A Basis on Which to Build?

A report by Europe Economics for the Campaign to Protect Rural England
# TABLE OF CONTENTS

**EXECUTIVE SUMMARY** ............................................................................................................. 1

**1 INTRODUCTION** .................................................................................................................. 3
   This Europe Economics Report .................................................................................................. 3

**2 TOO FEW HOUSES?** ............................................................................................................ 6
   What does “too few” mean? ....................................................................................................... 6
   Too few in total? ......................................................................................................................... 7
   Too few in the right places? ....................................................................................................... 9
   Too few of the right sort? ......................................................................................................... 11
   So is there any under-supply? ................................................................................................. 12
   What are the “benefits to the economy” from cheaper houses? .................................................. 14

**3 HOUSING MARKET VOLATILITY** ..................................................................................... 16
   Volatility and supply ................................................................................................................ 19
   Do high house prices worsen macroeconomic volatility? .......................................................... 21

**4 THE RESPONSIVENESS OF NEW HOUSING SUPPLY TO CHANGING PRICES** ................................................................. 22
   Does low responsiveness imply too little production? ............................................................... 22
   Supply responsiveness and house price volatility .................................................................... 23

**5 NEW HOUSES VERSUS NEW LAND** .................................................................................. 24
   Markets and Green Fields ....................................................................................................... 25
   Planning for affordable housing ............................................................................................. 27

**6 CONCLUSION** ..................................................................................................................... 29
EXECUTIVE SUMMARY

1 Europe Economics was commissioned by the Campaign to Protect Rural England (CPRE) to provide an analysis of the Interim Report of the Barker Review of Housing Supply.

2 Our analysis shows that, somewhat surprisingly, and despite the widespread consensus behind its view, the Interim Report does not offer compelling reasons to suppose that there are too few new houses built in the UK. Recent Census data show that the population of England and Wales is some 900,000 lower than previously thought, that there is a surplus of dwellings over households, that this surplus has increased in the past decade, and that this has happened in all regions of England except London (where the balance is unchanged). There are strong reasons to believe that these Census data are more reliable than other data sources suggesting the opposite effect.

3 House price rises since 1998 cannot reasonably be attributed to constraints on the supply of new houses, because
   - such house price rises are an international phenomenon, covering also countries in which there is little or no restriction on land supply, such as the US and Australia;
   - new housing represents less than 1 per cent of the housing stock or 10 per cent of the traded housing market, and hence can have very little effect on short-term fluctuations in price (although it can have significant effects on the long-term price); and
   - short-term house price volatility is primarily a demand-side phenomenon, driven by factors such as people’s changing expectations of their future wage or employment prospects.

4 The Interim Report’s figures on the number of houses required to meet particular targets for house price growth are interesting, but no good reason is offered why these price targets are desirable.

5 The most one could reasonably conclude from the Interim Report is that there may be a desirable policy goal of achieving more affordability of housing for certain low-income groups.

6 Affordability is about incomes just as much as about prices. Change in any number of influences on household incomes, such as making public sector pay scales more responsive to local conditions or raising housing benefit, would promote affordability without a need to increase new housing supply.

7 The Interim Report’s discussion of wider benefits to the economy from lower house prices amounts to little more than the proposition that if an important good in the economy were cheaper, and there were no negative consequences of this, then we would be wealthier.
While true, this does not add much to the debate about how or whether there is under-supply of new housing.

8 Housing market volatility is a demand-induced phenomenon. There are good reasons to suppose there may be problems on the demand-side of the housing market that contribute to this volatility. Problems of housing supply are an effect of housing market volatility, not a cause.

9 Demand-induced housing market volatility tends to reduce the responsiveness of housing supply to prices, and to increase the idle land-bank holdings of developers, to protect them from risk. Neither of these issues reflects any problem in the functioning of the supply side of the housing market. Instead, more land (which has already been granted planning permission) would be released and supply would be more responsive to price changes if volatility on the demand-side of the market were addressed.

10 If, notwithstanding the arguments above, housing supply is to be increased, the area where the evidence appears to suggest a need is affordable housing. Relaxing planning constraints to permit additional greenfield development will not lead to more affordable housing, because the market tends to supply larger, more expensive homes on such sites.

11 To achieve a greater supply of affordable housing will require reforms to the planning system (possibly accompanied by additional government subsidies) to encourage the building of more such dwellings. But this is a question of the mix of housing developed and not of releasing additional greenfield sites.
1 INTRODUCTION

1.1 This is a report by Europe Economics, commissioned by the Campaign to Protect Rural England. It discusses the Interim Report of the Barker Review of Housing Supply, and in particular the question of whether the Barker Review makes a robust case that the UK needs to release additional greenfield land to build more new houses.

1.2 On 10 December 2003 the interim report of the Barker Review of Housing Supply was published. In the 2003 Budget the Chancellor and Deputy Prime Minister asked Kate Barker, a member of the Monetary Policy Committee, to undertake a review of issues affecting housing supply in the UK. The Review will publish a final report with recommendations for Government in Spring 2004.

1.3 The Treasury specifies the scope of the Barker Review as follows:

   The weak responsiveness of new housing supply to rising house prices is a complex problem and the review will therefore consider:

   • The role of competition, capacity, technology and finance of the house-building industry; and
   • The interaction of these factors with the planning system and the Government's sustainable development objectives.

   The review will identify options for Government action if appropriate, including the use of fiscal instruments.

This Europe Economics Report

1.4 Most press interpretation of the Interim Report suggests that it makes a strong case that too few houses are built in the UK, and that planning controls on land supply are the key factor restricting supply below what is appropriate. While the Interim Report itself was measured in its presentation of the evidence, many newspaper reports focused on specific figures of how many new homes were “needed” — for example:

   (a) The FT ran a headline “Barker calls for 146,000 new homes each year”.
   (b) The Times preferred “Planning system releases too little land, too slowly” going on to say “As many as 145,000 extra homes need to be built each year to end the cycle of boom and bust that has driven up property prices.”
   (c) The Telegraph stated “Huge increase in homes needed to beat property price inflation”, going on to say “More than 320,000 homes must be built in Britain each year if house price inflation is to be brought under control.”

---

Throughout the rest of this document we shall use “Interim Report” to refer to the interim report of the Barker Review, and refer to The Barker Review of Housing Supply as “The Review”. When we talk about other interim reports or other reviews (e.g. the interim report of the Miles Review of the UK Mortgage Market) we shall specify the title more fully.
1.5 This impression would be strengthened by reading the Treasury’s own summary of the key findings of the Interim Report, which went as follows:

- The number of houses being built in the UK is not keeping pace with demand and is damaging the wider economy.
  - In 2001, around 175,000 dwellings were built in the UK — the lowest level since the Second World War. And over the past ten years, the number of new dwellings built has been 12.5% lower than in the previous decade.
  - Over the last 30 years, UK house prices went up by 2.4% a year in real terms – compared to the European average of 1.1%. In Germany it was 0%, and in France 0.8%.
  - If UK house prices had risen in line with the European average, since 1975, the UK would have been £8 billion better off. As a result of these price rises first time buyers in 2001 paid on average £32,000 more for their homes.
  - In 2002, only 37% of new households in England could afford to buy a house, compared to 46% in the late 1980s.

- The ratio of lowest quartile house prices to lowest quartile earnings has increased significantly in most English regions. In 1993, a London house cost around four times the annual income of a low income household. By 2002, the same house had risen to almost eight times annual income.

- The Review considers a range of factors that might be constraining the supply of housing in the UK arising from industry failures or the policy environment.

- The main constraint identified by the Review is land supply. This problem relates in part to the housebuilding industry, in particular, its response to risk which leads to reluctance to build out large sites quickly. The regulatory relationship and control over the use of land also influences the way in which land is made available for development.

1.6 We shall consider whether this widespread impression of the findings of the Interim Report is correct. Specifically our focus will be on whether the arguments and evidence advanced by the Interim Report itself, or other arguments commonly put forward, do indeed support the consensus view that the UK builds too few new houses and needs to release more greenfield land. We shall consider some of the issues the Interim Report raises², and whether the way to address these issues is through increasing the supply of new greenfield land.

