

A series of background briefings on the policy  
issues in the May 2015 UK General Election

# UK Housing and Planning Policies: the evidence from economic research

Christian Hilber

#ElectionEconomics



## CEP ELECTION ANALYSIS

### **UK Housing and Planning Policies: The evidence from economic research**

- In 2014, UK house prices per square metre were the second highest in the world (topped only by Monaco), with especially high valuations in London and the South East. New houses are about 40% smaller than in similarly densely populated European countries.
- Over the last 40 years, house price growth in the UK has been faster than in any other OECD country and has far outstripped earnings growth. Consequently, a ‘housing affordability crisis’ has developed. The homeownership rate has been in decline since the turn of the millennium, falling from 69.6% in 2002 to 63.6% in 2013. Extending Right-to-Buy might halt this decline, but it would be likely to worsen the affordability crisis.
- The ratio of London house prices to average UK house prices has increased substantially since the 1970s. The price-to-income multiple in the Greater London area in 2014 was 8.5; for the UK as a whole, it was 5.0.
- The UK’s planning system is the main cause of the affordability crisis, especially in London and the South East. Despite population growth and rising real incomes, construction of new housing has been decreasing steadily since the 1970s, leading to a substantial housing shortfall.
- Where supply is constrained, the main effect of policies that stimulate housing demand – such as Help-to-Buy – is to increase house prices rather than supply. These policies may thus be an ineffective waste of taxpayer money at best, and counterproductive at worst.
- A similar argument applies to property-related tax reforms. In supply-constrained areas, higher taxes are capitalised into lower property prices.
- The failure to revalue the council tax since 1992 and introduce effective property taxes has made the idea of a ‘mansion tax’ popular. Such a tax would be likely to reduce the prices of expensive houses making them more affordable for wealthy would-be buyers and imposing a one-time negative wealth effect on current owners. It may have the effect of encouraging owners to subdivide their properties in an attempt to circumvent the tax.
- The evidence firmly suggests that the stamp duty land tax – which taxes property transactions – reduces household mobility. The resulting mismatch in the housing market exacerbates the affordability crisis.
- The ‘bedroom tax’ is most likely to affect landlords, who reduce rents to keep their tenants. This limits the potential to free up used space. To the extent that landlords do not fully take the hit, it has the potential to trigger displacement as shortages of smaller properties in some areas imply that tenants have to move away.
- A local annual property tax with automatic annual revaluation could provide incentives for residential development by generating local tax revenue that is tied to local development. This could help to reduce the chronic housing shortfall.

## Introduction

*‘This is a really big issue. That is, of course, why no politician dares touch it.’* (Martin Wolf on the UK’s housing crisis, *Financial Times*, 5 February 2015).

Housing affordability is a key concern of an ever-larger fraction of UK voters who are crammed into artificially limited space. At the same time, a lot of wealth lies in housing assets and there are many vested interests in keeping things this way (such as current homeowners and private landlords). Substantive reforms could solve the housing crisis, but politicians of all stripes back away from such reforms out of fear of being demonised by the vested interests. Instead, proposed policies tend to tackle the symptoms – rather than the causes – of the UK’s housing crisis.

This Election Analysis provides an overview of the key issues and the underlying causes. It discusses the merits and demerits of key policy proposals from the major parties. It concludes with a discussion of those reforms that ought to be on the policy agenda.

## The housing affordability crisis

The central housing policy issue in the UK is the so-called ‘affordability crisis’ – the fact that both private rental and owner-occupied housing have become ever more unaffordable, especially for younger households trying to get on the housing ladder.

House prices in the UK – particularly in London and the South East – are among the highest in the world.<sup>1</sup> At the same time, housing unit sizes are much smaller than in comparable European countries. New houses in the UK are 38% smaller than in densely populated Germany and 40% smaller than in the even more densely populated Netherlands (Statistics Sweden, 2005).

This makes housing space in the UK some of the dearest in the world. In a ranking of the buying price per square metre of a ‘comparable flat’ in a prime inner city area of a country’s prime city (London), the UK comes second, only topped by the tiny city-state and tax haven Monaco (Globalpropertyguide.com, 2015). The rental price of the same ‘comparable’ flat in London is also the second dearest in the world. Table 1 provides the relative housing costs by country (city) with London being the benchmark.

