

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: $\uparrow P$ houses \rightarrow \uparrow 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

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

Source: <http://www.communities.gov.uk/housing/>

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

Person A's rate of return		
	Person B does not invest	Person B invests
Person A does not invest	4%	6%
Person A invests	2%	5%

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 ΔP

- 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 ΔD

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

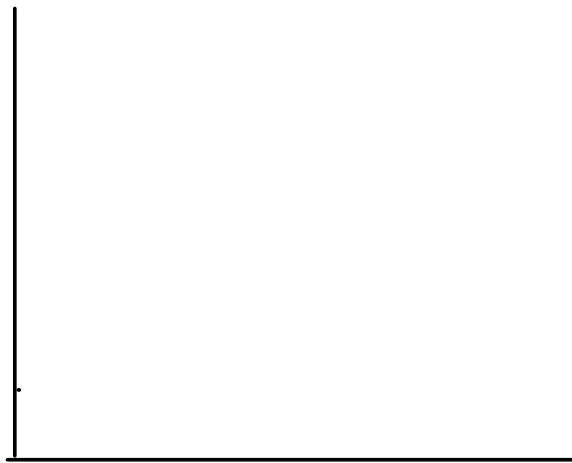


Figure 1(a) **Market Equilibrium and ΔP**



Figure 1(b) **Market Equilibrium and ΔD**

The Market System for Housing III: Supply Inelasticity (contd)

- How does the market system react to changes in demand?

- Equilibrium: P^* , Y^* combination

- \uparrow inward migration \rightarrow D shifts right: $\uparrow Q_d$; new equilibrium: $\uparrow P$, $\uparrow Q_s$

- Inelastic Supply

- Sizeable $\uparrow P$; small $\uparrow Q_s$

- Bulk of adj to ΔD via ΔP , not ΔQ_s



Figure 2(a) **Inelastic Supply**
Marie M Stack

- Elastic Supply

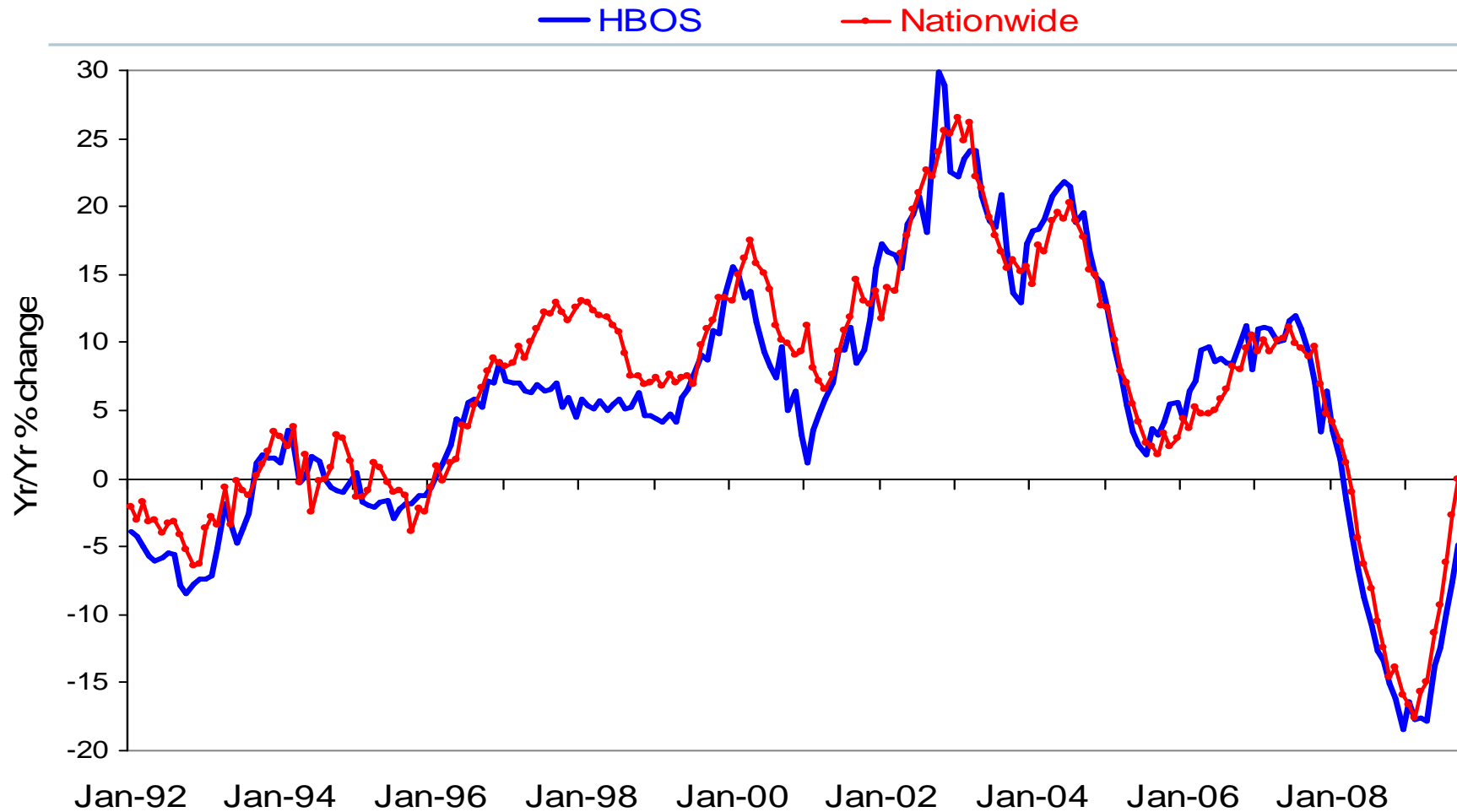
- Small $\uparrow P$; sizeable $\uparrow S$