² We do not attempt to achieve a comprehensive coverage of all of the material and issues raised in this wide-ranging review. Our focus is on the case for releasing additional greenfield land.
1.7 In a number of places we mention possible specific policy changes. It should be understood that we do not intend to make any policy recommendations (doing so was not part of our terms of reference). Rather, we attempt to identify strengths and weaknesses in the arguments and policy recommendations of others, and to identify possible alternative policy responses to the issues raised.
2 TOO FEW HOUSES?

2.1 There is a widespread consensus that “too few” new houses are built in the UK. The Interim Report takes it as read that this is true and that there is a shortage of housing overall. However, we shall argue that (somewhat surprisingly) the Interim Report has not shown that there is under-supply of housing, nor that the release of additional greenfield land for housing development would be either economically or socially desirable. In particular, there is no clear and robust concept in the Review as to what constitutes a “shortage”, or what it would mean to say that “too few” houses are built.

2.2 Partly, this reflects the fact, pointed out in Chapter 3 of the Interim Report, that “There is no obvious right answer for the number of houses we should build. Different policy aims suggest different numbers.” The scope of the Review does not specify what the right policy aims are, though it does promise that in the final Report “a policy agenda [will be] set out” (but even in this case it is ambiguous as to whether this policy agenda will include a consideration of the right aims for policy, rather than simply “making a real difference to housing supply” — i.e. increasing it). In the meantime, the Interim Report itself states that it “does not attempt to assess the socially optimal level of housebuilding.”

2.3 In the absence of any specified policy aims, it is difficult to debate whether those policy aims are correct. There is a distinct danger that policy could wander blindly into the assumption that building more houses is a Necessity and A Good Thing without anyone having to display robustly that the trade-offs involved (e.g. perhaps more greenfield land released for housing, so less countryside, more urban sprawl and the associated increase in road traffic, congestion, pollution and demand for infrastructure) really justify an increase.

What does “too few” mean?

2.4 Below we shall see how the Interim Report attempts to quantify what might be meant by “too few” new houses being built. But to inform our discussion, let us consider three sense in which there might be “too few houses”:

(a) Too few houses for all the households.

(b) Too few houses in the right places for the households

(c) Too few of the right sort of houses.

2.5 In each of these senses of “too few” it is further important to distinguish between situations in there might be too few houses because of some imperfection or regulatory failure that causes markets not to function properly, and other cases in which markets
function well but the outcome does not meet some policy objective. The focus of the Interim Report is fuzzy on this distinction. Policy objectives are not set out clearly in a way that allows them to be debated, yet there is likewise little evidence produced of any lack of proper functioning in the markets. A natural interpretation of this would be that, probably appropriately for an interim stage, the Review has so far attempted to work towards a clearer picture of what is going on, rather than provide an argument that there are really too few houses in any sense at all.

Too few in total?

2.6 The 2001 Census figures show that the population of England and Wales is 52,041,000 compared with the official mid-2000 population estimate of 52,943,000. That is to say, it turns out that the population of England and Wales is 900,000 less than had previously been thought. Because the population turned out to be significantly less than previously believed, the number of households, likewise, turned out to be lower.

2.7 Consequently, despite expectations to the contrary in earlier reports,\(^6\) in 2001 there were 4 per cent more dwellings in the UK than households, a surplus that has actually risen (up from 2.8 per cent) since 1991. In England in 2001 there were 3.7 per cent more dwellings than households, up from 2.4 per cent in 1991.\(^7\)

2.8 The increased ratio of dwellings to households has not been driven by increases in second homes (which constitute only 0.7 per cent of dwellings), nor by rises in the proportion of homes considered unfit, which has actually fallen considerably since 1991 (from 7.5 per cent to 4.2 per cent).

2.9 The Census data are clearly not consistent with the widespread consensus of a worsening aggregate under-supply of dwellings. The Census data shows that this popular belief has been based on a false statistical picture, arising from the unreliable inter-censal estimates (based on small samples and proxy measures) during the 1990s, and their tendency to exaggerate the population and hence the number of households. Exactly why inter-censal estimates were particularly poor during that period is a matter of debate, but perhaps some increased scepticism about such estimates might be a healthy

---

\(^5\) Paragraph 3.38.

\(^6\) For example, the House Builders Federation report “Building a crisis”, from June 2002 (which would not have had access to the final versions of the 2001 Census data) states on p11 that “In 1981, there were 4.1% more dwellings (18.0 million) than households (17.3 million) in England, a comfortable margin to allow for vacant dwellings, although not nearly enough to cover the number unfit for habitation. By 2000 this surplus had shrunk to 0.2%. The country almost certainly slipped into a crude deficit of dwellings (i.e. more households than homes) during 2001, the first deficit since the 1960s.” This study argued for a large expansion in housing supply, with a key aim being to build sufficient additional new houses that the housing stock should exceed the number of households by 3 percent, “thus achieving a home for all”. Of course, the Census data shows that this target had already been more than exceeded without any need for additional large increases in supply.

\(^7\) The latest version of the Census data at the time of writing this report shows a slightly higher number of household spaces than the dwellings figures in the Interim Report figures quoted here and in Table 2.1 (the households number is unchanged). For example, the total number of household spaces for England is given as 21,263 thousand. This gives a net balance of household spaces over households of 4.0 per cent, strengthening the arguments of this section further.
response in future. Furthermore, given that over the past decade the Market appears to have provided sufficient additional new housing to more than match household growth, within the current planning framework, it is not clear why we should not expect similar outcomes in the future.

Can we trust the Census?

2.10 The Census tells us that there are getting on for a million fewer people in the country than had previously been thought, and when the facts change this much reasonable people are prepared to change their views. On the other hand, reasonable economists and other policy-makers will sometimes dismiss the results of a particular survey as seeming too incompatible with other data, or not seeming to fit with one’s theories of what ought to be happening. That is appropriate, because it is in the nature of surveys and statistical samples that there can be measurement problems and one sample can sometimes be atypical and the result an “outlier”. Thus, it may seem tempting to dismiss the 2001 Census data as being too incompatible with other data.

2.11 However, the Census cannot be dismissed so easily. Rejecting the Census on the grounds that it does not tally with inter-censal samples would be a bit like rejecting a General Election result on the grounds that it differed from the opinion polls. The Census considers everybody and, though it is not infallible and subject to some measurement issues (like all statistics) there are good reasons to believe that a full survey like the Census will (for straightforward counting matters like the numbers of households and dwellings) typically give more accurate data than a sample survey. The Census

8 The Interim Report notes that the ONS is working with some local authorities “to improve inter-censal year estimates” (p.52).

9 For example, two important sources of sampling errors are statistical errors (even a perfectly-selected sample may turn out to be an outlier, through sheer bad luck) and selection biases (the people who agree to participate (or are otherwise found) in a sample may be unusual in some way). The first of these cannot exist at all in a Census, and the second will exist only to the extent that the Census fails in its aim of finding everybody — which should usually only be more than a minor problem for issues affecting only a very small number of people, which does not include housing. There are a number of other particular problems likely to arise with the inter-censal population estimates that do not arise with the Census, set out by the ONS in Census 2001: Frequently Asked Questions, http://www.statistics.gov.uk/census2001/pdfs/onc_qu_ans.pdf.

Another point here is to get a sense of the scale involved. It is quite common in sample surveys to offer the caveat that they will only be accurate to within a couple of percentage points (e.g. opinion poll surveys are commonly quoted as having a 3 per cent margin of error). But even a one per cent new error in aggregate national counts implies huge problems (problems that might have been associated with attempts to evade the Community Charge in 1991 — though these are thought to have affected the population count more than the households count — but which have no obvious source in 2001). For example, if the 2001 Census has understated the number of households by one per cent, that would be like overlooking a town larger than Liverpool. (And even if the 2001 Census did involve a new error of this magnitude, not made in 1991, the net surplus of households over dwellings would still have increased since 1991.)

The Interim Report does not identify any such new error; only mentioning (in the footnote on p.52) that some metropolitan areas such as Westminster were concerned about their Census figures (which, of course, it is in their interests to be, because of the relationship between population and local authority funding). The action the Interim Report identifies as taking place is more work on the inter-censal estimates, rather than any amending of the 2001 Census data itself. Where concerns were expressed about data in the 2001 Census, the One Number Census project investigated them and made appropriate adjustments to the initial figures.

