Housing

Lectures 7 and 8

Le Grand, Propper and Smith (2008): Chp 5
Bochel, Bochel, Page and Sykes(2009): Chp 16
Outline

• Govt policy: equity and efficiency

• Housing and the Market System

• Explaining the rapid rise of house prices

• Govt intervention in the housing sector
Housing and Govt Policy

• Govt Policy: Equity
  – Minimum standard: shelter is a basic human necessity
  – NB form of wealth: ↑P houses → ↑inequality
  – Inequality transmitted across generations

• Why provide housing directly?
  – Scale of housing costs
  – Regional disparities in housing costs

• Govt Policy: Efficiency
  – Free market outcome is inefficient
  – Housing decisions incur externalities (excluded from cost-benefit analysis)
  – eg homelessness is a negative externality
### Housing Tenure in the UK, 1914-2004

<table>
<thead>
<tr>
<th>Year</th>
<th>Home owner</th>
<th>Public rented</th>
<th>Private rented</th>
<th>Social Landlord</th>
</tr>
</thead>
<tbody>
<tr>
<td>1914</td>
<td>10.0</td>
<td>1.0</td>
<td>80.0</td>
<td>0.0</td>
</tr>
<tr>
<td>1938</td>
<td>25.0</td>
<td>10.0</td>
<td>56.0</td>
<td>0.0</td>
</tr>
<tr>
<td>1951</td>
<td>29.6</td>
<td>18.6</td>
<td>51.8</td>
<td>0.0</td>
</tr>
<tr>
<td>1961</td>
<td>42.7</td>
<td>26.8</td>
<td>30.5</td>
<td>0.0</td>
</tr>
<tr>
<td>1971</td>
<td>50.1</td>
<td>30.4</td>
<td>19.5</td>
<td>0.0</td>
</tr>
<tr>
<td>1981</td>
<td>57.7</td>
<td>29.0</td>
<td>11.1</td>
<td>2.2</td>
</tr>
<tr>
<td>1991</td>
<td>66.0</td>
<td>11.4</td>
<td>9.4</td>
<td>3.1</td>
</tr>
<tr>
<td>2001</td>
<td>70.4</td>
<td>14.3</td>
<td>9.8</td>
<td>6.5</td>
</tr>
</tbody>
</table>

Housing and the Market System

• Market system is primary means of allocating houses in UK

• Owner-occupied housing

• Inefficient and inequitable outcome
  – Externalities
  – Imperfect information
  – Slow adjustment to price changes and supply inelasticity
The Market System for Housing I: Externalities

• House spending
  – individual costs and benefits: socially inefficient

• External costs and benefits
  – Quality of housing and individual’s health
  – Effect on neighbours
  – Quality of neighbourhood and spatially based attributes

• Quality of neighbourhood and Policy
  – Education
  – Employment prospects
  – Crime
The Market System for Housing I: Externalities (contd)

- Identifying neighbourhood effects
  - Independent of residents’ characteristics
  - Child behavioural outcomes: positive
  - Adult outcomes?

- A general reluctance to improve neighbourhood quality. Why?
  - Poor return: dominated by neighbourhood conditions
  - Concerted action instead? The Prisoner’s Dilemma

<table>
<thead>
<tr>
<th>Person A’s rate of return</th>
<th>Person B does not invest</th>
<th>Person B invests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Person A does not invest</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Person A invests</td>
<td>2%</td>
<td>5%</td>
</tr>
</tbody>
</table>
The Market System for Housing II: Information Problems

• Information problems
  – Imperfectly informed eg change job → move house
  – Lack of information eg migrants
  – Asymmetric information: landlord’s judgement

• Overcoming the problem of asymmetric information
  – Discrimination: occupation, ethnicity, race, welfare-dependency
  – Minimum letting period, deposit, letters of reference

• Low-income individuals
  – Housing benefit to support rent payments
  – Social housing
  ⇒ excluded or restricted from the private rented sector
The Market System for Housing III: Supply Inelasticity

