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Help to buy: an academic's view based on economic theory and empirical evidence

Speech

Original citation:

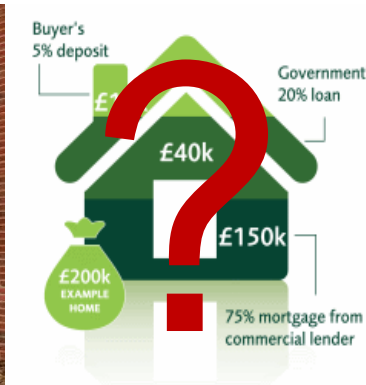
Originally presented at Hilber, Christian (2013) *Help to buy: an academic's view based on economic theory and empirical evidence*. In: *Help to who? Using the state to help to buy*, 05-06 Jun 2013, London, UK.

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Available in LSE Research Online: December 2013

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Help to Buy: An academic's view based on economic theory and empirical evidence

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June 2013



Overview

1. What will Help-to-Buy achieve?

- What does economic theory predict?
- Supporting empirical evidence

2. Who benefits?

- Winners and losers – not who you might think...

3. What should the government (not) do?

Starting point: A real problem...

- **House prices in UK are extraordinarily high**
 - ▶ UK has second highest buying price per square metre in the world (only topped by tiny Monaco!)
(Globalpropertyguide.com; last accessed March 2013)
- **And we live in extremely cramped housing!**
 - ▶ A new-build house in UK is 38 percent smaller than in densely populated Germany and 40 percent smaller than in the even more densely populated Netherlands ([Statistics Sweden, 2005](#))

⇒ **Might 'Help to Buy' solve this problem?**

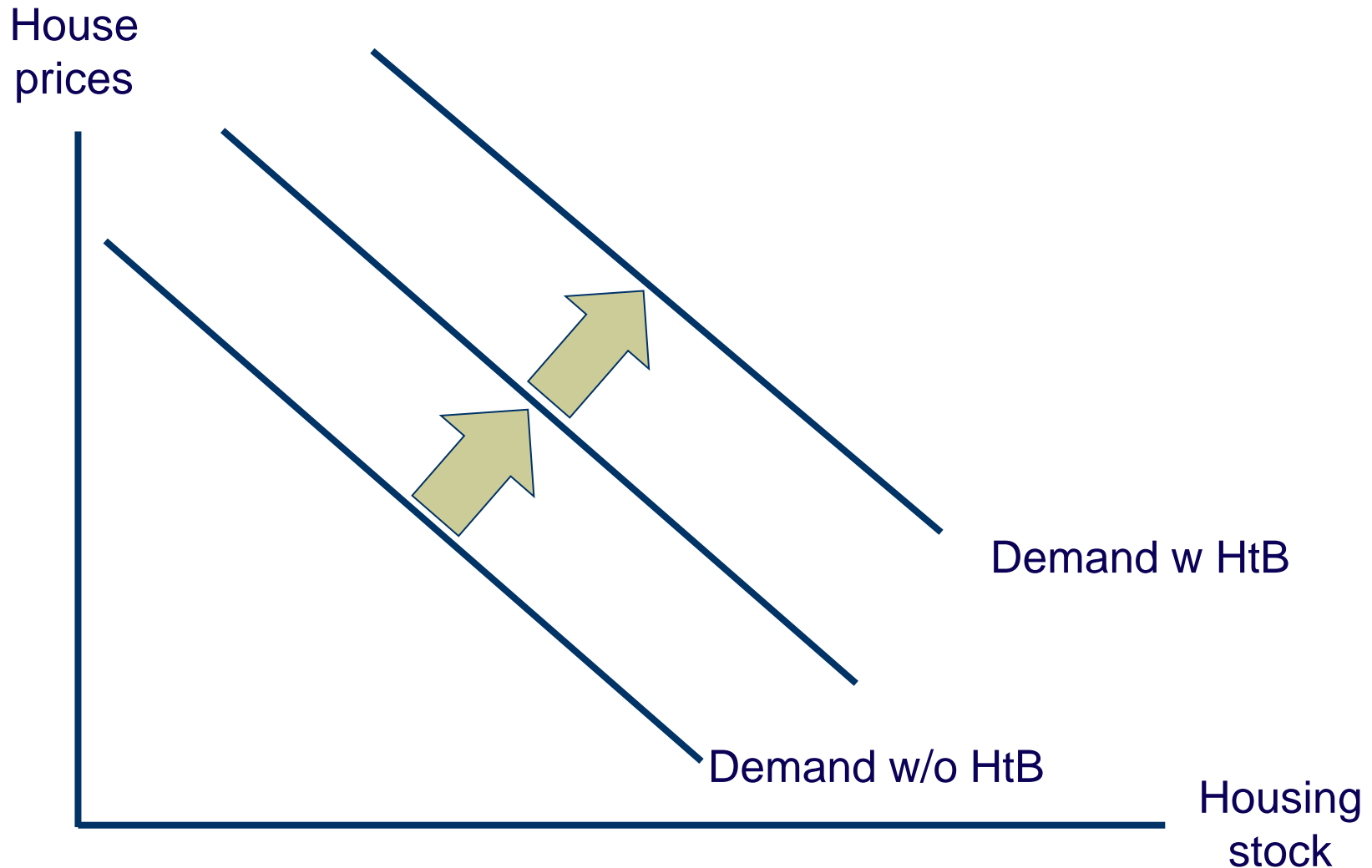
Insights from 'Economics 101'