- Most of adj to ΔD via ΔQ_s , not ΔP



Figure 2(b) **Elastic Supply**
Economics of Public Issues

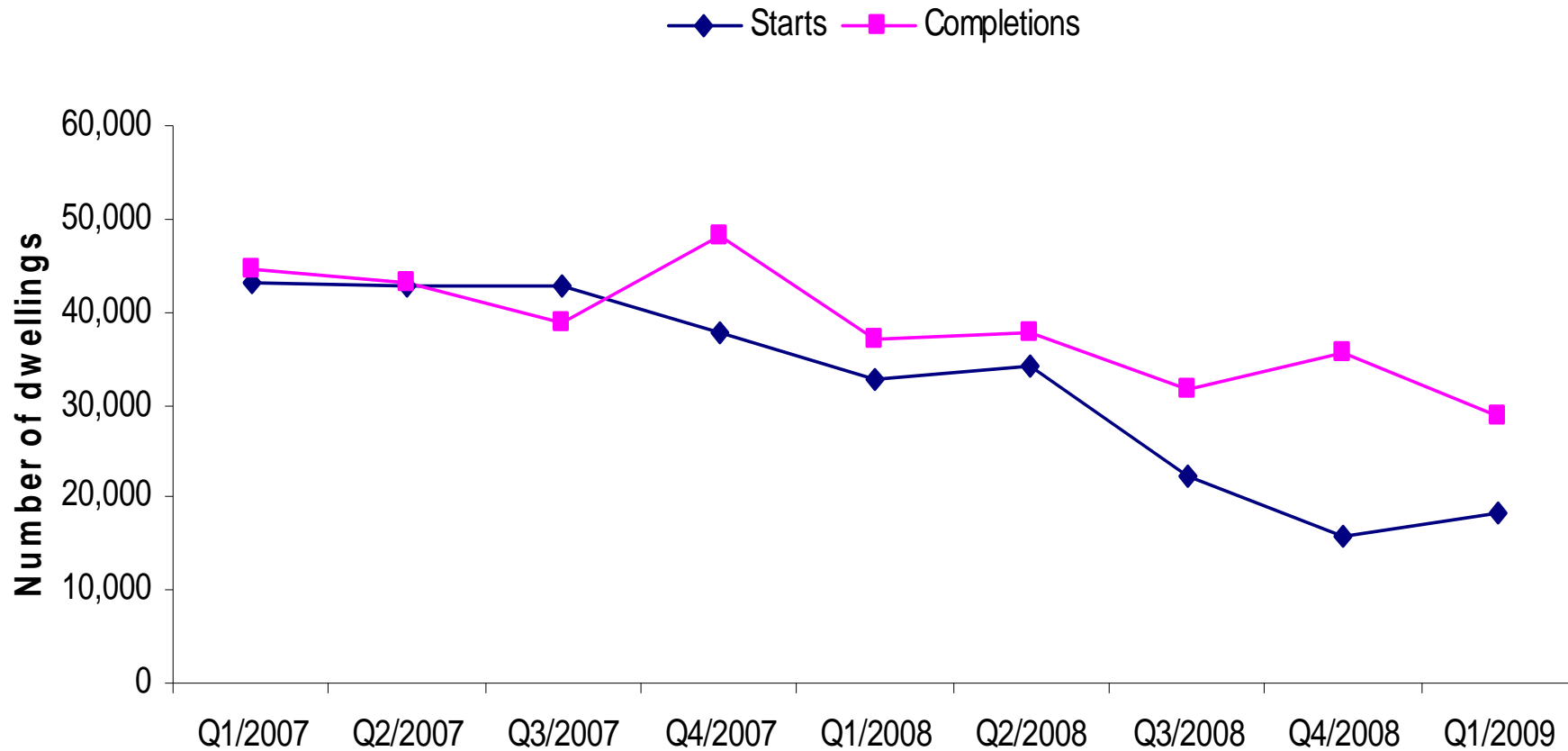
House Price Inflation: HBOS and Nationwide



Explaining the Rapid Increases in UK House Prices

- 1. Inelastic supply
 - UK housing output responds weakly to ΔP
- 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



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 → S shifts right → ↓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

- Advs 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?