It should also be clarified once again that the main source of over-estimate in the inter-censal data for households was the 900,000 over-estimate of the population, rather than any issue with the way the population was grouped into households. It is now believed that the 1991 Census under-reported the population by about 2 per cent compared with the 2001 Census margin of error of only +/-0.2 per cent. This suggests that, if anything, the figures for England discussed in this section and illustrated in Table 2.1 under-estimate the increase in the net surplus of dwellings over households during the 1990s.
Too few houses?

population data (as modified by the One Number Census project) is believed to have a margin of error of about +/-0.2 per cent, or only about 100,000 people.

2.12 It might also be tempting to say something along the lines of “But if the Census is right, why have house prices risen so much in the late 1990s?” But note:

(a) House price rises could be the result of demand-side factors, such as greater optimism among households about their future wage prospects, and there is no reason in economic theory why house prices should not rise at the same time as the net balance of dwellings over households increases.10

(b) Rises in real house prices in recent years have been an international phenomenon, happening also in countries such as the US and Australia where land pressures are much lower than in the UK — making it seem highly unlikely that a shortfall in the supply of land for new homes could be the main cause.

(c) Finally, new housing supply represents less than 1 per cent of the stock,11 or 10 per cent of the traded market,12 and is simply not significant enough to have a large effect on short-term prices either way. The housing market is dominated by second-hand homes.

Too few in the right places?

2.13 Although the aggregate Census data suggests that there are comfortably more houses than dwellings in England, it might be assumed from standard commentary (including that surrounding the Interim Report) that this was because of considerable geographical imbalances — with perhaps some regions having surpluses while other regions had deficits.13 The Census data suggest this also is not true, as can be seen from Table 2.1.


10 To see that a surplus can rise but prices rise also, driven by demand factors, consider the market for labour. Unemployment can be thought of as the net surplus of workers over jobs. And unemployment can rise at the same time as real wage rates rise (indeed this happens regularly in economies). Think, for example, of a case in which a new, more productive manufacturing technology arose requiring greater structural change than in the past. This new technology pays higher wages (reflecting the higher marginal product of the workers) but unemployment is higher (reflecting the greater need to re-train, say, when changing jobs).

11 i.e. each year new homes built that year contributes less than 1 per cent of the total stock. The total England and Wales housing stock is around 22.5 million (see Table 2.1), while the total number of new completions in 2002/3 was around 145,000, or 0.6 per cent of the stock.

12 The Council of Mortgage Lenders estimates that there are around 1.6 million property transactions per year in England and Wales. New housing completions of 145,000 thus represent 9.1 per cent of the traded market.

13 For example, “Building a crisis”, quotes figures based on inter-censal data claiming that both London and the South East had deficits in 2000 (i.e. more households than dwellings) — 1.1 per cent in the South East and 4.2 per cent in London.
Too few houses?

Table 2.1: Household and dwelling balance

<table>
<thead>
<tr>
<th>Region</th>
<th>1991 Households (Thousands)</th>
<th>1991 Dwellings (Thousands)</th>
<th>2001 Households (Thousands)</th>
<th>2001 Dwellings (Thousands)</th>
<th>Balance (number, per cent of households)</th>
</tr>
</thead>
<tbody>
<tr>
<td>North East</td>
<td>1,048</td>
<td>1,072</td>
<td>24</td>
<td>2.3</td>
<td>1,066</td>
</tr>
<tr>
<td>North West</td>
<td>2,720</td>
<td>2,792</td>
<td>72</td>
<td>2.6</td>
<td>2,813</td>
</tr>
<tr>
<td>Yorkshire and Humber</td>
<td>1,993</td>
<td>2,021</td>
<td>28</td>
<td>1.4</td>
<td>2,065</td>
</tr>
<tr>
<td>East Midlands</td>
<td>1,596</td>
<td>1,634</td>
<td>38</td>
<td>2.4</td>
<td>1,732</td>
</tr>
<tr>
<td>West Midlands</td>
<td>2,042</td>
<td>2,079</td>
<td>37</td>
<td>1.8</td>
<td>2,154</td>
</tr>
<tr>
<td>Eastern</td>
<td>2,035</td>
<td>2,093</td>
<td>58</td>
<td>2.9</td>
<td>2,232</td>
</tr>
<tr>
<td>London</td>
<td>2,841</td>
<td>2,912</td>
<td>71</td>
<td>2.5</td>
<td>3,016</td>
</tr>
<tr>
<td>South East</td>
<td>3,034</td>
<td>3,099</td>
<td>64</td>
<td>2.1</td>
<td>3,287</td>
</tr>
<tr>
<td>South West</td>
<td>1,903</td>
<td>1,968</td>
<td>65</td>
<td>3.4</td>
<td>2,086</td>
</tr>
<tr>
<td>England</td>
<td>19,213</td>
<td>19,670</td>
<td>457</td>
<td>2.4</td>
<td>20,451</td>
</tr>
<tr>
<td>Wales</td>
<td>1,128</td>
<td>1,184</td>
<td>56</td>
<td>5.0</td>
<td>1,209</td>
</tr>
<tr>
<td>Scotland</td>
<td>2,052</td>
<td>2,145</td>
<td>93</td>
<td>4.5</td>
<td>2,192</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>530</td>
<td>571</td>
<td>41</td>
<td>7.7</td>
<td>627</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>22,923</td>
<td>23,571</td>
<td>648</td>
<td>2.8</td>
<td>24,479</td>
</tr>
</tbody>
</table>

Source: Barker Review Interim Report, Table 3.3

2.14 The Interim Report itself notes the figures from this table and the aggregate figures mentioned above and states, quite straightforwardly, that “On the face of it, there now appears to be little problem...The surplus rose in all regions, except London where it remained static”\(^{14}\). It offers no arguments as to why this “on the face of it” idea about the present should be rejected — it just moves on to discuss projections of the future that there will be unmet need.

2.15 Nor is it clear that, despite important regional and sub-regional variations in house price rises, the perceived pressure in the South East relates to potential migration frustrated by high prices. Less than ten per cent of projected population growth in Southern English household numbers is generated by migration from the Midlands and North.\(^ {15}\) Constraining housing supply is not necessarily about reducing labour mobility. Greater labour mobility would tend to reduce regional wealth disparities and thus reduce localised housing pressure. For example, as relative house prices change, there would be a natural flow of people whose skills were mobile from south to north to take advantage of...

---

lower housing and other costs. This would be a relatively long-term decision, dependent on expectations of where jobs and development will occur in the future. At the moment firms and workers may tend to believe that planning constraints in southern England will be relaxed under pressure, and hence may lack proper incentives to bear the costs of relocating. In this way subverting planning policies would make English regional disparities larger, not smaller — the opposite of what the Government says it wants.

2.16 It might be argued, in response to this, that using demand for higher wages associated with high house prices to drive businesses to locate in regions other than those of their first choice would, in some way, undermine UK competitiveness. Whether this is true or not, we note that it is an argument that would apply to any form of regional policy that encouraged UK firms to locate in unfashionable regions. For example, regional subsidies paid to persuade firms to locate in the North-East of England require higher taxes on other UK businesses and workers, thereby reducing their international competitiveness. The point of regional policy is that it is believed that the gains from spreading economic development to the regions (in terms of economic externalities, environmental improvement, and social advantages) outweigh the losses.

2.17 Furthermore, internal migration to promote labour mobility might be facilitated by an enhanced private rental sector.

2.18 As has been argued in previous CPRE studies (and as the Interim Report acknowledges) we should also remember that the number of extra households responds to the price and availability of housing. If a region’s supply of new housing substantially increases, that can encourage inward migration from other regions so increasing the number of new households and this will, in turn, lead to future formation of more households. In addition, the speed with which young people leave the parental home, or the likelihood of parents living with elderly relatives are likewise affected by prices and availability.

Too few of the right sort?

2.19 Different kinds of households seek different kinds of dwellings. If much of the additional demand is expected to be for “affordable housing”, then it becomes relevant to establish what implications that has in a market economy.