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<sup>1</sup> UK house prices are also extremely volatile. Real house price swings in the UK were substantially larger during the last full real estate cycle than those in even the single most volatile metro area in the United States (Cheshire, 2009, and Hilber and Vermeulen, forthcoming).

**Table 1: International comparison of relative housing costs (prices and rents per m<sup>2</sup>; by country (city); UK (London) = 100%; 2014)**

Country (City)	Price/m <sup>2</sup> in % relative to UK (London)	(Rank)	Rent/m <sup>2</sup> in % relative to UK (London)	(Rank)
Monaco	174.1%	(1)	101.8%	(1)
<b>UK (London)</b>	<b>100.0%</b>	<b>(2)</b>	<b>100.0%</b>	<b>(2)</b>
Hong Kong	66.1%	(3)	58.5%	(4)
US (New York)	53.6%	(4)	63.9%	(3)
France (Paris)	53.3%	(5)	47.2%	(6)
Russia (Moscow)	46.4%	(6)	46.4%	(7)
Switzerland (Geneva)	44.2%	(7)	42.8%	(8)
Singapore	44.2%	(8)	39.1%	(9)
India (Mumbai)	33.2%	(9)	24.5%	(16)
Japan (Tokyo)	31.2%	(10)	48.4%	(5)
Israel (Tel Aviv)	27.5%	(11)	29.4%	(11)
Sweden (Stockholm)	27.3%	(12)	NA	
Finland (Helsinki)	24.3%	(13)	26.9%	(14)
Canada (Toronto)	23.9%	(14)	27.4%	(13)
Italy (Rome)	23.2%	(15)	27.6%	(12)
Luxembourg	22.2%	(16)	26.4%	(15)
Australia (Sydney)	22.1%	(17)	31.1%	(10)

*Source:* All data derived from [www.globalpropertyguide.com/most-expensive-cities](http://www.globalpropertyguide.com/most-expensive-cities) (last accessed: 1 February 2015). Relative prices and rents are based on own calculations.

UK housing costs are not only very high in absolute terms and relative to other countries but also relative to incomes. Conventionally measured ‘affordability’ – median house price to median income – in the Greater London area is now at its worst since data became available, despite the Great Recession. According to Demographia (2015), the price-to-income multiple in the Greater London area in 2014 was 8.5. For the entire UK, the multiple was 5.0. The Demographia study also notes that housing is particularly unaffordable in those countries that have adopted the UK’s ‘urban containment model’ (that is, the UK’s planning system).

The UK’s affordability crisis has been developing slowly since the 1960s. Real house prices – but not real incomes – have grown faster in the UK over the last 40 years than in any other OECD country (Hilber and Vermeulen, forthcoming).

Who are the losers in this affordability crisis? The obvious answer is young households, but although existing homeowners seemingly benefit from higher asset prices, most of them are also adversely affected. This is because they cannot realise the ‘gains’ unless they downsize their housing consumption, give up owner-occupation and rent or sell their house to move abroad. In the interim, they have to live in cramped spaces (Hilber and Vermeulen, forthcoming).

## What caused the housing affordability crisis?

Despite rising real incomes and strong population growth, construction of new housing has been decreasing steadily since the 1970s, leading to a substantial housing shortfall.<sup>2</sup> All major political parties agree that today there is a serious shortage of housing, that there is not enough housing construction and that housing should be more affordable.

Empirical research points clearly to the UK's planning system – in conjunction with strong demand for housing in some regions, notably the South East – as the main cause of this housing affordability crisis (Cheshire, 2009 and 2014, Cheshire et al, 2014, Hilber and Vermeulen, 2010 and forthcoming, and Overman, 2012).<sup>3</sup>

This system, which dates back to the Town and Country Planning Act of 1947, is extraordinarily rigid by world standards. This is a consequence of urban containment through 'green belts', strict controls on height, lack of fiscal incentives at the local level to develop and 'not in my backyard' (NIMBY) behaviour facilitated by the planning regime. The system's rigidity is exacerbated by the use of 'development control', which makes all decisions about whether development can go ahead subject to local political calculations and therefore more uncertain.

