharply after the mid-to-late 1990s, but then plummeted again. In Spain, the fall in house prices since the onset of the recession has reversed nearly half of the preceding increase. In Ireland, nearly two thirds of the price increase has been cancelled out again, and in the USA, prices have almost reverted to their mid-1990s level. In the UK, by contrast, house prices still remain comfortably on the new plateau reached in the mid-2000s (The Economist house price indicators, 2012).

Also, while there may be a general economic case for shifting taxation from other factors towards property wealth, this would at best have a trivial impact on house prices. As mentioned, the British house price explosion has been an international outlier even in a decade of widespread house price increases, matched only by Australia. The British tax structure, in contrast, is not unique at all in the treatment of property wealth. Hardly any country raises a large share of its tax take from property taxes. The OECD, in a comparative review of national tax systems, finds only five countries where this source contributes more than a minor share of tax revenue, one of which is – the UK (Andrews et al., 2011, p. 39).

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## Demographics: the same as everywhere else

Another red herring is the trend towards smaller average household size, which is said to have increased housing demand. This trend has indeed occurred, and it has increased housing demand – as in has in every other developed country. In terms of average household size, all developed OECD countries<sup>12</sup> fall within a range of 2.0 to 3.0, so the British figure of 2.1 is low, but not exceptional. Compared with neighbouring countries, it is a completely normal figure. Average household size in all North-Western European countries except Ireland falls within a range of 2.0 to 2.5 (OECD, 2011, p. 19).

The main difference between the UK and its North-Western European neighbours is not in demographics, but in completion rates of new dwellings. It is true that the current, very low level of building activities is a consequence of the recession and therefore not representative. But a longer-term time series from well before the recession shows that development in the UK has been depressed for decades.

**Table 8: Dwellings completed per 10,000 inhabitants, NW Europe**

	1980	1985	1990	1995	2000
Austria	68	54	47	66	66
Belgium	49	31	43	41	38
Denmark	59	44	53	26	29
Finland	104	103	131	49	63
France	70	53	59	70	52
Germany	64	55	40	74	51
Ireland	82	67	56	85	132
Luxembourg	55	36	67	66	38
Netherlands	81	70	68	64	47
Sweden	62	39	68	16	18
UK	45	40	36	34	31

Based on data from Eurostat (2010)

This does not mean that the demand side is completely irrelevant. The tax and benefit system does provide counterproductive disincentives against the formation of joint households, and there is a case for reforming it. But even a brief glance at Table 8 suggests that the housing affordability crisis is, above all, a supply-side phenomenon, even if slightly exacerbated by demand-side factors. Construction is a volatile activity, and many countries show low completion rates at some point. But none of the neighbouring countries has quelled development with such rigour for such a long time.

More recent data paint an even starker picture. Between 1995 and 2007, the most intense phase of the house price explosion, completion rates in the UK remained perfectly flat; in fact they decreased marginally (Oxley et al, 2009, p. 62). Housing supply in the UK has become completely unresponsive to demand.

<sup>12</sup> This is not true for the transition countries within the OECD, i.e. Turkey, Mexico and Chile, which record larger household sizes.

## Deregulation: an asset, not a liability

A different set of arguments blames problems in the housing market, or at least the rental market, on a lack of regulation. The Economist has recently praised Newham council, and others following in its footsteps, for taking action against 'rogue landlords'. This refers to landlords who either subdivide family homes into very small rental units, or who rent out parts of a building not intended for residential purposes (e.g. garages). The former practice will be reduced by raising the legal hurdles for conversion. The latter will be clamped down upon through the use of aerial photographs and more frequent visits by inspectors. The Economist's position: 'When demand outstrips supply against a background of profound housing need, tough action is required'.<sup>13</sup> These policies are not new in principle, but potentially represent a toughening of New Labour's compulsory licensing requirements regulating multiple-occupancy dwellings. Calls for a reintroduction of rent controls, recently advocated for example in The Guardian,<sup>14</sup> follow the same logic of banning the symptoms.

