Housing and the Economy: Policies for Renovation

Going for Growth 2011

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Going for Growth

Annual flagship publication that provides OECD analysis and recommendations on how to foster long-term growth (unlike the OECD's *Economic Outlook* which is about short-term growth).

Makes use of a wide range of comparable policy indicators across countries, which are used in empirical analysis to understand how structural policies and institutions affect long-term growth.

Based on these established links between structural policies and performance, 5 reform priorities are selected to boost GDP per capita.

Recently been used in the G20 Mutual Assessment Process (MAP): 1: Compare reform commitments made by countries to priorities identified in GfG; 2. Identify further growth-enhancing reforms.

Release of the 2011 Going for Growth: 8 March 2011

Why study housing within Going for Growth?

This study strengthens previous coverage of housing-related issues in Going for Growth by: 1: providing new cross-country comparable policy indicators; 2: analysing the links between these indicators and housing market and economic performance.

Housing markets affect economic performance:

-Housing influences household wealth, consumption and savings.

-Construction industry is an important part of the economy.

- Influence labour mobility, education and employment prospects.

Governments intervene to enhance housing opportunities

- Do policies achieve their objectives in an efficient and equitable way?

- Do policies have any adverse side effects?

Selected Main Findings

Cross-country study which highlights the importance of:

1. **Mortgage markets** and prudential banking **supervision**.
2. Responsiveness of new **housing supply**, including the impact of land-use regulations.
3. **Housing taxation policy**
4. Impact of housing market policies on **residential mobility** and labour market performance

The study also contains a range of **new cross-country indicators of housing policies** in OECD countries.

Each of the above factors have ***policy relevance*** *for the* ***United Kingdom.***

Liberalisation and innovation in housing finance markets lowered cost of borrowing but also carried risks

1. Lower requirements for down payments is associated with an increase in homeownership among previously credit constrained households.

2. Financial liberalisation is estimated to have increased real house prices by as much as 30% in the average OECD country over recent decades...

3. … and lead to greater house price volatility, which can pose risks for macro stability if it is not coupled with appropriate regulatory oversight, as witnessed by recent developments.

United Kingdom: *housing demand and house prices rose strongly up until end of 2007, reflecting mainly income and population growth but also partly the easing of lending conditions…*

Responsiveness of new housing to prices varies across countries

A responsive supply helps to avoid excessive increases and volatility in prices, but it can translate into more volatile housing investment.

How can policies affect supply responsiveness?

Housing supply may be constrained by both policy and non-policy factors:

-Geographic conditions can restrict housing supply in certain areas.

Policy reforms can increase supply:

1. Designing and enforcing efficient land-use regulations.
2. Providing complimentary infrastructure and other public services.
3. Link the assessment of property value for tax purposes to the market value.

United Kingdom: there is scope to reassess land-use policies in order to make better use of vacant land with little environmental value (reconsider Green Belt boundaries).

Housing is tax favoured in many OECD countries

Most investments: income streams (benefits) taxed while expenses (costs) are tax deductible. But in many countries owner-occupied housing is taxed favourably:

-The benefits of owner-occupied housing (*i.e.* imputed rental income) are generally not taxed while many countries allow the expenses (*i.e.* mortgage interest payments) to be tax deductible.

-Most countries use **recurrent property taxes** but:

1. These taxes are often not large enough to offset mortgage subsidy.
2. The property value for tax purposes lags well behind the market value.

Policy goal: tax housing in the same way as alternative investments.

United Kingdom: mortgage interest is no longer tax deductible but the current property tax base should be updated to better reflect market values. This would provide more incentives to use vacant land.

Favourable tax treatment of housing can have undesirable consequences

1. Lead to excessive housing investment and crowd out more productive investments adversely affecting growth.

2. Encourage speculative behaviour by lowering the cost of borrowing to finance housing investment and raise house price volatility adversely affecting macroeconomic stability.