Evidence for England suggests that planning constraints magnify the impact of growing housing demand on house prices across the country, but the effects are starkest in London and the South East. Housing is being built where there are the fewest disincentives to permit development rather than where demand is greatest.

Research analysing data for England over recent decades finds that in places with tight regulatory constraints, house prices respond much more strongly to labour demand shocks than in places with less tight constraints (Hilber and Vermeulen, forthcoming). According to the estimates, house prices would have risen by about 100% less in real terms between 1974 and 2008 if, hypothetically, all regulatory constraints were removed.

Removing all constraints is of course neither practicable nor desirable. More pragmatically, if the South East (the most tightly regulated English region) had the regulatory restrictiveness of the North East of England (less regulated, but still restrictive by world standards), house prices in the South East would have been roughly 25% lower in 2008 and perhaps 30% lower in 2015.

Why are not all regions and local authorities equally restrictive? Hilber and Robert-Nicoud (2013) argue that land use constraints benefit owners of developed land via increasing prices, but hurt owners of undeveloped land via increasing development costs. In this setting, more

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<sup>2</sup> According to the Department for Communities and Local Government (2015a), the UK built close to 380,000 new homes in the fiscal year of 1969-70 (when statistics began). Housing construction subsequently gradually declined – despite a growing population and growing incomes – until it fell below 200,000 from 1990-91 onwards. Since 2009-10, the figures are firmly below 170,000. Housing construction reached a record low in 2012-13 with less than 135,510 new homes. In 2013-14, figures were only slightly higher at 140,930 new homes, reflecting the typical increase in housing construction associated with an economic recovery.

<sup>3</sup> The effects of the UK's planning system are not confined to housing. Cheshire and Hilber (2008) provide evidence that firmly links regulatory constraints to the extraordinarily expensive price of UK office space. Cheshire et al (2015) demonstrate that 'Town Centre First' policies in England imposed a loss of output of 32% on a typical store opening after the rigorous implementation of the policy in 1996.

desirable locations (such as London boroughs) are more developed and, as a consequence of political economy forces, more regulated.

More tangibly, in wealthy local authorities with strong demand pressures, homeowners and landlords have most assets to protect so they have the strongest incentives to restrict local development either via voting or lobbying. Struggling places with weak demand and high unemployment may be more prone to permit commercial development to create local jobs. Even residential development may become palatable since it creates construction jobs.

What about physical, geographical and topographical constraints? Constraints due to scarcity of developable land mainly apply to highly urbanised areas (Hilber and Vermeulen, forthcoming). But in these areas – most pronounced in the Greater London area – the effect is large in the sense that due to scarcity constraints, house prices increase strongly in response to positive demand shocks.

Put differently, house prices in London would still be fairly high by world standards if the planning system was reformed and various regulatory constraints relaxed. Moreover, such reforms would be likely only to lower price pressures gradually and over longer time periods.

### **Does Help-to-Buy (or other mortgage subsidies) create new housing and more homeowners?**

The government's 'Help-to-Buy' scheme is intended to stimulate housing demand – which, in theory at least, should translate into new housing being supplied and higher homeownership.

But evidence from the United States (Hilber and Turner, 2014) suggests that there is only a very weak link at best between mortgage subsidies and homeownership attainment. In fact, in tightly regulated housing markets, the subsidies have a *negative* effect on homeownership because the price effect – through increased demand – more than offsets the income effect from the tax deduction. In less regulated markets, subsidies do have a positive effect on homeownership rates, but only for higher income groups.

Longstanding UK evidence, summarised in Barker (2003), shows that housing supply is incredibly unresponsive to demand shocks. In large part this is due to an extraordinarily inflexible planning system. This effect is most pronounced for London and the South East. Consistent with this, a related study finds that central government grants in the UK are roughly fully capitalised into house prices – that is, the present value of the change in the grant allocation roughly equals the change in house price (Hilber et al, 2011).

The effect of Help-to-Buy, which also works through stimulating the demand side, can thus be expected also to become fully capitalised. Consistent with this, according to Nationwide, following the announcement of Help-to-Buy, house prices in London shot up by 25.8% between 2013Q2 and 2014Q2, and a residential building boom failed to emerge.