The Economist quotes Toby Lloyd of the homeless charity Shelter, who sums up the problem in a punchy but accurate way: 'Where you have lots of desperate people there are lots of opportunistic crooks'. It is the combination of high demand and unresponsive supply which puts landlords, at least in some local markets, in the comfortable position of considerable market power. There is no point in first providing ideal conditions for 'rogue landlords' and then trying to regulate their behaviour away. The market power of 'rogue landlords' has to be broken by opening up the rental market to new entrants. Competitive pressure, not inspectors and aerial photographs, must impose discipline on landlords. Calls for greater regulation are not just futile but actively counterproductive. The OECD shows that indicators of rental market regulation are negatively associated with indicators of the quality and availability of rental housing (OECD, 2011a, pp. 18-19). This is explained by the fact that regulation decreases the willingness of potential landlords to offer their property to the market. Despite a toughening in some respects, the rental market in the UK is still fairly lightly regulated, which is not a liability but one of its few assets. Tiny, low-quality rental units are a makeshift solution. In a functioning housing market, they would disappear or be reduced to a fringe phenomenon. But in the current dysfunctional housing market, they are the lesser evil. None of the proposals for intensified regulation would add a single unit to the dwelling stock.

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<sup>13</sup> The Economist, 'Down and out in London. Newham cracks down on Dickensian housing conditions', 31 December 2011.

<sup>14</sup> Angela Phillips: 'Why I like the subsidised neighbours', The Guardian, 1 November 2010.



## Redistributing the shortage?

A further set of arguments interprets the housing shortage as a distributional issue: some people are constrained on housing space because others have too much. An extreme version of this argument is presented by George Monbiot, who proposes the use of 'housing footprints': 'Your housing footprint is the number of bedrooms divided by the number of people in the household. Like ecological footprints, it reminds us that the resource is finite, and that, if some people take more than they need, others are left with less than they need'. He quotes a figure of 37% of the housing stock being 'officially under-occupied',<sup>15</sup> and derives a policy of housing rationing.

In order to evaluate this proposal, it must be clarified what 'officially under-occupied' means. The figure comes from the English Housing Survey (ONS and DCLG, 2010), which compares the number of rooms households actually have to the number of rooms they 'need'. Need is defined by the 'Bedroom Standard', a formula similar to the one used to determine HB entitlement. Households are classified as overcrowded when they undercut the Bedroom Standard for their household type by one room, and as under-occupied when they exceed it by more than one room. Since the measure of need is entirely arbitrary, the only thing that these figures 'reveal' is that some people have more rooms than others.

The standard of need is a minimalistic one. Only 3% of all households fall short of it, while 36.1% exceed it, leaving the majority classified as neither overcrowded nor under-occupied. This supports the position that there is a general lack of housing space rather than an excessively unequal distribution. But even when taking these figures at face value, they do not support the case for a rationing of the housing stock. A geographical breakdown shows that overcrowding and under-occupancy are inversely related. London has the highest rate of overcrowding and the lowest rate of under-occupancy, while the opposite is true for the South West. Monbiot commits a 'lump-of-housing fallacy'.

A more moderate version of the distributionist position concentrates on the number of vacant dwellings. Insofar as the anti-development lobby concedes at all that there is a shortage of low-cost housing, making better use of the existing stock without extending it is virtually their only policy proposal (CPRE, 2006, p. 21-22). There is nothing inherently wrong with this approach, but its contribution towards overcoming the affordability crisis could not be more than a minor one. Absolute numbers of vacant dwellings always appear large, but as a proportion of the total dwelling stock, they are almost insignificant. The UK's vacancy rate, at 3.4%, is one of the lowest in Europe (Eurostat, 2010). High vacancy rates are a considerable problem in those countries that have a tradition of controlled rental markets: many Eastern European, but also some Mediterranean countries, record double-digit figures. This suggests, again, that the relatively light level of regulation in the British rental market is a plus: the size of the dwelling stock is inadequate, but at least a high proportion is put to use. Of course there may be some scope for lowering the proportion of vacant dwellings in the UK even further, but this cannot contribute more than a small share to overcoming the housing shortage. In a dynamic housing market, there will always be at least transitory vacancies, just as there is always transitory unemployment even in the most smoothly functioning labour market.

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<sup>15</sup> George Monbiot: 'Let's take the housing fight to wealthy owners with empty spare rooms', The Guardian, 4 January 2011.