2.20 An important source of projected housing pressure is household fission. If households are dividing, presumably these smaller households each need less space. There is no analysis of this issue in the Barker Review, or of what may frustrate a shift downward in

---

16 House prices are an important behavioural force in the model of regional net internal migration developed for the ODPM, quoted in the Experian report *The economic impact of restrictions on housing supply: an investigation for the Barker Review.*

17 See the joint Treasury/DTI/ODPM PSA target.

18 As a working definition, when we talk of “affordable housing” in this document we will typically mean relatively small, “no-frills” housing that is, nonetheless, fit-for-purpose (e.g. large enough to meet housing needs).
demanded house sizes that would free up under-utilised housing, for example through sub-division of large houses into flats.

2.21 The notion of a given requirement for “affordable housing” is not at all straightforward. If those dependent on housing benefit cannot afford housing on the open market, that is because of a policy decision by government about the conditions under which housing benefit is given and about how much housing benefit to provide. Of course, there are issues about the relative merits of subsidising renters, rather than properties, but the point being made is that, even to the extent that there is an affordability problem, there are available policy solutions here other than building new houses — a point that standard commentary often does not recognise.

2.22 Some of the popular perception of the importance of affordability issues arises from special affordability problems attached to public sector workers on national pay scales, such as nurses or teachers. If those in such jobs cannot afford housing, they might leave those kinds of employment or migrate. For public sector occupations, a move towards setting pay scales in line with local conditions (an idea mooted by Gordon Brown in his 2003 Budget), with a corresponding reallocation of resources to reflect different regional labour markets, could in principle lead to many affordability issues disappearing. Again, there may be policy solutions quite outside housing.

2.23 An additional issue about the sort of housing is whether enough of the dwellings provided are appropriate for rental as opposed to owner-occupation. People with insufficient assets to obtain finance to buy a house may yet have a high enough income to rent property. But dwellings appropriate for rental may have different characteristics from owner-occupied dwellings (e.g. higher density, less garden space, supplies and fixtures that need less maintenance, etc.).

So is there any under-supply?

2.24 Much of the focus of press reporting was on figures that the Interim Report uses for purely illustrative purposes (such as the claim that an additional 146,000 new houses need to be built each year), and which have no robust basis at all as figures of need. In particular:

(a) Restoring affordability for new households to that prevailing in the second half of the 1980s would require some 93,000 to 146,000 additional new houses per year.

(b) The Interim Report considers how many additional new houses per year would be required to lower UK real trend growth in prices to zero (240,000) and how many would be needed to lower trend real price growth to 1.1 per cent (145,000).

2.25 Although these studies are interesting in their own right, and their conclusions may well be correct, the fact remains that the price stability targets on which the headline numbers are based are wholly arbitrary definitions and not related to any assessment of “need”.

2.26 For example, what special reason could there be to target the affordability levels of the late 1980s? Why not the early 1950s, or the late 1760s? Presumably it is relatively more
convenient to obtain data for this period, and being a decade or so back it gives use some sense of how the market is evolving, but that does not make it a good objective for policy.

2.27 Furthermore, as the Interim Report itself acknowledges, how are we to determine precisely where in the house price cycle the market is at the moment? If house prices were to fall over the next couple of years affordability could, in principle, even exceed the levels of the late 1980s. Would policy then seek to drive prices up so as to reduce affordability back to this "ideal" level?

2.28 Affordability relates incomes to prices. If our concern is about the access of relatively less well-off members of society to housing, one way to increase affordability is to raise the incomes of the less well-off — raising housing benefit, for example. Building extra houses is not obviously the best answer to every housing-related issue.

2.29 Similarly, although figures on how many new houses would be needed to eliminate all real house price inflation or to achieve the average European real price inflation provide interesting context, they do not constitute any good basis for policy. Why would zero real inflation be the right level? Why not real falls of 5 per cent per year? Why the European average, rather than the American or Japanese or New Zealand average?

2.30 These figures, quoted widely in the press, are largely meaningless in terms of policy — as the Interim Report itself accepts, when it states that it "does not attempt to assess the socially optimal level of housebuilding."

2.31 The only Barker Review figure that represents a defensible notion of need is the 39,000 additional new homes a year figure produced by Alan Holmans, made up of 31,000 affordable and 8,000 other houses.

2.32 However, using a defensible concept of need, and being an accurate number for need are not the same thing. Holmans’ 39,000 figure is based on a set of judgements about who needs housing that are themselves open to challenge. For example, Holmans regards married couples living with their parents as housing-needy. Although some people living in such conditions may be doing so because they have few alternatives, other such people are relatively affluent and living in conditions they have chosen. The judgement that they are all housing-needy is one imposed on their circumstances by others.

---

19 Paragraph 3.30.
20 In a later section we discuss other ways to address affordability, such as by increasing the provision of affordable housing.
21 Paragraph 3.38.
22 Indeed it will almost invariably be the case that such people are trading off reduced housing costs (in some cases near zero when parents do not charge rent) for more of other goods, such as leisure activities and cars. This is not to say that such a trade-off is unreasonable, or that support for the poor should not be at sufficient levels to allow them to enjoy life (rather than merely survive). Having your own house but being unable to afford much leisure might be very unattractive. But is someone who prefers a difficult housing situation with some leisure really in need? And if they are, why isn't the right answer to raise housing benefit or income support levels so that they can have both housing and leisure (as discussed below), rather than building extra dwellings?
Too few houses?

2.33 The Interim Report itself terms Holmans’ definition of needy households “broad”, and points out (as has been pointed out in previous CPRE studies) that there is an issue of circularity — “more households form and migration is higher when there is more house building”.\(^{23}\) As the Interim Report says, Holmans’ figures imply that all potential additional households ought to be accommodated wherever they occur — but why should that be a policy objective that out-ranks preserving greenfield land?

2.34 In some parts of the world, duties to elders and children are considered part of having a community-minded society. For example, in Singapore the Multi-Tier Family Housing Scheme encourages married couples to stay together with their parents or grandparents in the same dwelling as an extended family for mutual support and care for their elderly members. It is quite conceivable that our own social norms will develop along such lines.

2.35 For example, there may be a case for housing improvement grants to be more facilitated in cases where they would make an existing dwelling suitable to add a parent to the children’s house (or vice versa) — by extending and altering the dwelling — even in cases where such a relative does not need any special care.

2.36 On the other hand, perhaps Holmans’ definitions of housing need would be shared by many people. In a later section we shall ask whether, even if there is a real need for additional affordable housing, this really implies a need for additional land release.

2.37 Given that there is a surplus of dwellings over households, a “need” for additional affordable housing reflects several policy decisions over incomes as well as housing provision. For example, those wanting affordable housing might be able to afford housing (and hence not be in need) if housing benefit levels were higher. Clearly this could have tax implications, but it should be understood that there is an available policy trade-off here between higher taxes and more countryside with less urban sprawl. Building extra houses is not the only (or even obviously the best) way to address affordability issues.

What are the “benefits to the economy” from cheaper houses?

2.38 The Interim Report says that the “the UK economy would be better off with an increased supply of housing.”\(^{24}\) But there is little in the Interim Report to substantiate this claim.

2.39 The analysis on pp. 21 and 22 claims to show a sort of cost-benefit approach, representing a net welfare gain from lower house prices (removing the “deadweight loss”). However, the analysis on which it is based did not specify what changes brought about the lower prices.\(^{25}\) This claim amounts to little more than saying that if something scarce

---

\(^{23}\) Paragraph 3.23.
\(^{24}\) Paragraph 4.1.
\(^{25}\) From the accompanying technical report from Experian, “The Economics Impact of Restriction on Housing Supply: An investigation from the Barker Review” (2003) it is clear that this is because the Review asked simply what would be the effect. Experian was not asked to explain where the effect came from.
Too few houses?

(i.e. land) weren’t, and nothing else changed, then the economy would be better off. This is, of course, true — indeed one might not be too unkind to term it a “truism”. Obviously if an important product like land were less scarce (and nothing else changed) then the economy would be better off. One could equally well say that if people worked longer and slept less, and there were no costs to this, then the economy would be richer. Indeed we could calculate the “deadweight loss” of the “sleep constraint”. But such a statement doesn’t get us very far in assessing whether it is appropriate to promote additional greenfield housing development. By assuming away the costs of extra land release (or less sleep) it ignores the very reasons why we choose to employ the constraint. Obviously there are costs to such a constraint, but there are benefits also, and measuring the costs gives us only half of an equation. Once we added in an assessment of the benefits of constraining land release, the conclusion might (in principle) just as easily be that we build on too much land as that we build on too little.