- Aside

- Market equilibrium and $\Delta P$
  - Demand: $\uparrow P \rightarrow \downarrow Q_d$; Supply: $\uparrow P \rightarrow \uparrow Q_s$
  - Equilibrium: $P^*, Y^*$ combination
  - $P > P^*$: excess supply; $P < P^*$: excess demand

- Market equilibrium and $\Delta D$
  - $\uparrow Y \rightarrow D$ shifts right: $\uparrow Q_d$ at each $P$
  - demand exceeds supply at $P^*$: $\uparrow P$

Figure 1(a) Market Equilibrium and $\Delta P$

Figure 1(b) Market Equilibrium and $\Delta D$
The Market System for Housing III: Supply Inelasticity (contd)

• How does the market system react to changes in demand?
  - Equilibrium: $P^*, Y^*$ combination
  - ↑ inward migration $\rightarrow$ D shifts right: ↑$Q_d$; new equilibrium: ↑$P$, ↑$Q_s$

• Inelastic Supply
  - Sizeable ↑$P$; small ↑$Q_s$
  - Bulk of adj to $\Delta D$ via $\Delta P$, not $\Delta Q_s$

• Elastic Supply
  - Small ↑$P$; sizeable ↑$S$
  - Most of adj to $\Delta D$ via $\Delta Q_e$, not $\Delta P$

Figure 2(a) Inelastic Supply
Figure 2(b) Elastic Supply
House Price Inflation: HBOS and Nationwide
Explaining the Rapid Increases in UK House Prices

1. Inelastic supply
   - UK housing output responds weakly to $\Delta P$

2. Expectations
   - $\uparrow D \rightarrow \uparrow P \rightarrow \uparrow P^e \rightarrow \uparrow D \rightarrow \uparrow P$

3. Earnings and ability to borrow
   - ...but credit crunch

Elasticity of Supply and equity of outcomes
Dwellings: Starts and Completions

Number of dwellings

Source: Royal Institution of Chartered Surveyors (RICS) Housing Market Surveys
Why is UK Housing Supply Inelastic?

• 1. Land shortages
  – Land is fixed in supply
  – UK is relatively densely populated
  – Location, mobility and substitutability

• 2. House building
  – Time taken to build a house
  – Market risk: volatility of house prices
  – Developers’ degree of risk-aversion
  – Additional risks: govt regulation
Govt Intervention I: Direct Provision

- **Social housing**: housing provided by public sector at sub-market rents

- UK shift from local authority provision to non-profit housing associations

- Priority categories
  - formerly in care or in custody
  - escaping from a violent partner
  - pregnant

- Efficiency and supply inelasticity
  - Supply-side subsidy $\rightarrow$ S shifts right $\rightarrow$ $\downarrow P$
  - Public house-building to combat developer’s risk-aversion
    ...but public sector housing subject to political and fiscal concerns
Govt Intervention II: Regulation

- Externalities in housing decisions
  - congestion, environmental degradation

- Development of brownfield sites
  - Risks

- Development of greenfield sites
  - Infrastructure

⇒ Govt regulations and an efficient outcome

- Housing market is heavily regulated

- Govt planning regulations
  - Designate land for particular uses

...but planning process is politically designed, not market driven
Govt Intervention III: Subsidies

• Demand subsidies for housing
  – Housing benefit
  – Favourable tax treatment to owner-occupied housing
  – Financial schemes eg ‘Right to Buy’ policy

• Housing benefit system
  – Govt subsidy for rented housing among low-income tenants
  – Level of subsidy varies spatially

• Advantages of demand subsidies v social provision
  – Individual choice
  – Flexibility
Govt Policy III: Subsidies (contd)

• Effectiveness of housing benefit system?
  – Take-up rate
  – Stringent landlord requirements
  – Amount varies across groups

• Criticism of housing benefit
  – Few incentives to shop around v voucher system
  – Tendency towards below-average price and low quality accom
  – Disincentives to work and save
Summary

• Market system: externalities, imperfect information and supply inelasticity

• Govt policy and equity: decent homes at affordable prices

• Govt policy and efficiency: housing decisions and externalities

• Govt policy: direct provision, regulation and subsidies

• Need for social housing and demand subsidies?

• Does regulation exacerbate the inelasticity of supply problem?