## Planning: the evidence

The anti-development lobby has a two-pronged strategy of arguing. The main track is to deny that there are any problems in the British housing market. Housing is portrayed to be plentiful, inexpensive and of high quality (CPRE, 2006, pp. 11-15). But since virtually every measure shows the opposite, this position can only be maintained by using figures in an extremely selective way (e. g. 'Of 18 nations surveyed recently, the UK had among the lowest [house] price increases in 2005' (ibid., p. 14)). The second strand of reasoning is to acknowledge that there are shortages, but to claim that there is no evidence that the planning system had anything to do with this. The Planning Officers' Society (2011) comments: 'This is their [the government's] perception of the impact that planning has, which we do not believe is supported by any serious body of evidence'. The CPRE (2006, p. 17) asserts: 'The principal factor in the decline in housebuilding [...] was the dramatic falling off in the building of state-subsidised council and housing association homes [...] This fall had nothing to do with the planning system and much to do with Government spending decisions' (emphasis in the original).

Housing costs in any given housing market have, of course, many potential determinants other than planning. On the demand side, labour market conditions, local amenities, environmental and aesthetic factors, demographics, crime and social capital, and the availability of housing finance are obvious candidates. On the supply side, topography and natural obstacles, the extent to which an area is already built-up, the state of the pre-existing housing stock, market power of developers and/or construction companies come to mind. Over the last three decades, a substantial body of econometric literature has evolved to disentangle the impact of these different potential determinants, estimate their relative importance, and establish how they interact. These studies typically take some measure of housing costs, for example real-term house prices, real-term rents or the Median Multiple, and express it as a function of a set of explanatory factors. Alternatively, the evolution of housing costs is compared across markets which are similar in many respects, but differ strongly in one aspect. Since about the 1980s, most of the literature includes some composite index attempting to measure the restrictiveness of regulatory constraints. Naturally, there is some disagreement in the literature, which is unsurprising given that the severity of regulatory obstacles is difficult to measure (see Quigley and Rosenthal, 2005). But the assertion that there was 'no evidence' about the impact of planning on house prices can only be maintained by completely ignoring the literature.

Already in 1990, Brueckner (1990) summarised the econometric literature in the following way: 'There is now a large empirical literature documenting the effects of growth controls on housing and land markets. The evidence to date conclusively establishes that growth controls raise housing prices in communities where they are imposed' (ibid., p. 327). Since then, these findings have been strengthened and reinforced.

Pollakowski and Wachter (1990) have modelled real house prices in Montgomery County, Washington D.C., as a function of an index of zoning restrictiveness specified for that area itself as well as adjacent ones. A set of economic control variables are included. They conclude: 'The results of our study confirm results found elsewhere: land-use regulations raise housing and developed land prices within a locality. They also demonstrate that [...] the effects of zoning and growth management controls taken together exceed their impact when separately measured' (ibid., p. 323).

Malpezzi's (1996) cross-sectional study covers over fifty US metropolitan housing markets. Several measures of housing costs are used as the dependent variable, expressed as a function of a comprehensive index of regulatory constraints and of economic and demographic control variables. The author states: 'Our results suggest that regulation raises housing rents and values and lowers homeownership rates' (ibid. p. 236).

Dawkins and Nelson (2001) provide a more cautious review of the empirical literature, pointing out that there are studies which find demand-side factors to be relatively more important than regulatory controls. On balance, though, these authors also conclude: 'The most important policy implication to be gleaned from this review is that local planners play a significant role in determining the severity of housing price inflation attributable to urban containment policies' (ibid.,

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p. 11).

Saks (2005) models the interaction of local housing markets and labour markets for several metropolitan areas in the USA, using an index of regulatory restrictiveness as a determinant of house prices. The purpose is estimate how a given increase in housing demand, triggered by an increase in labour demand, leads to different outcomes in different cities depending on the severity of planning provisions. He finds that 'metropolitan areas with constrained housing markets respond differently to a labor demand shock than less restricted locations. Raising the degree of housing supply regulation by one standard deviation results in 17 percent less residential construction and twice as large growth in housing prices in response to an increase in labor demand' (ibid., p. 21).