2.40 A further model is reported on pages 24-26. The scenario here simply describes a short-lived economic boom fuelled by housing construction that is not yet fully crowded-out within the modelling period, and that is caused by some unexplained increase in the response of housebuilding to rising house prices. The main value of such a model would appear to lie in assisting the Bank of England in assessing the impact on the economy if the government encourages a sudden large expansion in house-building. Though interesting and valuable in its own way, such modelling adds little to the debate about whether the country needs more new housing.

2.41 Secondly, the wider costs of increased housing are not explicitly incorporated into these macroeconomic models, as the Interim Report itself acknowledges. For example, there is no explicit modelling of how the economy might be affected (e.g. agriculture, rural businesses, tourism income or required wages) if considerable tracts of English countryside were destroyed, and no setting against the asset value of the countryside lost (although the Interim Report does, in another section, mention studies on contingent valuation of different land uses). As the footnote to Box 1.1 on p.21 of the Interim Report puts it, “There will also be some welfare gains from restricting supply if there are environmental costs of a higher level of housebuilding.” It is widely acknowledged there are indeed such costs, and they make a material difference to whether releasing additional greenfield land for new housing is desirable.

26 Once again, this implies no criticism of the Experian consultants asked to produce this model, who were simply asked by the Review to quantify the effects of an increase in housing supply elasticity, not to explain where such an increase came from.

27 Indeed, the caveats around footnote 7 on p.22 of the report are so extensive as to acknowledge that Experian’s modelling is intended as an illustrative exercise, rather than an argument in favour of new housing.

28 It might be objected that the economy is unlikely to be affected, as the Interim Report suggests (in Box 8.2) that, for example, only 1.5 per cent extra of available undeveloped land in South-East England would become built up. Even if this figure is right, the fact that 1.5 per cent seems like a “low” number should not dazzle us. It is very hard to say exactly how much extra building changes the nature of a landscape, but it is clear that the landscape affected is far larger than the actual area covered over. It should also be pointed out that an argument along these lines could be repeated many times. Who notices that one extra slice of salami has gone from the sausage, until suddenly half the sausage is gone?
3 HOUSING MARKET VOLATILITY

3.1 The Interim Report considers that housing market volatility creates a number of problems, including:

(a) making inflation management more difficult for the Bank of England;
(b) adverse welfare impacts during price downswings; and
(c) undermining housing investment in new supply.

3.2 Housing market volatility is mainly driven by demand-side factors (as the Interim Report itself says — "house price volatility is driven mainly by demand"). Indeed, problems with the supply of new housing are a consequence of market volatility rather than a cause.

3.3 The new houses available in a typical year represent only a tiny fraction of the housing stock (less than one percent) and a small proportion of the active market (typically some 10 per cent). Now although over the long-term constraining new supply should, indeed, typically mean that prices are higher (so that the trend rate of growth in prices is higher than would otherwise be the case), in the short-term new houses are such a small proportion of the market that their supply can make relatively little difference to the ups and downs of house price cycles.

3.4 Indeed, the following table illustrates that UK house price volatility is actually lower than average, although land pressure is much less constrained in other (less densely populated and less built up) parts of Europe, and the trend rate of growth in real prices is consequently considerably lower. Since volatility is a phenomenon in places where population density is less than in the UK, it seems unlikely that UK housing market volatility can reasonably be attributed (as much popular commentary seems to do) to general constraints on land supply.

---

29 Paragraph 1.36

30 For example, real house prices rose over 50 per cent between 1996 and 2001. Given that new housing comprises less than 1 per cent of the stock, even an (implausible) doubling or tripling in new house building over this period could not have eliminated a 50 per cent real rise.
Table 3.1 House Price Volatility

<table>
<thead>
<tr>
<th>Country</th>
<th>1971-2001 Average</th>
<th>Trend</th>
<th>Volatility of house prices around trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>3.3</td>
<td>2.4</td>
<td>15.1</td>
</tr>
<tr>
<td>Germany</td>
<td>0.1</td>
<td>0.0</td>
<td>11.1</td>
</tr>
<tr>
<td>France</td>
<td>1.2</td>
<td>0.8</td>
<td>7.6</td>
</tr>
<tr>
<td>Italy</td>
<td>1.5</td>
<td>1.2</td>
<td>15.5</td>
</tr>
<tr>
<td>Spain</td>
<td>3.3</td>
<td>3.0</td>
<td>17.3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.8</td>
<td>1.3</td>
<td>25.1</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.1</td>
<td>1.7</td>
<td>14.3</td>
</tr>
<tr>
<td>Ireland</td>
<td>3.1</td>
<td>2.2</td>
<td>17.4</td>
</tr>
<tr>
<td>Sweden</td>
<td>0</td>
<td>-1.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Finland</td>
<td>0.7</td>
<td>0.7</td>
<td>13.5</td>
</tr>
<tr>
<td>Denmark</td>
<td>1.3</td>
<td>0.2</td>
<td>13.4</td>
</tr>
<tr>
<td>Average</td>
<td>1.8</td>
<td>1.1</td>
<td>15.4</td>
</tr>
</tbody>
</table>

1 Geometric mean.
2 Based on a regression of (log) real house prices on a constant and a time trend.
3 Coefficient of variation.
4 Spain between 1972 and 2001 only

Source: Interim Report, Table 1.1

Demand-side issues and volatility

3.5 Housing market volatility is principally a demand-driven phenomenon. The government has acknowledged the possibility that there may be problems on the demand-side of the housing market by commissioning the Miles Review of the UK Mortgage Market.

3.6 The Miles Review found that

(a) Borrowers tend to attach much greater weight to the level of initial monthly repayments than to the overall cost of borrowing over the life of the loan.

(b) Many borrowers have a poor understanding of risk and therefore pay little attention to the insurance which longer-term fixed-rate mortgages can provide against unexpected interest rate rises.

(c) The way in which many mortgage lenders compete for new business results in cross-subsidisation from existing borrowers paying standard variable rates (SVR) to new borrowers taking out discounted variable and short-term fixed-rate mortgages. This means that longer-term fixed-rate mortgages appear expensive when compared with discounted mortgages.

3.7 Our own work suggests that problems may arise on the demand side of the housing market, for with a long-term product like a mortgage there may be problems of short-sightedness inducing cycles in housing demand that track cycles in unemployment and short-term wage growth.
3.8 The intuition here is that, with cycles in unemployment or short-term wage growth, a naïve foresight shorter than a full economic cycle will imply that agents base their housing choices on an atypical subset of their lifetime earnings. When wages are high and unemployment low, they would mis-perceive themselves as having higher lifetime wealth, and hence be prepared to over-pay for their housing. Conversely, when wages are low and unemployment high, they would mis-perceive their lifetime wealth as lower than its true expectation, and hence under-pay for their housing.31

3.9 Here is not the place to debate the exact nature of demand-induced volatility in the housing market. But if indeed there are problems on the demand side of the housing market, such as inappropriate or inadequate regulation, then the way to address that is by addressing the demand side of the market. Increasing supply to aim to address demand-side volatility problems will:

(a) simply chase the problem, with relatively little effect in volatility in the short-term, and none in the long-term as the stock of housing is simply driven out to the next supply constraint, at potentially significant environmental cost in the meantime; and

(b) give an excuse for not addressing the real problems (thus not assisting consumers – for demand-side problems such as perception errors involve welfare losses that are not removed by increasing supply).

3.10 Instead, demand-induced volatility should be addressed directly. The Miles Review contains a number of specific issues, the addressing of which might reduce demand-induced volatility. For example:

(a) The regulatory environment may worsen people’s focus on short-term interest rates through rules insisting on prominence being given to the variable rate on promotional literature.