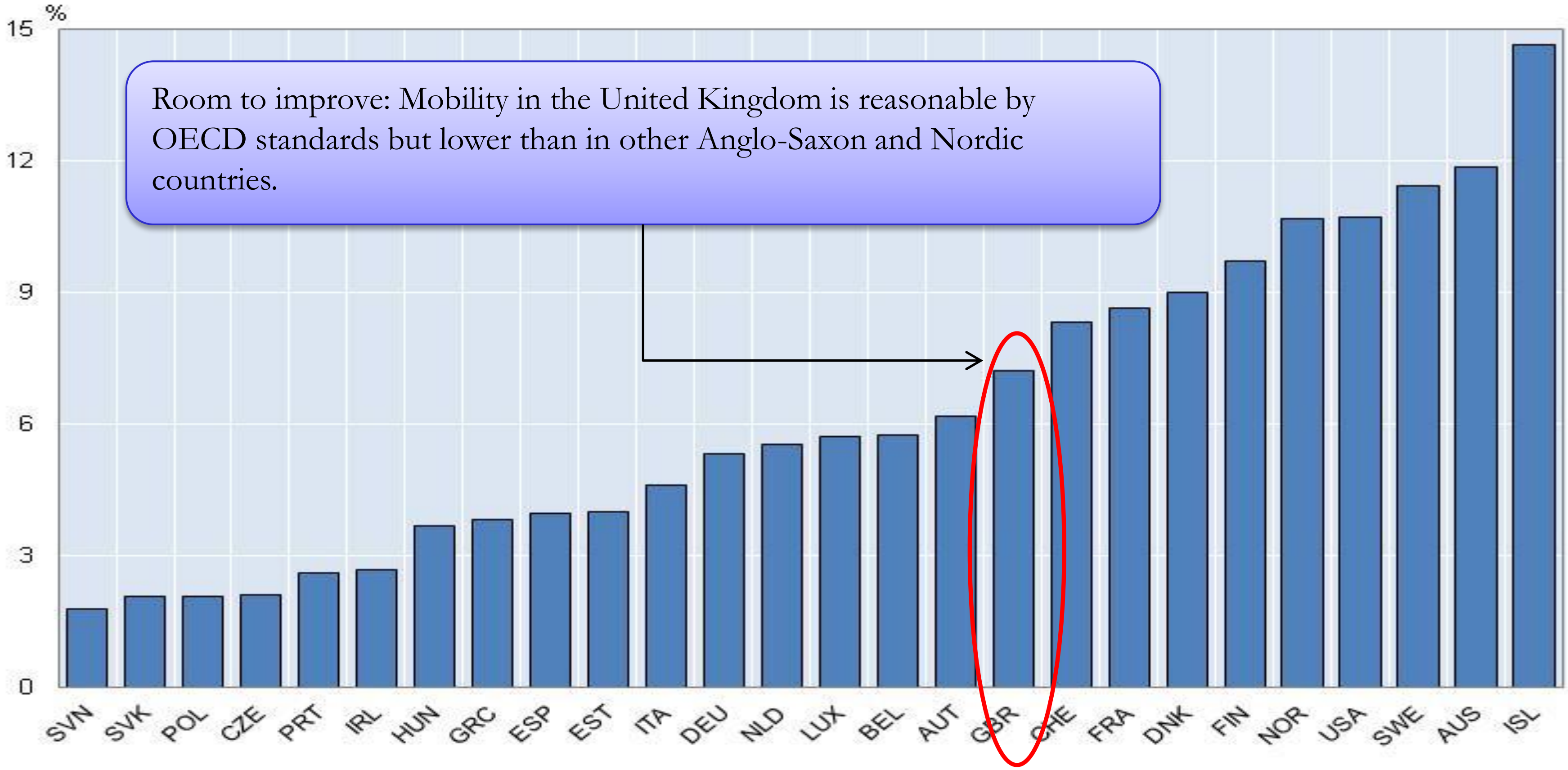
3. Tax reliefs for mortgage debt are inequitable:

   - Tend to be capitalised in house prices, thereby preventing some financially-constrained households from owning their home.

   -Favour the better off: higher income households are more likely to be homeowners and tax reliefs usually take the form of a deduction against earned income as opposed to a tax credit.