- **Main effect of Help to Buy**
 - ▶ Equity loans and the mortgage guarantee both **boost demand** for housing, especially of first-time-buyers
 - ▶ Higher willingness-to-pay, all else equal
- **Also: starter homes and new builds are reasonably close substitutes for other types of housing (incl. rental)**
 - ▶ Positive effect on **aggregate demand** for housing

Insights from 'Economics 201'

- **Policy strongly affects ability of potential first-time buyer to afford **down-payment** on starter home**
 - ▶ Additional boost to housing demand
 - ▶ Because of capital gains & 'moving up the housing ladder' feeds through to trade-up homes
- ⇒ **Has substantial impact on overall housing market (Ortalo-Magné & Rady 2006)**

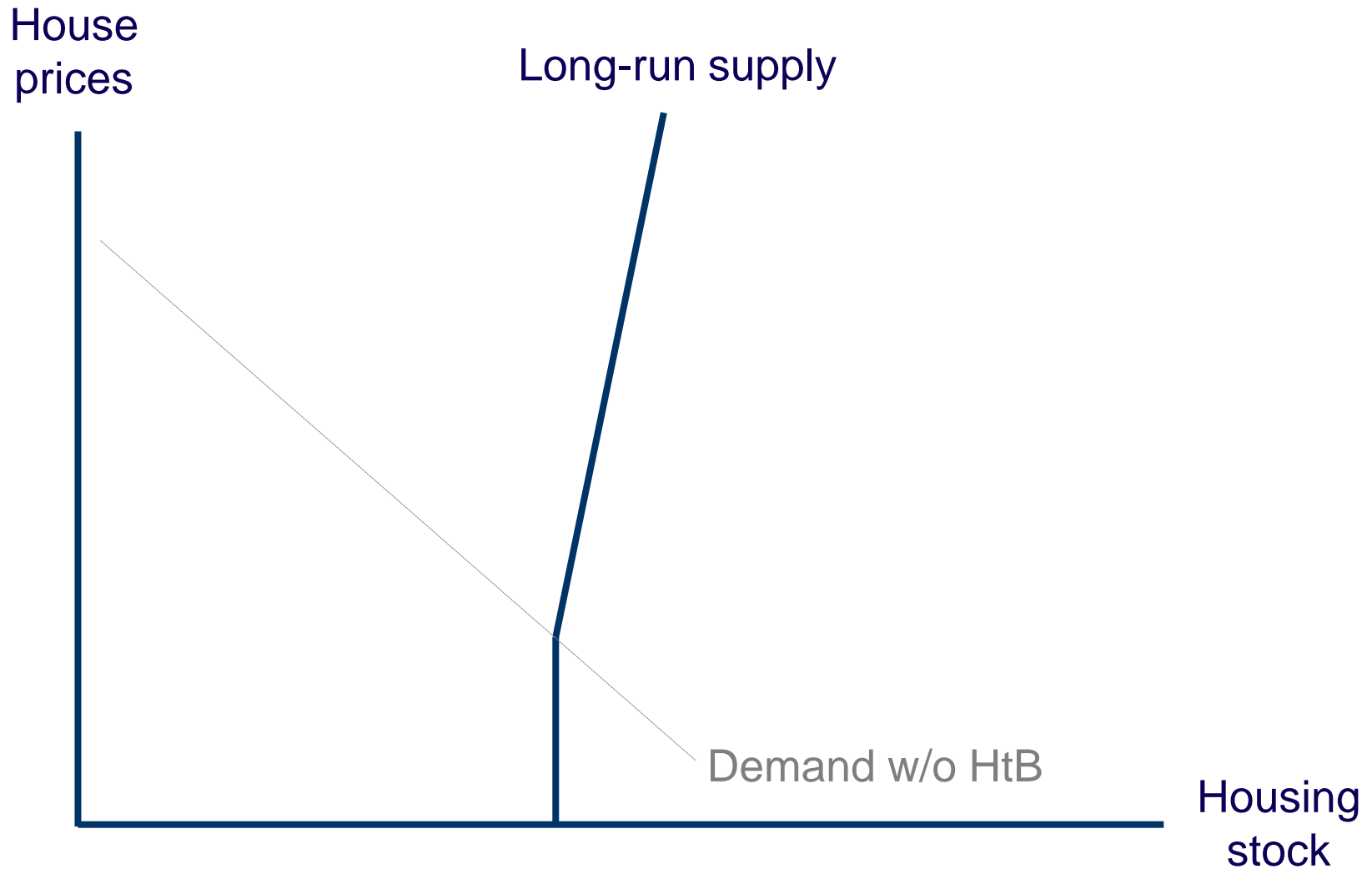
The demand side...