Moreover, the scheme may have created a systemic risk in that the government (that is, the taxpayer) assumes most of the risks associated with the guarantee schemes, with the remaining risk being assumed by the marginal homebuyers (that is, those who could not obtain loans in the absence of the scheme).

So who benefits from mortgage subsidies such as Help-to-Buy? Almost certainly it is not the young first-time buyers who are the supposed main beneficiaries. Instead, the main beneficiaries are wealthy and older homeowners via the increase in their property values, especially those who are thinking about downsizing or moving abroad.

Proponents of Help-to-Buy have argued that the equity loan scheme only applies to new build homes. This should only increase the demand for new build homes and thus lead to more construction. But as Hilber (2013) explains, this is a flawed argument: existing homes, new build homes and rental homes are all reasonably close substitutes, so Help-to-Buy will affect aggregate demand for housing and not just that of new build.

There are a number of further concerns with the Help-to-Buy scheme and other potential schemes that are designed to stimulate housing demand. These are discussed in Hilber (2013, 2015a and 2015b) and the Annex.

## **Does Right-to-Buy help to solve the affordability crisis?**

The Conservatives' manifesto proposes to extend the Right-to-Buy to tenants of housing associations. To the extent that the discount granted to tenants is substantial, this has the likely effect of nudging many housing association tenants to become homeowners, probably slowing down and possibly reversing the decline in the homeownership rate – a trend observed since 2001.<sup>4</sup>

Increasing homeownership attainment may be desirable. There is some evidence for the United States that homeownership is associated with social benefits, particularly in places with tight supply constraints (Hilber and Mayer, 2009, and Hilber, 2010). But there is also evidence suggesting that (leveraged) homeownership may impair the labour market (for example, Blanchflower and Oswald, 2013) or adversely affect entrepreneurship (Bracke et al, 2014). So it is not per se clear whether the Right-to-Buy subsidy to housing association tenants – which more or less randomly benefits some lower income households – is justifiable from a social welfare point of view.

What is clearer is that the policy imposes significant costs to the taxpayer. This is because housing associations receive public funding and they presumably must be compensated for their policy-induced losses. Otherwise, the policy would significantly harm housing associations and endanger their ability to finance new homes. Also, the policy will not solve the affordability crisis. In fact, it is likely to make it worse, even if the ability of housing associations to finance new homes is unaffected. This is for two reasons:

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<sup>4</sup> According to the Department for Communities and Local Government (2015b), the UK homeownership rate peaked at 69.6% in 2002. It had fallen to 63.6% in 2013. This decrease can be attributed to a dramatic decline in attainment among younger households. According to the Office for National Statistics (2015), in 1991, 67% of the 25-34 age group were homeowners but by 2011-12, this had declined to 43%. Similar trends were observed for the 16-24 age group (from 36% to 10%) and for the 35-44 age group (from 78% to 64%). By contrast, older age groups were more likely to own in 2011-12 than in 1991. The decline in homeownership attainment since the 1990s has essentially been driven by two short periods with dramatic declines in the number of first-time buyers taking out a mortgage. The number declined by 31% between 2002 and 2003 and by 47% between 2007 and 2008. Since 2008, the number has been roughly stable and a slight recovery can be observed since 2011. But the overall homeownership rate continued to decline between 2011 and 2013: from 65.0% to 63.6%.

- First, a transition from housing association tenant to homeowner does not create any new home. Total supply of and demand for housing are unaffected.
- Second, the incentive of a converted homeowner to oppose new construction is likely to be much larger than the incentive of the identical person as a tenant. Thus, a Right-to-Buy induced increase in homeownership will, due to political economy forces (see Hilber and Robert-Nicoud, 2013), make building new homes even more difficult and thus accelerate the housing affordability crisis. This is a particular problem in the UK since the planning system encourages NIMBY behaviour.

## **Tax reforms: council tax, mansion tax, stamp duty land tax, inheritance tax and bedroom tax**

Most housing-related reforms that are currently on the political agenda propose some changes to the tax or welfare system.