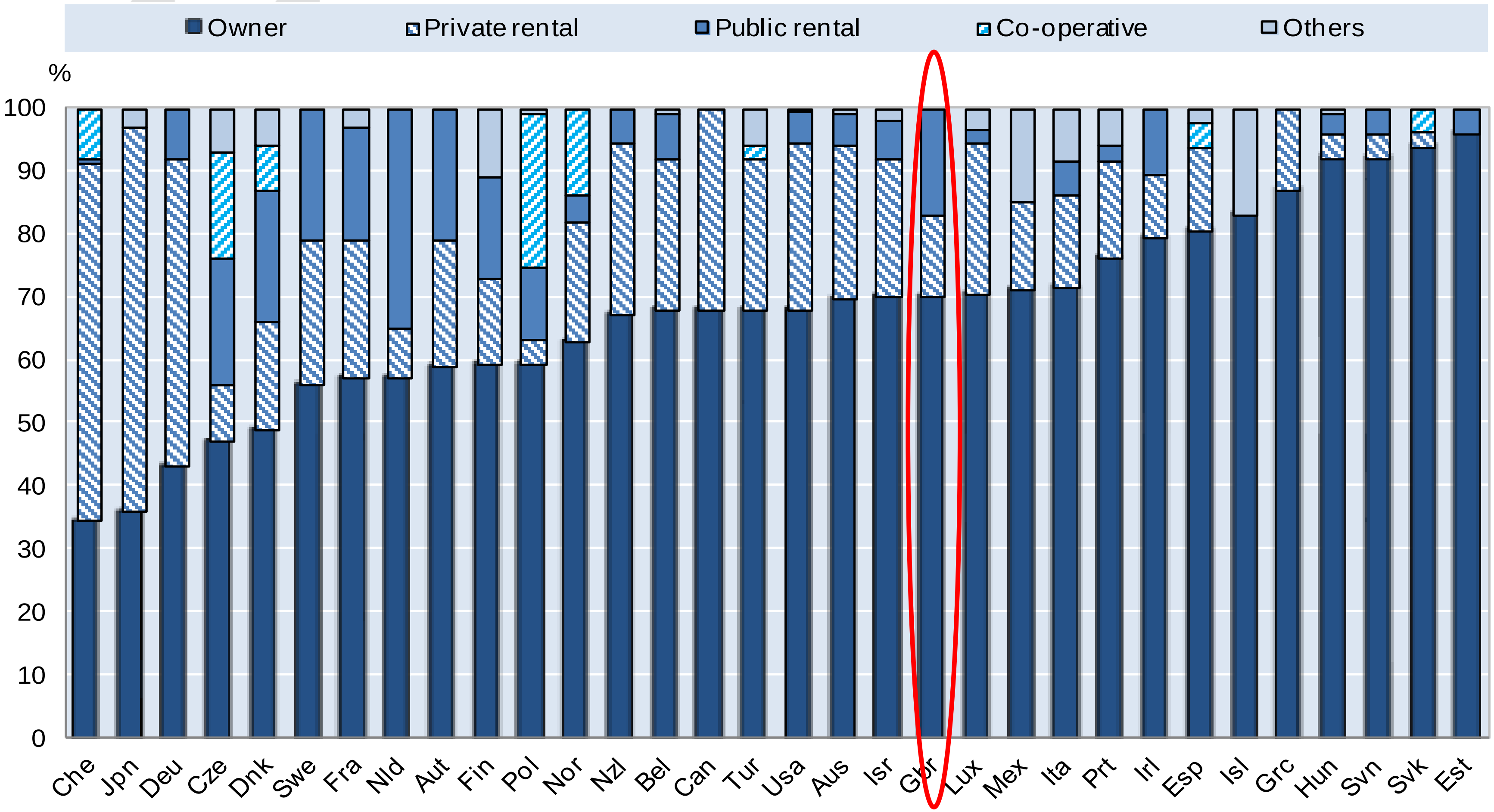
Residential mobility varies across countries with implications for the functioning of labour markets

Percentage of households that changed residence within one year, 2007



Average mobility rate in the OECD is 6%.

The division between owners and renters varies across OECD countries with homeowners and social tenants less mobile



Average homeownership rate in the OECD is 65%.

