

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?

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?**

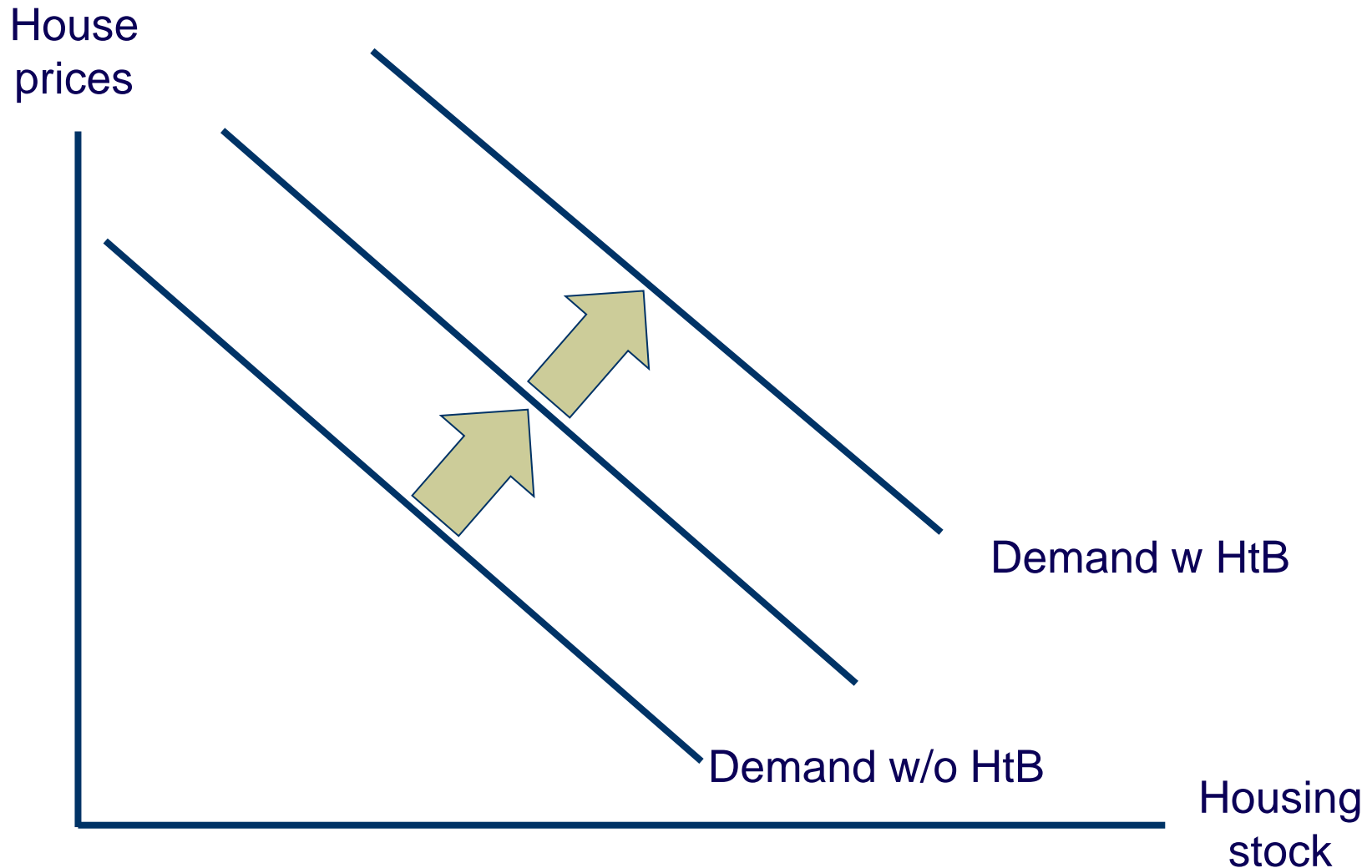
Insights from 'Economics 101'