Glaeser and Gyourko (2003) model house prices in forty-five US metropolitan markets as a function of an index of planning restrictiveness, and a set of controls. They are specifically interested in the importance of state-imposed controls relative to scarcity of developable land. Their conclusion: 'The bulk of the evidence marshalled in this paper suggests that zoning, and other land-use controls, are more responsible for high prices where we see them. [...] Measures of zoning strictness are highly correlated with high prices. Although all of our evidence is suggestive, not definitive, it seems to suggest that this form of government regulation is responsible for high housing costs where they exist' (p. 35).

Anthony (2003) estimates the effect of the 'Growth Management Act', a set of planning restrictions and regulations covering the whole state of Florida. He concludes: 'Using data from the entire state over a 16-year period, with two measures of affordability and after controlling for alternate hypotheses, this research finds that Florida's GMA has had a statistically significant and negative effect on housing affordability in the state'.

Glaeser et al. (2005a), using a broad data pool of US metropolitan areas, are especially interested in the relative importance of regulatory constraints compared with the importance of natural constraints and increases in construction costs. They find that 'new construction has plummeted and housing prices have soared in a small, but increasing number of places. These changes do not appear to be the result of a declining availability of land, but rather are the result of a changing regulatory regime that has made large-scale development increasingly difficult in expensive regions of the country' (ibid. p. 20).

The OECD, in an international comparison of housing policies and their evidence base, also points out that 'there is an emerging consensus that local land-use regulation has become a binding constraint on the supply of new housing units in some countries'. They caution, however, that 'there is much less of a consensus on the magnitude of the impact' (Andrews et al., 2011, p. 30).

The above-mentioned studies examine larger areas containing many different housing markets. Case studies focusing on one single housing market can also be insightful when well-selected. Glaeser et al. (2005b) concentrate on housing costs in Manhattan, which represents an especially insightful case study because it makes alternative explanations (scarcity of developable land plus high demand) more plausible than in almost any other housing market in the world. However, even for this rather extreme case, the authors find that regulatory constraints are a more important determinant than scarcity of space, high demand or market power in the building industry: 'one-half or more of the value of a condominium can be thought of as arising from some type of regulatory constraint preventing the construction of new housing' (p. 367).

The case study by Chi-man Hui and Sze-mun Ho (2003) can be seen in the same light, because it concentrates on the extreme example of a housing market faced with an exceptionally high population density, natural obstacles to outward

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growth, and high demand: Hong Kong. Again, even in this unusual case, the authors find: 'The analysis demonstrates that most of the planning variables affect housing prices statistically' (p. 357).

Cox (2011) provides further insights into the workings of growth boundaries. The author documents the situation in three housing markets – Portland, Las Vegas and Phoenix – which have long been characterised by relative price stability despite high demand, and which have then experienced sudden house price escalations. These cities had been ring-fenced by urban growth boundaries comparable to British Green Belts, but with comfortable cushions between the urban fringe and the growth boundary. As these cities faced high housing demand, they expanded outwards, and as long as they remained safely within the growth boundaries, prices remained stable.<sup>16</sup> But as soon as they approached them, prices started to shoot up. The critical point the author is trying to make is that non-binding boundaries, whether natural or regulatory, can become binding in a sudden rather than a gradual fashion, because even small reserves of developable land can be sufficient to keep prices down. This is a critique of previous empirical models which included natural obstacles (coastlines, mountains etc.) located at a considerable distance from the urban fringe. These models were therefore likely to overestimate the importance of natural constraints and thus underestimate the importance of regulatory ones.