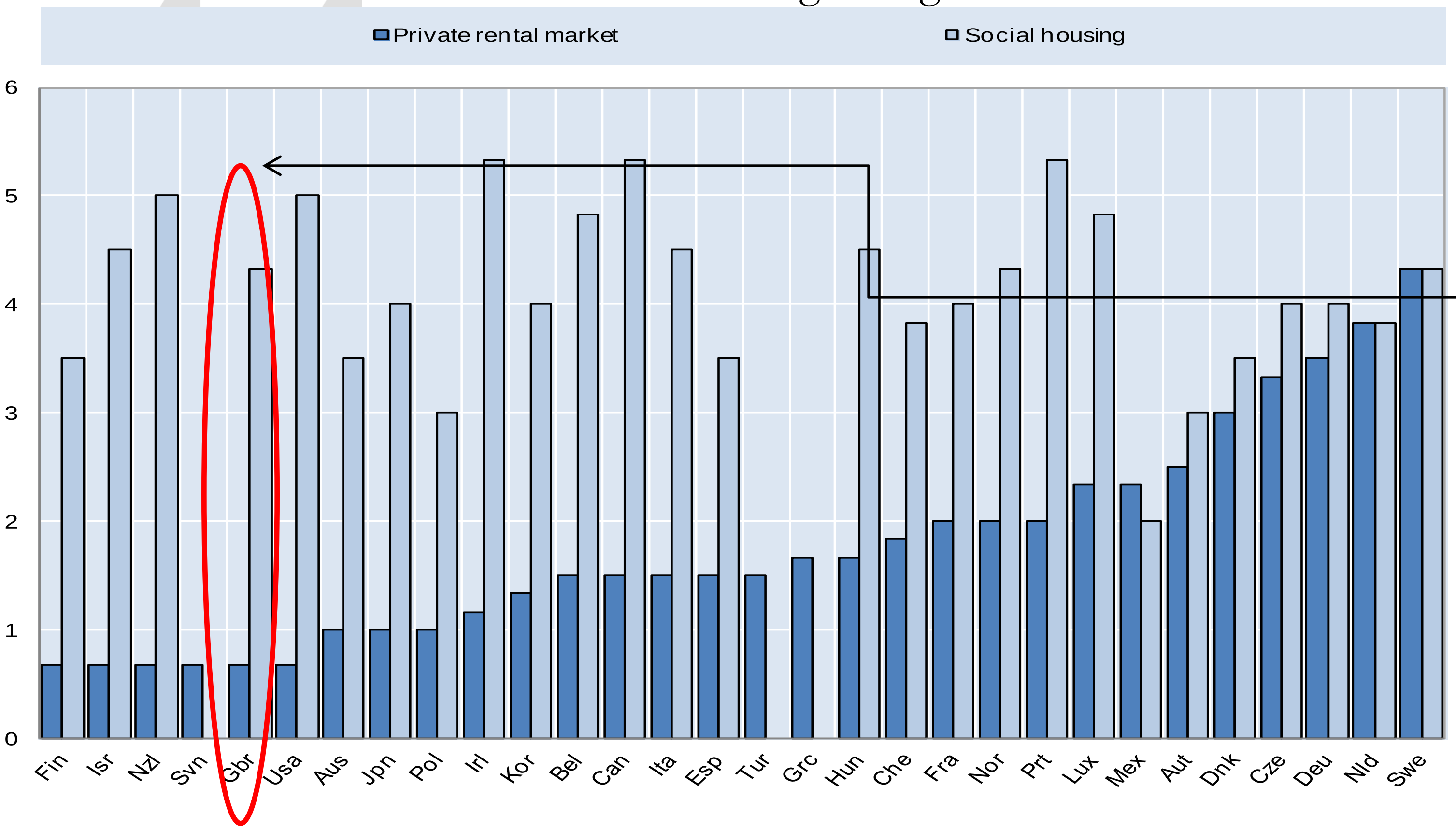
In the UK, homeownership is dominant, the share of social housing is sizeable while the private rental market is relatively small, hampering mobility.

How can policies increase residential mobility?

1. A more responsive housing supply increases residential mobility, possibly by evening out housing cost differentials across regions (relevant for the United Kingdom).
2. Greater access to credit facilitates residential mobility, but too high leverage ratios can potentially undermine mobility as households in negative equity may be unable/unwilling to move.
3. Lower transaction costs in buying and selling homes increase residential mobility.
4. Less strict rental regulations promote mobility.

Strict rental regulations can hinder mobility

Scale 0-6: Increasing in degree of rent control



Rental regulations in private markets are low in the UK, but they are much stricter in social housing…

-Across OECD countries, strict rent controls in private markets hinders mobility.

In the UK, strict rent control in social housing compared to private market locks-in social tenants.

Design housing support carefully

Social housing provision directed to those most in need can achieve their goals at a lower cost than less targeted systems.

But they can concentrate low-income households into neighborhoods with negative consequences for access to education and labour market outcomes.

A frequent reassessment of eligibility is required.

Well-designed portable **housing allowances** may be preferable to social housing as they do not directly hinder residential mobility…

-but their design should consider any adverse impacts on work incentives.

United Kingdom: shift from provision of social housing to allowances. But, it is unclear if the supply of private rentals has made up for the reduction in social housing.

Conclusions

Better housing policies are needed to promote growth:

1. Innovations in mortgage markets should be coupled with appropriate regulatory oversight and prudential regulations.
2. Improve supply responsiveness of housing by improving land-use and planning regulations and tax incentives.
3. Favourable tax treatment of housing should be removed.
4. Reform housing policies to facilitate residential mobility.
5. Use carefully design targeted social housing system and portable housing allowances.