### *Council tax and mansion tax*

One key cause of the lack of residential construction in the UK is the fact that local authorities have virtually no fiscal incentives to permit development. In many countries where planning decisions are taken at the local level, local property or income taxes provide incentives to local authorities to permit development. The only local tax in the UK is the council tax. One key flaw of this tax is that there has not been a revaluation since 1992 – postponed by successive governments as being politically too difficult. This has had two consequences:

- The tax bears little relation to underlying property values and it has little weight in the tax system compared with other countries (and compared with what it would be under an efficient tax system – see Mirrlees et al, 2011).
- Moreover, the equalisation system, which redistributes revenues on what is called a ‘needs’ basis, more or less eliminates any revenue gain in the medium term for local authorities that permit more development relative to those that are more restrictive.

Thus, the council tax provides insufficient incentives to local authorities to permit development within their boundaries. The lack of incentives coupled with NIMBY behaviour (which is encouraged and facilitated by the UK’s planning system) can largely explain the massive housing shortage.

Partly as a response to the flaws of the council tax, the Liberal Democrats and Labour propose a so-called ‘mansion tax’ on homes worth over £2 million.<sup>5</sup> This is understandable in light of the failure to uprate council taxes, but it would be likely to have a number of adverse and unintended consequences:

- First, it makes national a component of tax revenue that would be better local (see City Growth Commission, 2015). This further reduces any (remaining) fiscally induced incentives at the local level to permit residential development. This is because the increased property-related tax revenue (that is, the benefit from

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<sup>5</sup> The mansion tax would not be relevant today if there had been council tax revaluations after 1992.



government perspective) goes to the central government, whereas the infrastructure-related costs and other expenses associated with new residential development (that is, the cost from the government's perspective) are still assumed by local authorities. So there is an even bigger wedge between the costs associated with development and the corresponding (lack of) benefits from the perspective of local authorities.

- Second, depending on the tax rate, the mansion tax may lead to the subdivision of homes to circumvent the tax. Whether this happens will in part depend on whether the potential savings from subdivision exceed the cost of now having to pay council tax on all subdivided units.
- Third, the mansion tax is likely to be negatively capitalised into property prices, implying that fewer houses than expected will be above the threshold.
- Fourth, this negative capitalisation of the tax (the expected present value of the tax should equal the change in house price) also implies a one-time negative wealth effect for existing owners of expensive homes. The tax would thus hit wealthy and long-term residents in London hardest since virtually all homes above £2 million are located in London. It would not hit wealthy would-be buyers from abroad. The tax is thus likely to be highly ineffective in reducing purchases of London properties by wealthy foreigners.

#### *Stamp duty land tax reforms*

The latest stamp duty land tax (SDLT) reform, announced in the Autumn Statement 2014, eliminated a longstanding anomaly of the tax. Under the old rules, homebuyers had to pay the tax at a single rate on the entire property price leading to large discontinuous jumps in the tax at threshold property prices. For example, a house sold for £250,000 implied a tax liability of £2,500, whereas a house sold for £250,001 implied a liability of £7,500.

Under the new rules, homebuyers only pay the rate of tax on the part of the property price within each tax band – like the income tax. While this reform is a step in the right direction, it does not address the fundamental problem of the SDLT, namely that it creates a disincentive for people to move house, which has adverse consequences for the functioning of housing and labour markets.

Research strongly suggests that the adverse effects of the SDLT on housing transactions and household mobility are very large. Whereas Besley et al (2014) find that the 2008-09 stamp duty holiday temporarily increased transactions by 8%, Best and Kleven (2015) estimate the effect of the elimination of the tax on the transaction volume to be 20% in the short run. Hilber and Lyytikäinen (2013) find that the increase in stamp duty from 1% to 3% at the cut-off of £250,000 reduces the annual rate of mobility by 2 to 3 percentage points or about 30%. This adverse effect is confined to short-distance and non-job-related moves, suggesting a distortion in the housing rather than the labour market.