(b) The liquidity of sterling swap markets and in options on swaps is currently limited at horizons over 10 years;

(c) Buyers of mortgage-backed securities that have embedded options that reflected the ability of borrowers to pre-pay fixed rate mortgages will find it hard to gauge the value of those options when data on pre-payments is limited;

31 Another possible error is that agents may believe that housing is more affordable when nominal interest rates are low (because of the front-loading issue set out in the Interim Report). Unless agents are credit constrained (which the Miles Review claims is not credible) then the short-term cash-flow impact of lower nominal interest rates should not be an important measure of affordability. Rather, what is relevant is the real lifetime burden of the mortgage debt as a proportion of wages, so that the true affordability of housing depends no the long-term real interest rate rather than the short-term nominal rate.

On the other hand, if agents do face credit constraints, because low inflation means a greater chance of house prices falling and hence the comfort to lenders from a deposit being eliminated, there is a countervailing effect that lender should insist on lower loan-to-value ratios. These effects balance when house prices are unaffected by lower nominal interest rates (with the real interest rate unaffected), but loan terms reduced so that the cash-flows of mortgage-holding households remain constant. Thus being prepared to pay higher house prices when short-term nominal interest rates are low (which appears to be a common phenomenon in the UK market) is a form of error akin to money illusion.

For more on these points see, for example, “When Might People Pay Too Much for their Housing?” Europe Economics Staff Working Paper, February 2003.
(d) Building societies may run up against legislative limits if wholesale funding or securitisation of mortgages emerged as the most effective means to fund fixed-rate mortgages.

(e) Some sorts of bonds used to finance mortgage lending in other countries may be harder for UK lenders to issue.

(f) Accounting rules may make lenders uncertain over how hedging of certain types of interest rate risk can be done in a way that avoids significant fluctuations in reported profits.

(g) Lenders may believe that certain types of redemption charges for pre-paying fixed-rate mortgages are effectively unenforceable. This may mean that the range of fixed-rate products offered to households is restricted and types of mortgage with desirable features not offered.

3.11 Discussing the details and relative merits of these proposals falls outside the scope of this report. But any measures that succeed in reducing demand-induced volatility would be expected to increase the size and responsiveness of housing supply, as we shall now explain.  

Volatility and supply

3.12 Housing market volatility undermines new supply of houses in a number of ways:

(a) Volatility makes the use of purchasing options a more attractive way to buy development land. Greater use of such options means that land that could be developed sits idle waiting for the exercise (or expiry) of an option to purchase;

(b) Even when land has been purchased and planning permission obtained, higher price volatility raises the option value of waiting (land development is a textbook example of a “real option”) and thus again increases the stock of land lying idle waiting to be developed;

(c) The responsiveness of new supply to rising prices may be particularly undermined, since developers know that if they incur large costs they expose themselves to the risk of financial distress. If there is a fall in house prices and a recession more generally, before they can sell the houses they construct, they can face severe cash-flow problems and restrictions on the credit available to tide them over until the housing market picks up;

32 We note that similar sentiments are expressed by John Muellbauer, in his submission to the Barker Review, where he states that “any reforms which reduce the volatility of returns in housing, whether on the ‘demand’ side or on the ‘supply’ side will increase the supply elasticity of new housing. This is [an] argument why the attempt to separate policies into ‘supply’ and ‘demand’ side may be overly simple.”

33 For more on options and real options, see Brealey, R.A. & Myers, S.C. Principles of Corporate Finance, Seventh Edition (2003), McGraw-Hill.
(d) In extreme cases, because of time lags between observing a change in prices and making a profit on development, in a highly volatile market house price rises can lead to a fall in the supply of new housing\(^{34}\);

(e) Volatility may make housebuilders reluctant to undertake significant investment in plant or in alternative construction techniques;

(f) Volatility may reduce the incentives for housebuilders to engage in significant brownfield developments, particularly at high densities (because of the length of time that capital becomes tied up, e.g. in up-front preparation activities such as decontamination; because high density dwellings cannot be sold one-at-a-time in advance of the whole site being completed; and because full payment typically awaits completion — such limits on flexibility are more problematic for developers when volatility is greater).

3.13 Presumably partly as a consequence of such volatility, previous research by the CPRE suggests that developers hold substantial land-banks of some 20-22 months production already having at least outline planning permission, and that these land-banks have grown in recent years.\(^{35}\) The Interim Report estimates that total land-banks equate to about 3.5 years production, of which around one third has only outline planning consent while between 11 and 16 months production has detailed planning consent but is not under development. This compares with only 6-12 months production actually under development.

3.14 Thus there is a chain from greater volatility to higher risk for developers, leading to a response from developers to address that risk, this response carrying costs for developers, and those higher costs leading to reduced supply and/or higher prices.

3.15 None of these ways in which new housing supply is undermined, and the stock of idle land raised, by housing market volatility in itself represents any form of market failure on the supply-side, nor any criticism of housebuilders. Rather, the added reluctance to develop brownfield sites and the greater idle land stock are efficient market responses to the conditions developers face, including demand-induced housing market volatility as well as the long-term trend.

3.16 What this means is that if there are ways to reduce demand-side volatility, then housing supply could potentially be greater as a direct consequence. Developers will not need to hold such large land banks to manage their risk, and the development of brownfield land will become relatively more profitable. Then housing supply can be increased without relaxing planning constraints or building on additional greenfield land.

---


\(^{35}\) Housing Myths: Housing Solutions, CPRE Briefing Note, September 2003.
3.17 The Interim Report comments that US landbanks are smaller than those in the UK. Though there may be many factors that would explain this, it is interesting to note that US house price volatility is, likewise, lower than that in the UK.

Do high house prices worsen macroeconomic volatility?

3.18 As we have argued, house price volatility is a demand-driven phenomenon, so we shall not consider the (difficult and controversial) question of the extent to which house price volatility drives (as opposed to reflecting) wider macroeconomic volatility.36

3.19 The Barker Review considers the most important economic consequence of constraints on housing supply to be a higher trend growth rate in house prices. This may well be correct. A scarcer resource will obviously tend to be higher priced than a less scarce resource (though it is not immediately obvious that it will have a higher trend growth rate).37

3.20 But do higher house prices worsen macroeconomic volatility? Under present monetary policy arrangements the relative importance of housing debt in household wealth gives the Bank of England a powerful lever to manage demand — the short-term interest rate and its effect on mortgage interest rates — arguably thereby reducing macroeconomic volatility (because the Bank is more able to offset economic shocks) rather than worsening it.

3.21 However, if the UK were to join the euro, then a given interest rate change will tend to have a larger effect on the UK economy (because of the greater important of mortgage debt here) than, say, the German economy, thereby undermining the ability of a single European interest rate to be appropriate for all members. Of course, seeking to address matters that made UK membership of the euro more problematic was a stated purpose of the Chancellor’s housing market reviews. The relative merits of facilitating euro membership compared with the protection of the environment and the conservation of the countryside is, again, a question that falls outside the scope of this report. But it is important that the seeking of such goals does not distort the analysis of the Review and lead to the costs and benefits of different proposals not being treated in a balanced way.

---

36 This should be an important issue for the Miles Review.
37 And it does follow that if land were less scarce then (if reducing land scarcity carried none of the costs it actually does cost in terms of amenity loss and damage to the environment) then we would be better off. But that would be true of any important product in the economy, and is no more profound than saying that if computers cost less to make and reducing the cost of computers came without consequences, then we would all be better off. Obviously it is true, but does not add much to the debate.
4 THE RESPONSIVENESS OF NEW HOUSING SUPPLY TO CHANGING PRICES

4.1 As set out above in Section 1, the weak responsiveness of new housing supply to rising house prices is the starting point of the scope given to the Review.

4.2 The Interim Report notes that in most markets, as prices rise the supply of a product increases in response. It also notes that responsiveness of new housing supply is much higher in France, the US, and Germany than in the UK.

4.3 The Interim Report appears to conclude, from the proposition that new supply responsiveness to price is low, that there is under-supply in the UK.38

Does low responsiveness imply too little production?

4.4 Some clarification is needed here. Low elasticity of supply in itself says nothing about whether the supply of new housing is appropriate. Treated as a low responsiveness of supply to a price change, low supply elasticity could equally well mean that in times of falling or stagnant house prices, supply continued unabated (or did not fall sufficiently) even thought here was little demand. Over a cycle, these effects might even themselves out.