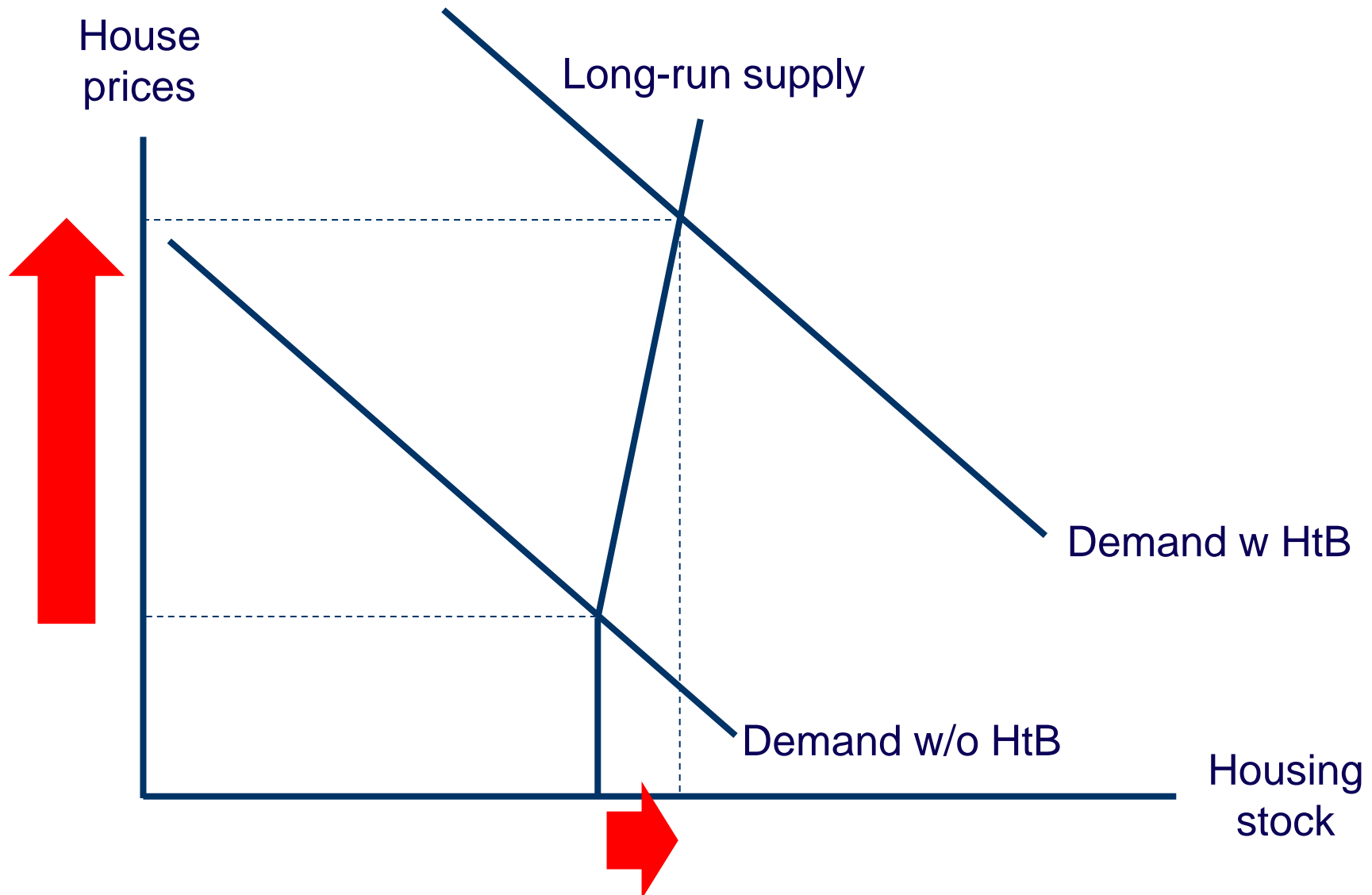
What about supply?