The key conclusion of all this research is that the SDLT is highly inefficient. The recent reforms are by and large sensible, but they do not address the crucial issue of the tax, namely that it constrains household mobility and thereby discourages downsizing by the elderly and upsizing by expanding young families. An annual local tax on property should be strongly preferred to the SDLT for at least two reasons:

- First, such a tax does not affect the decision to move and thus does not distort housing and labour markets.
- Second, annual local taxes on the value of property provide greater incentives to permit development (additional tax revenue for the local authority and local taxpayers).

#### *Inheritance tax reform*

The Conservatives' manifesto proposes effectively to take family homes out of inheritance tax for all but the richest households by raising the threshold for couples to £1 million. This policy helps existing homeowners and their children but hurts existing tenants and their offspring. It hurts tenants and their offspring because they co-finance the policy via forgone tax revenue without receiving any benefits. The policy thus cements wealth inequality. In fact, it may cement the *increase* in wealth inequality. This is because, as Rognlie (2015) demonstrates, surging house prices are almost entirely responsible for the growing returns on capital that have been associated with increasing inequality in the rich world.

#### *Bedroom tax*

The 'bedroom tax' restricts the amount of housing benefit that council and housing association tenants can claim. The housing benefit is cut for tenants who have a spare bedroom, which presumably means either the landlord has to reduce the rent (if it is private accommodation), the tenant has to find housing in a cheaper area (if they want to keep an extra room) or else move to a smaller housing unit.

The aim of the policy has been mainly to reduce costs, but the policy has a number of additional effects. To the extent that affected tenants move or can move to smaller units, this will free up 'unused' space. But evidence from the 1990s UK housing benefit reforms (Gibbons and Manning, 2006) is suggestive that the incidence of the bedroom tax may fall predominantly on landlords who reduce the rents to discourage tenants from moving to smaller homes or more affordable locations. This limits the potential to free up 'unused space'. To the extent that the incidence does not fall fully on landlords, the tax has the potential to trigger displacement (since there are shortages of smaller properties in some areas) with possibly adverse implications for children's education.

### **Supply-side reforms**

The analysis thus far has highlighted the pitfalls of existing and proposed housing policies, mainly on the demand side. Following the logic of the evidence, more promising reforms would aim to focus on the supply side and, in particular, on reforms of the planning system.

One could think of short- or longer-term and more fundamental reforms to increase land supply. Either way, changes should reflect issues of market failure so as to ensure that land-based public goods (such as urban open spaces, wildlife habitats, national parks, areas of outstanding natural beauty, historic districts in cities or heritage buildings) are adequately supplied and externalities (that is, the fact that enjoyment and value of any parcel of land depends not only on what one can do with the parcel in question but also on the uses of all other parcels in the neighbourhood) reflected.

In the short term, the specific boundaries of the green belts could be revised to release some accessible land with low or negative environmental value and low amenity value (Cheshire, 2014). In practical terms, this would imply re-designating some land that is high intensity agricultural use or perhaps used for golf courses or derelict and near current or planned transport routes or access points. In London, for example, three tube stations are situated within the green belt, as are several Crossrail stations, including Shenfield, Taplow and Iver.

One estimate (Stringer, 2014) is that there are 20,000 hectares of land within 800 metres of a station in London's green belt that do not have markers of environmental quality. Even if only half of that area were re-designated, there would be space for 500,000 houses (at 50 houses to the hectare) taking less than 2% of London's green belt. This would assume taking no land in an area of outstanding natural beauty, a site of special scientific interest, a designated wildlife site or an area that was used for recreational purposes.

In the longer term, one could revert to protecting all land only on the basis of its environmental or amenity value taking account of infrastructure costs and carbon footprint. This could be done by increasing the areas of outstanding natural beauty so that there were substantial green spaces within reach of all major cities ('green fingers' more than 'green belts'), retaining all habitat or national park protection but using land price differentials as price signals to let planners know where or when land would be more usefully used in some other use.

There would be a presumption in favour of development if the price of land, to be developed for an alternative use, exceeded its current value by more than a fixed amount (a 'threshold' acting largely as a greenfield development tax) and it could be shown that this price differential was not justified by the environmental or amenity benefits associated with the land in its present use (Cheshire and Sheppard, 2005). In fact, the Guidance to the National Planning Policy Framework (NPPF) issued in 2014 already incorporates this idea although not as a presumption to allow development.