Since the above-mentioned models control for a wide range of factors, they are in principle transferable to other contexts. But to gain an appreciation of the magnitudes involved, the study by Hilber and Vermeulen (2010) is of particular interest because it refers to UK markets only. This study also places special emphasis on separating the impact of regulatory constraints from topographic ones, while also controlling for the extent to which an area is built-up already. They find 'a substantial impact of regulatory supply constraints: house prices in an average local planning authority in England in 2008 would be 21.5 to 38.1 per cent lower if the planning system were completely relaxed [...] Physical supply constraints matter as well, although the impact is more modest' (p. 56). There are, however, at least three reasons to believe this is still a significant underestimate of the impact of the planning system, and this is acknowledged by the authors themselves. Firstly, by 'completely relaxed', the authors refer to the state of planning controls that existed in the first year of the period covered in the study, 1974. They make the simplifying assumption that no binding planning controls existed then, which is clearly not true: the systematic increase in the price of land began in the late 1950s and early 1960s (Hartwich and Evans, 2005, p. 17). Secondly, the study takes natural obstacles such as steep slopes as constants. What it cannot account for is the possibility that in a more liberal planning regime, some plots that are currently undevelopable could be made developable. Thirdly, the model assumes that once a plot is built upon, it is no longer available for development, not accounting for the role of height restrictions in preventing vertical extensions. This is highly likely to result in overestimating the impact of scarcity of land, and thus underestimating the impact of regulatory restrictions.

In summary, there is overwhelming empirical evidence that planning restrictions have a substantial impact on housing costs. It is also fully plausible, albeit not (yet) definitely confirmed, that planning restrictions play a much more important role than scarcity of developable land, be it due to topographic obstacles or past development. Even in very densely populated and built-up places, regulatory restrictions have been found to be important determinants of housing costs. If such evidence can be found for Manhattan and Hong Kong, then there is hardly any place in Britain where housing shortages could be blamed on scarcity of space. High housing costs are a self-inflicted problem.

<sup>16</sup> Indeed, as Glaeser et al. (2005a, p. 332) note, the population of Las Vegas nearly tripled in two decades while house prices increased only in line with inflation.

## The coalition's plans: an interim solution

Demographia uses a much simpler, binary way of classifying planning regimes, which, given its crudeness, is a surprisingly powerful predictor of affordability. They classify regimes by their default option. In restrictive systems, development is prohibited unless specifically allowed. In permissive systems, development is generally allowed (subject, of course, to environmental regulation etc.) unless specifically prohibited. In their sample, none of the permissive markets has a Median Multiple above 4.0, while most of the restrictive markets have. So on the face of it, the easiest way out of the housing affordability crisis is a reversal of the default option, i.e. a general presumption in favour of development. The government's current proposals, judging from what is currently known, can be interpreted as a cautious step in this direction.

But this is a shallow solution. The main deficiency of these reforms is not simply that they do not 'go far enough'. The more fundamental deficiency is that they go against the grain of the incentive structure which the current system provides. In a restrictive planning system, planning authorities can easily block development, but this does not explain why they actually choose to do so, i.e. why there seems to be a political demand for restrictions. Planning Minister Gregg Clark has accused reform opponents of a 'nihilistic selfishness', which, given the misinformation campaigns and scaremongering used by some conservation groups, is an understandable reaction. But it is shallow insofar as it treats NIMBYism as if it were an attitude, rather than a situational response to the incentive system people find themselves in. As Pennington (2002) phrased it: 'It is as a direct consequence of the nationalisation of development rights that people are placed in a position where they have everything to lose in terms of amenity and property values and nothing to gain in terms of financial compensation when decisions regarding the allocation of housing land and other developments are made' (p. 64, emphasis in the original).

And this is the more fundamental flaw in the current planning framework. Development always entails both costs and benefits, but in the current system, costs and benefits are very poorly aligned. For a local community, new development entails a loss of green field sites, possibly more congestion and crowding, and for homeowners it is very likely to entail a decline in the value of their house. Development also entails benefits, of course, but these do not accrue to the same people who bear the disadvantages. At least two benefits of development are worthy of mention:

- When planning permission is granted, the value of a piece of land multiplies, or indeed explodes in some regions. But the vast majority of residents do not benefit from this increase, which accrues to the owner and/or the developer. As Leunig (2007, p. 17) explains: 'In the South East of England, for example, agricultural land is worth £7,410 per hectare, with residential land worth £3.32 million. The owner of an average sized 57 hectare farm could thus make a windfall gain of £189 million from development'. The gain is subject to taxation, but 'none of it accrues directly to the local authority'.
- Up to a point, there are economies of scale in the use of public services. New development broadens the taxpayer base, which should enable either a lowering of local tax rates, or an improvement of local public services (or a combination of both). But due to the high level of centralisation in the current tax system, such considerations play no role in the local decision-making process.