- **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)**

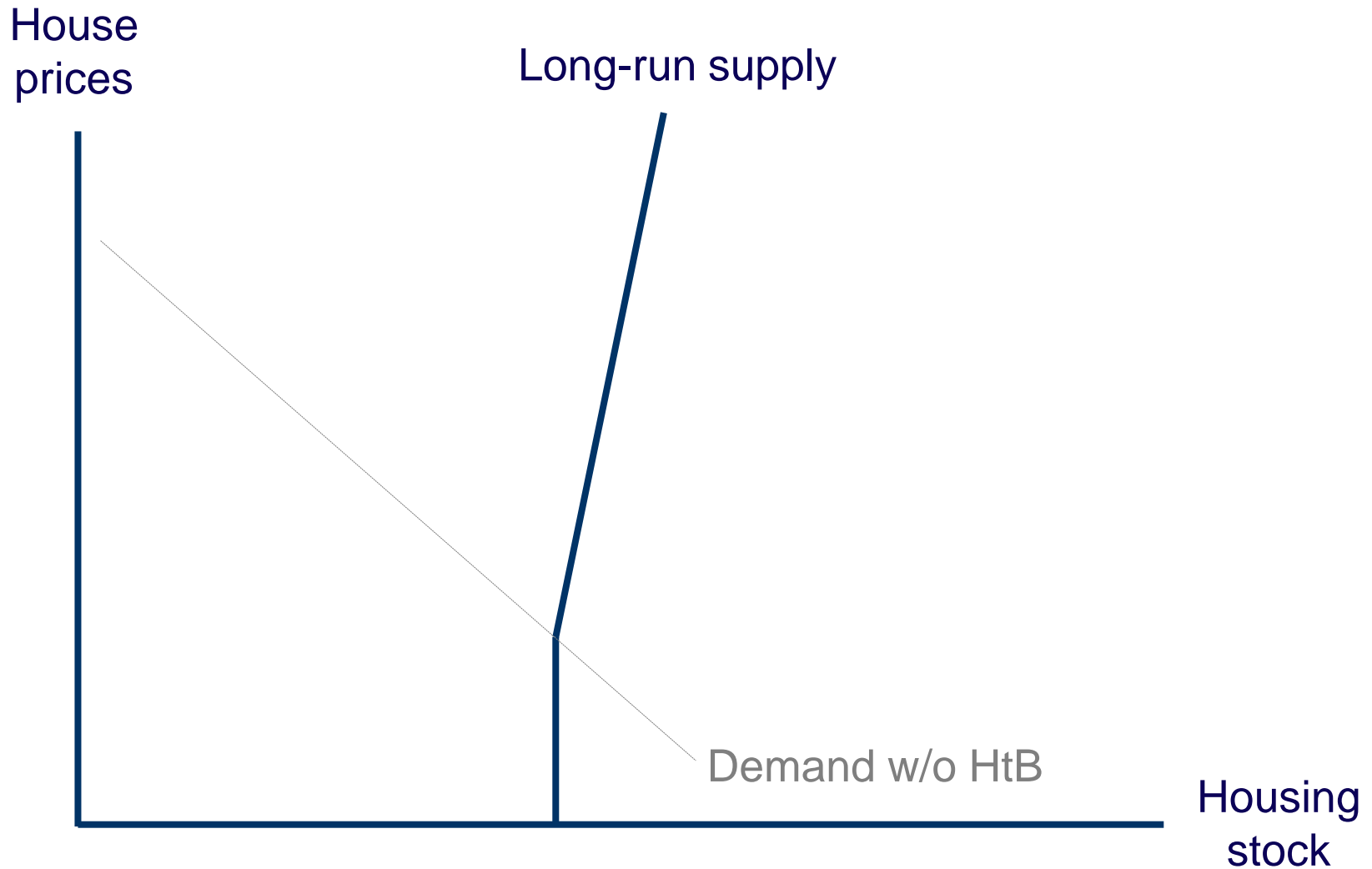
The demand side...