4.5 Also, the time-scale involved is not straightforward. Given that there are lags of perhaps eighteen months between starting construction on a house (let alone obtaining planning permission) and completion, the relevant price to guide developer decision-making is not the price of housing today, but rather the developer’s expectation of prices in eighteen months (or more) time. Such expectations are intrinsically unobservable and difficult to model, especially given the unpredictability of the scale and period of house price cycles.39

4.6 These high-level observations are intended to suggest that the picture is not a clear one, and to show the need for some more precise notion of elasticity to be used to answer a particular question.

4.7 In the study by Experian described on pp.23-24 of the Interim Report, the relevant elasticity is that of new housing investment with respect to the real price of housing. As the Experian study notes, it takes a considerable time for an increase in the flow of new

---

38 For example, paragraph 3.1 notes that “Chapter 1 [of the Interim Report] looked at the costs of price rises and an undersupply of housing, and drew on evidence to quantify the cost to the UK. The previous chapter [i.e. Chapter 2 of the Interim Report] examined evidence of whether the UK has a poor supply responsiveness that can push prices up and create such an undersupply.”

39 In fact, if new housing supply is efficient but the demand-side inefficient, then the housebuilder’s relevant expected future price might potentially be totally unaffected by pricing movements today. In that case reduced responsiveness of new housing supply to short-term price movements might even indicate increasing efficiency of new housing supply, rather than decreasing efficiency.
investment to have a material effect on the stock. An increase in the supply elasticity of
this investment variable from zero to two from 1994 onwards leads to an increase in the
number of residential properties by 1.6 per cent by 2002. With no explanation of what
caused the increased supply elasticity, it is hard to know what to make of this scenario.
But what it does show is that even this remarkable increase in elasticity leads after eight
years to house prices only 1.2 per cent lower.  

4.8 As noted in Section 2 above, the GDP gains comprise solely the short-term investment
and consumption effects of a housing boom — the headache is postponed until after the
period considered.

4.9 But the relevant point here is that these simulations suggest that a marked increase in
supply elasticity response would in itself have only limited effects on the real price of
housing after almost a decade. This again suggests that action might be more effectively
focused on the demand-side.

Supply responsiveness and house price volatility

4.10 As set out in Section 3, and as acknowledged by the Interim Report, house price volatility
is a demand-side-driven phenomenon.

4.11 Chapter 2 of the Interim Report discusses the findings of Pryce that significant house
price volatility can have the consequence that can involve a perverse, backwards-sloping
supply curve (i.e. higher growth in house prices results in lower output). This can arise
with highly volatile house prices because of the lag between building new houses and
realising the profits from development. This is not because of any flaw in the supply-side
of the market. Quite the reverse — observing such a result when house price volatility is
high would indicate that the housing supply market was working well.

4.12 The most natural way to address this would be to address the demand-side of the market
so as to reduce inappropriate volatility — thereby reducing the risk to developers and
increasing supply responsiveness to price as well as reducing the need for developers to
hold such large landbanks (to insure themselves against risk in the market) and thereby
increasing the supply of land.

4.13 This is another illustration of how policy responses other than changes in land-use
planning policy might address the issues of concern to the Review.

---

40 Remember that new housing is less than one per cent of the total stock of houses, and only around 10 per cent of the traded
market.
5  NEW HOUSES VERSUS NEW LAND

5.1 According to UK government figures, about 10-11 per cent of England is built up. This is a higher figure than in any other European country. Nonetheless, the Treasury’s summary of the Interim Report states that “the main constraint identified by the Review is land supply” and refers to this as a “problem”.

5.2 In this section we shall argue that an increase in the supply of dwellings could be achieved without relaxing planning constraints on building on greenfield sites.

5.3 As discussed above, 2001 Census figures suggest that the period since 1991 has actually, contrary to what was expected, seen an increase in the excess of the number of dwellings in the UK over the number of households, so it is not clear that there is any problem of under-supply of housing.

5.4 However, if it is desirable that more new dwellings should be built, first, as has been argued in previous sections, if demand-induced housing market volatility were reduced by addressing demand-side problems, then developers would not need to hold such large land banks, so more land would be developed and more houses built without any need to loosen planning constraints.

5.5 Next, where pressure for dwellings arises because of household fission, there has not been a population change, so allocating additional greenfield sites would involve an increase in the land allocation per person. In contrast, if such pressure is not accommodated by building new homes there will be a tendency for larger dwellings, which subsequent to household fission will be larger per person than before, to be converted into smaller units, thus leading to more dwellings being provided on the same amount of land. Though this is a long-term process, which may take place over decades (for example, being triggered as children grow up and move away from home) it should be recognised as a factor that may become more important over time, and that could be encouraged through policy changes.

5.6 In Section 2 we have argued that if there is any problem of under-supply, it is a problem of under-supply of affordable housing. But if planning constraints are relaxed so as to allow extra development on greenfield sites, what the market will tend to provide is four or five bedroom detached dwellings — i.e. not affordable housing.

5.7 The fall in new housing output over the past thirty-five years can be accounted for entirely by the reduction in social housing provision. At the post-World-War-II peak in 1968/9

---

41 In Europe, only the Netherlands has a higher population density than England, but only 9.3 per cent of the Netherlands is built up (Source: CPRE).

42 For example, this effect is illustrated in Chart 10.8 in the Interim Report, with the Review’s account of the reasons being covered in 10.29 ff.
there were over 400,000 housing completions in the UK, of which nearly 200,000 were social housing. By 2001 social housing provision was little over 22,000.

5.8 Private housebuilding, by contrast, has remained fairly constant since about 1960. As social supply of additional higher density, affordable housing has fallen away, the market has not responded by expanding its output of this sort of dwelling.43

5.9 The tendency for developers to seek planning permission for relatively low density dwellings is an important reason why the government is not meeting its targets for housing density. National planning policies set out in Planning Policy Guidance Note 3 on Housing advocates new housing at 30 to 50 dwellings per hectare. But the current national average density for new housing is around 27 dwellings per hectare (although that figure has increased in recent years).

Markets and Green Fields

5.10 It is instructive to consider why the market provides these low-density dwellings, given that the need appears to be for higher density affordable dwellings. Why, if there is demand for smaller dwellings, doesn’t the price of such dwellings rise so that profits made building them encourage supply? 44

5.11 One important reason appears to arise from the fact that much greenfield development consists of relatively small-scale developments at the edge of towns. At the edge of a town the most straightforward sort of development will be large, low density dwellings for relatively affluent people with cars who are happy to travel a reasonable distance for their shopping and leisure activities.

5.12 On the other hand high-density dwellings appropriate for people who want to live in such dwellings (such as students, or those who spend little time at home and want city nightlife, older people who may value proximity to neighbours or those who are relatively less affluent) will usually prefer to be closer to services and facilities and/or be well served by public transport. Often the sorts of people who require smaller, higher-density dwellings — or cannot afford larger ones — do not have cars.

5.13 This means that high-density, smaller dwellings on greenfield sites at an urban edge will tend not to be attractive to their target market (in the sense of the people who would live in them), and hence not profitable for the Market to provide, nor appropriate in a social sense. This is something that planning policy ought to be able to affect.

---

43 The significance of the fall in total output is should not be exaggerated, however. During much of the 1950s and 1960s demolitions ran at around 100,000 per year, compared with only 10-20,000 more recently. This means that the net increase in stock per year in 1953-79 ran at around 200-300,000, compared with 140-180,000 more recently — a less dramatic contrast than is often suggested.

44 Note that it is irrelevant whether the people who live in higher-density dwellings would prefer to buy or rent. Even if those who live in such dwellings would rent, there remains the question of why they are not built for purchase by landlords.
5.14 Even in cases where developers might decide that higher density housing is attractive, local authority planners will sometimes rule out high density developments as not being “in keeping” with the area. Edge-of-town development is often where affluent people already live in relatively low density dwellings. So what is most in keeping with such areas is to build additional low density dwellings for affluent people. While it is natural that decision-makers should react in this way, there are social and environmental consequences.