In both cases, the reason why these gains are more or less irrelevant at the local level is that fiscal autonomy of sub-national levels of government is virtually non-existent in the UK. Approximately 95% of all tax revenue accrues to the central government, a share which is even higher than in France (87%), which has traditionally been regarded as a textbook model of centralised governance. In federalist systems such as the USA, Switzerland and Germany, the federal governments receive less than 70% of the total tax take (OECD, 2011b). Is it a coincidence that these are also the countries where real-terms house prices are still at around the same level they were three decades earlier?

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## Conclusion

Housing costs in the UK have exploded in recent decades. Real-terms house prices in 2011 were more than two and a half times higher than in 1975, with rent levels following suit. Nothing about this was inevitable. Many other countries have experienced rising housing costs as well, but in most other cases, the increase has been milder and/or largely transitory. Only Australia shows a similar pattern of a huge and lasting increase. In the USA, Germany and Switzerland, real-terms house prices are still close to their 1975 levels.

Unfortunately, the housing debate is muddled with non-explanations that have been advanced because they suit a pre-conceived political agenda. None of these explanations can explain more than a trivial fraction, at best, of the housing cost increase. It is not explained by a lack of developable land, nor by a lack of social housing or a lack of spending on cash benefits. It is not driven by speculation or a lack of regulation and taxation. It is not a distributional issue either. Rather, the empirical evidence from around the world shows, as conclusively as econometric papers get, that planning restrictions are a key determinant of housing costs. A good deal of the literature, though not all of it, suggests that this is by far the most important determinant. In particular for the UK, where there are few insurmountable topographic obstacles to speak of, it is reasonable to assume that other factors can be almost ignored.

The government's NPPF is a cautious attempt to address the anti-development bias in the planning system outside of protected areas. This is a reasonable first-aid measure, but no more than that. The anti-development bias does not stem from procedural details of the planning system, but rather from the combination of a restrictive planning system and an over-centralised tax system. This combination makes NIMBYism an entirely rational situational response, rather than an attitude. It creates a situation in which local residents face the disadvantages of development, but not the gains. A more thoroughgoing reform must therefore overhaul the incentive structure in such a way that local residents everywhere can observe the costs as well as the benefits of development. It must enable rational trade-offs between preserving valuable pieces of countryside and other desiderata. One way to achieve this is to extend the coalition's 'localism' agenda to local finances and planning. If local authorities had to cover most of their expenditure through local taxes, they would have an interest in enlarging their tax base, and granting planning permission would be one way of doing so. People would be free to vote for NIMBY policies, but they would be aware of the opportunity cost. Blocking development would mean foregoing tax cuts or better local public services.

Opinion surveys show strong resistance to development, which allows the anti-development lobby to present their views as fully in accordance with the public mood. But this is not the least surprising given that these surveys bear no resemblance to real-world decision-making processes, which involve opportunity costs and trade-offs. They are no more meaningful than asking 'would you prefer to get up two hours later in the morning' or 'would you prefer to work closer to home': other things equal, how could the answer be in the negative? What matters is the choice people make when faced with real-world opportunities, facing the benefit and (opportunity) cost of each, and making trade-offs. Unless the planning system moves a lot closer to a decision-making process of this type, there will be no lasting solution to the housing affordability crisis.

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**Kristian Niemietz** joined the IEA in 2008 as Poverty Research Fellow. He studied Economics at the Humboldt Universität zu Berlin and the Universidad de Salamanca. In 2007, he graduated as Diplom-Volkswirt (MSc in Economics), with a dissertation on the privatised pension system in Chile. During his studies, he interned at the Central Bank of Bolivia (2004), the National Statistics Office of Paraguay (2005), and at the IEA (2006). After graduating, he went on to work for the Berlin-based Institute for Free Enterprise (IUF). Kristian is currently a PhD student in Public Policy at King's College London, where he also teaches economics. He is a regular contributor to various journals in the UK, Germany and Switzerland.



**Institute of Economic Affairs  
2 Lord North Street  
London  
SW1P 3LB**

**[www.iea.org.uk](http://www.iea.org.uk)**