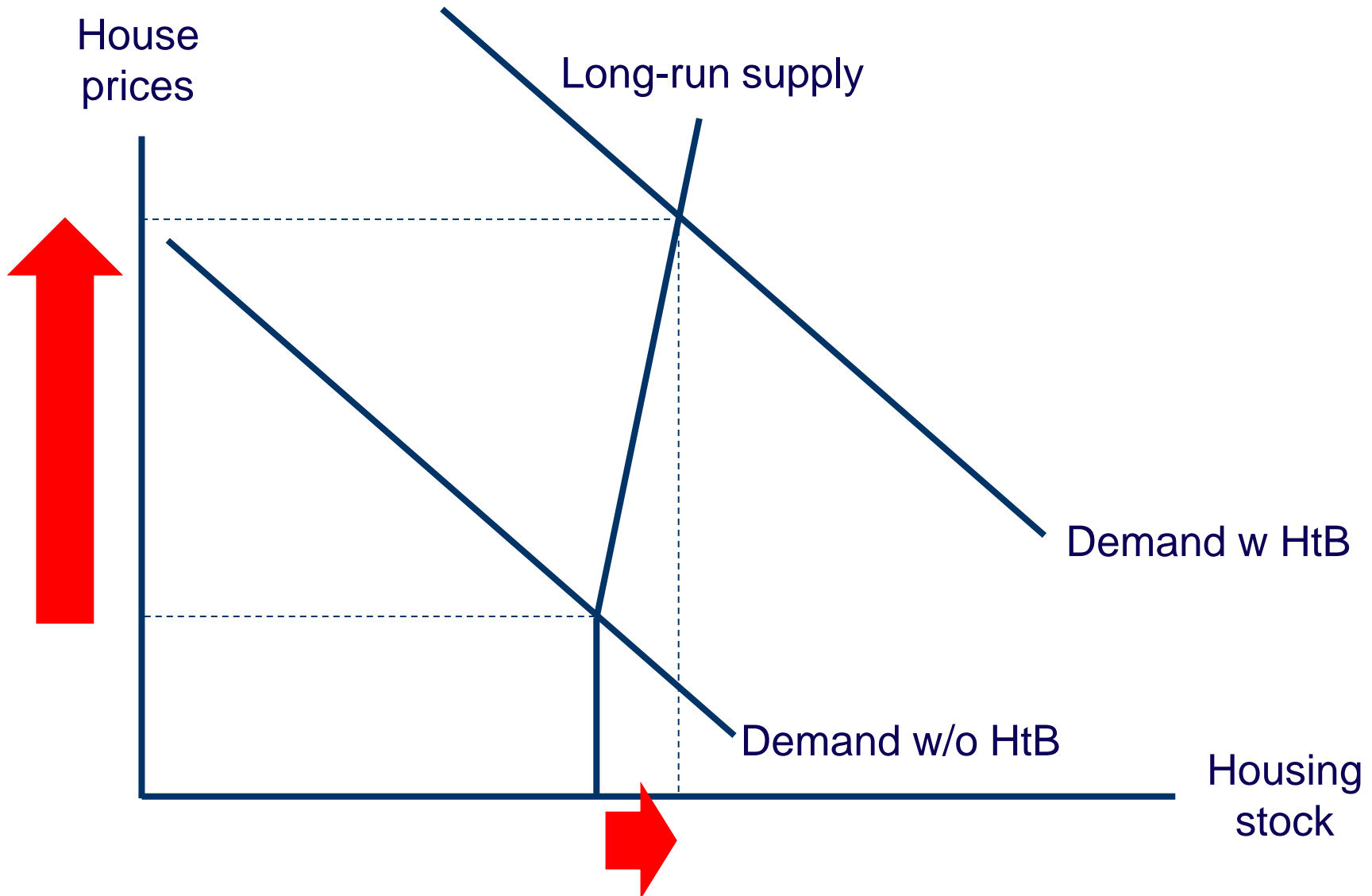
What about supply?

- **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....**

References

- **Globalpropertyguide.com**
(<http://www.globalpropertyguide.com/most-expensive-cities>; last accessed: 28 March 2013)
- **Hilber, C. and T. Lyytikäinen (2013)** 'Housing Transfer Taxes and Household Mobility: Distortion on the Housing or Labour Market?', London School of Economics, mimeo, April 2013). (Paper presented at the CEMMAP Workshop on Housing: Microdata, Macro Problems, May 2013)
- **Hilber, C and T. Turner (forthcoming)** 'The Mortgage Interest Deduction and its Impact on Homeownership Decisions,' *Review of Economics and Statistics*.
- **Hilber, C. and W. Vermeulen (2010)** *The Impacts of Restricting Housing Supply on House Prices and Affordability – Final Report*, London: Department for Communities and Local Government.

References (cont.)

- **Hilber, C. and W. Vermeulen (2012)** 'The Impact of Supply Constraints on House Prices in England', London School of Economics, SERC Discussion Paper No. 119, September 2012.
- **Mirrlees, J., Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., Johnson, P., Myles, G. and Poterba, J. (2011)** *Tax by Design: the Mirrlees Review*. Oxford University Press.
- **Ortalo-Magné, F. and S. Rady (2006)** 'Housing market dynamics: on the contribution of income shocks and credit constraints', *Review of Economic Studies*, vol. 73(2), pp. 459-485.
- **Statistics Sweden (2005)** *Housing Statistics in the European Union 2004*, Karlskrona: Boverket, Publikationsservice.

Q & A

Thank you!

*Presentation with references & hyperlinks
is downloadable from:*

<http://personal.lse.ac.uk/hilber/>