Other supply-side reforms could work via altering fiscal incentives at the local level. In fact, the coalition government introduced the New Homes Bonus in an attempt to encourage local development. This has been ineffective since the fiscal incentive is only of a temporary nature (for three years) and is far too timid to offset the local authority's costs associated with residential development.

More fundamental reforms would be necessary to provide sufficient incentives to local authorities to change their ways. In an ideal world this would work by replacing the council tax, the proposed mansion tax and the stamp duty land tax with a proper annual local property tax with automatic annual revaluation based on neighbourhood specific price changes. This could be designed to be revenue neutral. Such a reform is politically difficult but it would help to address various housing-related issues in one go.

An alternative, and much less radical proposal, would be to provide fiscal incentives through the central government grant allocation system by tweaking the grant allocation formula and taking account of the amount of housing development granted. Local authorities that facilitate residential development could be compensated with permanent and sizeable fiscal 'development grants' that exceed the cost to local authorities. Alternatively, they could be allowed to tax developers so they are compensated for any extra infrastructure or other expenses a community would need to incur to accommodate additional development.

Finally, the planning laws could be altered to allow developers (potential winners) to compensate NIMBYs (potential losers) in an attempt to gain planning permission.

## Conclusions

Empirical research points clearly to the UK's rigid planning system as the main cause of the housing affordability crisis. Demand-side policies such as Help-to-Buy do not work in this setting because they merely increase house prices.

The current property-related taxes are inefficient, especially the council tax and the stamp duty land tax. While the former is regressive and does not provide sufficient incentives to permit development at the local level, the latter hampers household mobility and generates distortions in the housing markets. Importantly, it discourages downsizing of the elderly and upsizing of expanding young families.

This Election Analysis presents a set of more supply-side friendly policies. The obstacles to moving to such policies are vast since these policies antagonise vested interests, which appear to have been created in perpetuity. But the long-run consequences of political inaction – and the continuation of excessively low rates of new building – could prove socially explosive and economically traumatic.

April 2015

***For further information, contact:***

Christian Hilber ([c.hilber@lse.ac.uk](mailto:c.hilber@lse.ac.uk))

Or Romesh Vaitilingam on 07768-661095 ([romesh@vaitilingam.com](mailto:romesh@vaitilingam.com))

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## **Annex on Help-to-Buy**

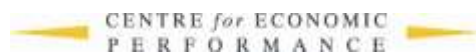
There are a number of further concerns with the Help-to-Buy scheme and other potential schemes that are designed to stimulate housing demand (Hilber, 2013 and 2015a).

First, introducing such schemes is politically fairly straightforward and often popular. But withdrawing them may possibly pose a threat to the macroeconomy since the withdrawals will be likely to affect house prices adversely, especially if they coincide with an economic downturn. This will create obvious losers and may therefore be politically infeasible.

Second, the taxes needed to finance schemes such as Help-to-Buy have a ‘deadweight loss’ – a pure welfare loss to the society.

Finally, such schemes may have ‘systemic risks’. In the case of Help-to-Buy, all risks including the default risk are assumed by the marginal homebuyers who take up Help-to-Buy (and who, by their nature, are likely to be risk-neutral or risk-loving, have low income and/or uncertain job prospects) and by the government (that is, the taxpayer).

In contrast to the United States or Canada, there is no ‘cushion’ in the form of private mortgage insurance companies that bear the risks associated with a house price bust. And unlike in the United States where securitisation markets spread the mortgage-related risks such as the default risk to various investor groups, in the UK the government assumes all risks associated with a serious housing downturn. The fact that mortgages in the UK are not non-recourse (unlike in most of the United States) helps in the sense that there would be fewer defaults (compared with the United States) but would also arguably mean prolonging the crisis.



Centre for Economic Performance  
London School of Economics and Political Science  
Houghton Street London WC2A 2AE UK  
Tel: +44(0)20 7955 7673 Email: [cep.info@lse.ac.uk](mailto:cep.info@lse.ac.uk) Twitter: @CEP\_LSE  
Facebook: <https://www.facebook.com/centre4economicperformance>

