



# Spatial Economics Research Centre

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## Housing – and more than housing: what a bad budget!

Posted by Paul Cheshire, SERC and LSE

The British housing market, especially the English housing market, is in crisis. This is not a crisis just confined to housing: it threatens to extend to the whole economy. We have analysed these issues on this blog [several times before](#). The supply elasticity of new housing is approaching zero. In each of the last three years fewer private market houses have been built than in any peacetime year since early in the 20<sup>th</sup> Century.

The noose constraining new housing development has been tightening for 30 years at least. The cause is mainly the constraints on land supply imposed by our planning system. If these are made worse by the way the planning system injects risk and uncertainty into development, reinforcing the monopoly power of larger British developers (only born and bred British developers can understand the system and only big ones really have the resources to negotiate a way through it), and by a fiscal system which still effectively fines local communities who permit development.

As I [argued in 2009](#) this results in housing becoming ever less affordable relative to incomes, and to ever increasing price volatility. In turn, this creates problems for monetary policy. It also fuels an obsession with house prices, and sucks savings into housing consumption and speculation. Not getting onto the housing ladder is a long term disaster for someone who aspires to a decent standard of living and at least a moderately comfortable old age. Given that housing demand is highly income-elastic, and - as [Nick Boles has perceptively observed](#) - as people get richer they aspire to a patch of garden too and the fact that over the past 60 years, real house prices in England have risen more than almost any other asset, it is entirely rational for people to pour money into housing.

That does not make it good for us collectively to behave like this. It is very bad news for people who end up spending too high a fraction of their incomes on the [most cramped housing in the developed world](#). It is also bad for the performance of the real economy. Over-borrowing to get into the housing market was a major cause of the financial crisis; our housing obsession also almost certainly diverts both funds and the willingness to take a risk from productive entrepreneurial activity.

To illustrate with a personal anecdote: my wife – also an academic - held a chair in Switzerland and so bought a flat there in 1994. Having returned to a chair in London she sold that flat in 2012 for exactly the same number of Swiss Francs she paid in 1994. But while this was the same number of Swiss Francs, converted into pounds Sterling it represented a capital gain of some 50%. The Franc's appreciation is not hard evidence - but certainly suggestive of a causal relationship. Real house prices in Switzerland have been stable at least since the 1960s (of course there is a cycle but there is no long term upward trend) so the Swiss feel little pressure to be owner occupiers and do not divert all their available funds and credit into buying houses. The Swiss economy has been similarly stable and hasn't it done well?

Since 2010 the coalition has been trying to make the planning system more responsive to market signals, and give local communities incentives to allow development. As colleagues [suggested at the time](#), it was a mistake to get rid of one planning system without having another in place. The new planning policies and incentives *may* help to deliver more houses but even if they do it will certainly take time. [Well under half](#) of local authorities even have local plans approved yet – a requirement of the new National Planning Policy Framework which goes live today. NIMBY resistance to allowing housing to be built where there is most demand is as strong as ever. The last thing a home-owner in the green Home Counties wants is new houses occupying any rolling acres [near them](#). Note the [outrage](#) caused by the Planning Minister when he suggested it is reasonable for those lucky enough already have a patch of garden, not determinedly to frustrate the desires of those seeking a patch of garden of their own.

As colleagues and I have [argued before](#) the balance of our judgement is that the coalition's changes will fall far short of what is really needed to improve things on the supply side. But it will be at least another four years before we can judge whether the politically costly reforms of the past two years will actually deliver any improvement anyway.

Which brings me to the budget: this is pumping up the demand side and encouraging more borrowing. As [Robert Peston](#) and others have noted, the government (that's us) are shouldering a risk banks have sensibly been fighting shy of. There has to be a significant risk that house prices have further to fall. The budget measures will feed through into house prices higher than they otherwise would be: indeed that is more or less all they will do. Supply is, after all, more or less perfectly inelastic for the reasons given above. We have shaken up a broken planning system but not yet achieved any improvement.

Higher house prices will lead to housing becoming yet more unaffordable, and yet more borrowing secured against highly volatile assets – which policy itself has made yet more volatile. In the long term, house prices tend to rise in real terms. But in the short term, this debt still has to be serviced – while incomes are stagnant, and interest rates will be rising.

All in all a recipe for double disaster: a terrible housing situation made worse and a serious additional risk in the offing. Perhaps the only explanation is the very cynical one. The election is even closer than the economic disaster to which this budget may contribute. Let the next Chancellor get out of that one!

Posted by [Max Nathan](#) on [Wednesday, March 27, 2013](#)

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