5.15 Such issues are much less of a problem in the case of brownfield sites or house conversions to higher density, where infrastructure is typically already much more accessible and issues of a mis-match of housing types are rarer.45

5.16 Land use planning, given the current situation, raises problems if carried out in a piecemeal, responsive manner. A more strategic approach might raise fewer such problems, and help secure public confidence in planning decisions. Furthermore, if additional greenfield land is allocated for development through a loosening of planning constraints so that more at-the-margin greenfield development is granted permission, what we should expect are additional low-density dwellings — not the affordable housing that is actually needed.

The rental market

5.17 The Interim Report suggests that the UK tax regime has tended to favour owner-occupation over rental.46 However, there is no explicit consideration of the other workings of the private rental market, such as regulatory or information problems. The rental market represents an important issue justifying additional consideration, for it could have a material effect upon the nature of housing supply. If there are problems with the workings of the private rental market, there then there might be insufficient profits to be made from building accommodation for rent.

5.18 Rental accommodation will naturally tend to be higher-density than owner-occupied dwellings. Hence a natural consequence of problems in the private rental market might be that the market would tend to provide lower density housing than would be socially optimal.

5.19 Rental property is also important in promoting labour mobility, especially between regions where house prices differ considerably, since the deposits required to rent are usually much smaller than those required to take out a mortgage.

---

45 Chapter 7 of the Interim Report contains a useful discussion of the differential VAT treatment of new build compared with repairs, maintenance and improvement of the existing stock (and the reduced VAT rate on conversions) and of the possibility of applying different rates of VAT to greenfield as opposed to brownfield development. Another related possibility might be the imposition of a development tax on greenfield development, so as to take account of the need for additional publicly-funded infrastructure.

46 Paragraph 7.38.
5.20 It does not fall within the scope of this report to consider in detail the workings of the private rental market and whether there are significant problems of the sort that might lead to lower density supply, but we would suggest that this is a potentially relevant issue that should be given more detailed consideration in the final report of the Review.

Other reasons

5.21 There are a number of other reasons why markets may tend to have provided higher-end housing over the past thirty years, even in a period in which provision of new social housing has fallen so much. Even though new build fell away, where local authorities continued to hold social housing stock the rents charged were at below-market rates. This would tend to crowd out market provision of such dwellings.

5.22 Secondly, in other cases council houses were sold to their occupiers at prices well below market rates — some 1.6 million English dwellings since 1980. This again would crowd out market supply of such dwellings, leaving developers to focus on the top end.

5.23 More recently, while house prices have been rising for much of the past decade, the private sector may naturally have tended to prefer to provide more expensive dwellings. The idea here is that, during housing market upswings, capital appreciation means that the increase in current assets of existing home-owners is greater than those of non-owners/first-time buyers. The greater equity holdings of current home-owners might then mean that lenders would be more willing to lend to such people than to non-owners or first-time buyers. That might mean that the prices current owners would be prepared to pay for trading up would be proportionately higher than the prices first-time buyers could pay, meaning that new housing supply of larger, second- or third-purchase properties would be relatively more profitable for developers.

5.24 The way to address this aspect of the market's under-provision of affordable housing is by addressing the demand-induced volatility discussed in earlier sections. Reduced volatility will make it relatively more attractive for private sector housing developers to provide more affordable dwellings.

5.25 However, even with lower housing market volatility the planning issues explained above will still leave a need for planning policy to encourage affordable housing and to prevent piecemeal incremental development chipping away at the countryside a piece at a time, but typically building inappropriate dwellings when it does.

Planning for affordable housing

5.26 Given that the market will tend not to provide affordable housing, even though that is the social need, there will be an important role for the planning system.

5.27 It does not fall within the scope of the current report to enter into a detailed discussion of planning policies. What is relevant to point out, however, is that given that planning policies need to encourage additional affordable housing if the actual housing need identified is to be met (it will not be sufficient simply to loosen planning policies and see
what sort of housing the market offers), there may be the opportunity to provide additional housing without loosening the constraints on greenfield land release, by using planning policy to drive higher density dwellings and more affordable housing.\textsuperscript{47}

5.28 Using the planning system in this way might potentially impose additional costs on development, and could lead to a reduction in supply (although this is not clear, and if some of the account above of why the market tends to provide lower-density dwellings is correct, then improvements in the way the planning system works might increase developer profits at the same time as facilitating higher densities). But even if there is some reduction in land supply (noting that other measures suggested in this report would increase land supply) it is at least plausible that the supply of land would not fall so far as to offset the increased number of dwellings achieved by requiring higher densities. In other words, at higher densities more houses can be built on less land.

5.29 There seems little good reason for the planning policies to be changed so as to make five bedroom owner-occupied housing cheaper. Given that what is needed is affordable housing, an available policy option is to build the houses we need on the land we currently allocate, through more effective use of the planning system.\textsuperscript{48}

\textsuperscript{47} For example, the GLA is requiring a significant proportion of new dwellings (50 per cent in inner London, and 30 per cent in outer London boroughs) to be affordable housing, funded through the development gain on the award of planning permission. For more on this see Affordable Housing in London: A Report for the Greater London Authority Three Dragons, July 2001.

\textsuperscript{48} Another policy option might be for the government to further subsidise the building of affordable housing.
6 CONCLUSION

6.1 We have argued that

- The Interim Report of the Barker Review has not shown that there is under-supply of housing, nor that the release of additional greenfield land for housing development would be either economically or socially desirable.

- The most one could reasonably conclude from the Interim Report is that there may be a desirable policy goal of achieving more affordability of housing for certain people such as married children living with their parents.

- There may be issues of volatility on the demand side of the housing market, but if so the way to address that volatility is to deal with the regulatory environment on the demand side.

- Addressing demand-side volatility would increase the supply of land that comes forward for development, because it would reduce the land banks developers need to hold to protect themselves from volatility-induced risk. This would lead to more land being developed for housing without any need to relax greenfield planning constraints.

- Affordability issues for key public sector workers are not simply a matter of house prices. For example, they arise partly because of national pay scales. Moving to pay scales that reflect local conditions could substantially reduce affordability issues for this category of worker.

- If the greater supply of land (because of lower demand-side volatility) and the greater affordability for public sector workers leaves residual affordability issues, these can be addressed by raising the level of housing benefit. Affordability depends on incomes as well as prices.

- If, even after reducing demand-induced volatility, using local pay-scales, and raising housing benefit, there is still a problem of housing affordability, one way to address that is to make more use of the planning system to provide additional affordable housing within the current framework of land release. Another is to use more subsidy to increase the supply of affordable homes.

6.2 Unless society’s preferences for land use have changed in some way, there is little in the Interim Report to justify any relaxation of planning constraints to facilitate additional greenfield development. Of course such rules should always be kept efficient, and regional and local planning bodies appropriately resourced so as to avoid unnecessary delays. But changes to established planning policies are not the only (or even obviously the best) way to address the issues raised by the Interim Report, and might even stimulate public resistance.

6.3 On the other hand, if commissioning the Review reflects a change in the government’s approach to planning for housing, it would be useful to know what the alternative underlying principles and objectives it envisages are to be, so that these can be properly aired and debated.
Campaign to Protect Rural England

The Campaign to Protect Rural England (CPRE) exists to promote the beauty, tranquillity and diversity of rural England by encouraging the sustainable use of land and other natural resources in town and country. We promote positive solutions for the long-term future of the countryside to ensure change values its natural and built environment. Our Patron is Her Majesty The Queen. We have 59,000 supporters, a branch in every county, nine regional groups, over 200 local groups and a national office in central London. Membership is open to all. Formed in 1926, CPRE is a powerful combination of effective local action and strong national campaigning. Our President is Sir Max Hastings.

Campaign to Protect Rural England
128 Southwark Street
London SE1 0SW

Tel: 020 7981 2800
Fax: 020 7981 2899
Email: info@cpre.org.uk
Web site: cpre.org.uk

CPRE is a company limited by guarantee, registered in England, number 4302973.
Registered charity number: 1089685

A report by Europe Economics for the Campaign to Protect Rural England

Europe Economics
Chancery House
53-64 Chancery Lane
London WC2A 1QU
Tel: (+44) (0) 20 7831 4717
Fax: (+44) (0) 20 7831 4515
www.europe-economics.com

February 2004