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Speech

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

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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?
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?
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 closes substitutes for other types of housing (incl. rental)

- Positive effect on aggregate demand for housing
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...

House prices

Demand w/o HtB

Demand w HtB

Housing stock

Intro /Problem  Theory  Evidence  Who benefits?  What (not) to do?  References
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 effect of Help to Buy...

Intro /Problem | Theory | Evidence | Who benefits? | What (not) to do? | References

House prices | Long-run supply | Housing stock

Demand w/o HtB | Demand w HtB
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
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?
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....
References


Thank you!

*Presentation with references & hyperlinks is downloadable from: http://personal.lse.ac.uk/hilber/*