- **UK planning system extraordinarily inflexible**
 - ▶ Since 1947: virtually no fiscal incentives at local level to permit development
 - ▶ Government reforms since 2010 not (yet) 'biting'
 - **Underlying causes?**
 - ▶ UK = highly centralized country, virtually no fiscal power at local level
 - ▶ Political power tilted towards homeowners (NIMBYs or better: BANANAs)
- ⇒ **Perhaps world's most restrictive planning system...**

The supply side...



The effect of Help to Buy...



Evidence

- **Hilber and Vermeulen (2010, 2012)**
 - ▶ Demonstrate that **tight local planning constraints in parts of England** (in conjunction with strong demand) are to a good extent responsible for extraordinarily high house prices
 - ▶ Had the SE the restrictiveness of the NE, house prices in the SE would be 25% lower

Evidence (cont.)

- **Hilber and Turner (forthcoming)**

- ▶ Mortgage interest deduction in US

- Raises house prices in regulated cities
- **Reduces** homeownership attainment in these cities
- Zero overall effect on homeownership attainment

- ▶ Why? Subsidy pushes up prices in constrained places and prevents marginal would-be-buyers from becoming homeowners

⇒ **US wastes 100 Billion US-dollar each year!**

Winners and Losers

- **Main beneficiaries = Existing owners of owner-occupied housing**
 - ▶ Mainly wealthy & elderly population
 - **First time buyers not better-off**
 - **Mobile renters worse-off**
 - ▶ Typically poor & young
 - **Tax payers bear cost of schemes & risk**
- ⇒ **But wealthy also pay more taxes**
- ⇒ **Zero sum game?**

We may ALL be losers...

1. Taxes needed to finance scheme have a 'deadweight loss'

- ▶ Pure welfare loss for society

2. Systemic risk (...yet again)

- ▶ Government does not only provide 'implicit government guarantee' but **directly bears various costs *and* risks**
- ▶ If housing markets collapse then government takes direct hit...
- ▶ Unlikely? Perhaps, **but...**

What should the government (not) do?

- **Subsidies to consumers are ineffective, costly & risky**
- **Must tackle ‘supply side’ problems instead!**
 - ▶ Give strong incentives to local authorities (and NIMBYs) to facilitate construction of new housing and expansion of existing housing
 - ▶ One idea (of many): Introduce proper local property tax and get rid of e.g. ‘absurd’ stamp duty (Mirrlees Review 2011; Hilber & Lyytikäinen 2013)

And what can we learn from the US housing crisis?

- **Securitization can improve social welfare in principle BUT...**
 - ▶ Design and implementation of securities market in US was flawed + markets were poorly regulated
 - **Lessons from the US debacle**
 1. Ensure competition – no monopoly or duopoly
 2. ‘Too big to fail’ is bad – commit to no government backing, so investors face true risks
 3. Regulation ought to focus on market efficiency and systemic risks
- ⇒ **It appears British politicians may not have learned these lessons....**

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Q & A

Thank you!

*Presentation with references & hyperlinks
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<http://personal.lse.ac.uk/hilber/>