Centre for Housing Research
AOTEAROA NEW ZEALAND

Kāinga Tipu

Focussing on the Housing System and Modernising Housing Policies

Duncan Maclennan
Institute for Governance
University of Ottawa

April 2008

This paper is the first part of a presentation made to the Centre for Housing Research Aotearoa New Zealand (CHRANZ) in Auckland in November 2007 and it sets out the major impacts of globalisation on housing markets and policy possibilities. A second paper, Housing, Economic Change and the Governance of Metropolitan Areas, then considers how large cities have been adapting policies for homes and neighbourhoods in ways that are of relevance to Auckland.

Contact Duncan Maclennan at dcmaclennan@sympatico.ca.

Trunks, Tails and Elephants: Modernising Housing Policies

1. Grasping at Parts, Missing the Whole

The housing sector is a complex system, with market and non-market sectors, local boundaries and global drivers, and with significant links to markets for land, labour and finance. The outcomes of the system shape the wellbeing of households, fashion neighbourhood domains and externalities, and manifest spatial differentiation and separation in ways that impact society, the environment and the economy (Maclennan, 2008). In relation to the economy (the key concern of this paper), housing commonly absorbs a fifth of household incomes, comprises the main component of both household assets and debts and has significant implications for employment and labour mobility. Housing is a big system and the functioning of that system impacts the major goals of governments, such as environmental sustainability, social cohesion and economic competitiveness.

The above observations are obvious to economic and social researchers on housing. However it is equally obvious that this 'large and significant system' view of housing does not prevail in policymaking in most of the OECD countries. If it did, there would be an evidenced awareness for policy of how housing markets impact non-housing policy goals, such as greenhouse gas reductions, the long term distribution of wealth or the fast integration of visible minorities, rather than areas of doubt and mystery. With a sense of the wider roles of housing systems it is likely that there would also be more effective (housing) policies to deliver housing outcomes.

Governments, influenced by evidence, experience and ideas change the ways they think. Over the last twenty years governments have evolved new policy paradigms about competitiveness of industries, cities and regions and how to respond to growing global challenges (OECD, 2006). These syntheses focus on issues for mobile business capital, such as innovation or corporate tax rates, and on human capital, drawing attention to the importance of education, training and migration, for example. The conventional wisdom emphasises the flexible and more mobile factors of production.

The focus on more flexible markets for labour and financial deregulation, shifting both opportunities and constraints, has led to some reconsideration in the design of housing policies (Maclennan and Pryce, 1996). However the modern policy synthesis has been mis-specified by de-emphasising the relatively fixed and localised aspects of economic and social life. The outcomes that governments aim for reflect an interaction of both truly global drivers of change and ineluctably local demand and supply systems. Within these systems, it is land, infrastructure and housing that are the relatively fixed factors and planning, construction and government sectors that literally put the global response in particular places.

The contention of this paper is that any nation or city will fashion more effective responses to challenges of globalisation if it includes these relatively localised and fixed factor systems in the core of research, analysis and policy making. This is not simply a matter of more logically complete theoretical models or better-specified empirical work for policy. More fundamentally it is about the scope and vision for housing, and planning, policies and about the choice of policy instruments and how to use them. Keynes noted the limitations of pursuing simplistically rational policies in a world of irrational behaviours. The challenge for the conventional wisdom is to go beyond simplistic flexibility mantras to deal effectively with the systems that are inevitably sticky, either because of the nature of the goods or the markets involved.

Housing is not just a big system; it is inherently sticky too, with spillovers, lags and recursive effects across a range of key sectors and systems. But this is not how housing systems, let alone housing policies, are regarded in the OECD countries; see Maclennan, (2005). It is arguable that as housing has multiple, moderate, cross-sectoral, spillover impacts the pervasiveness of silo management and the paucity of evidence based policy have always precluded a true recognition of housing system roles within government. Through the 1980's, across the OECD, there was a wave of housing policy change (called Wave 1 here) that was associated with attempts to reduce public spending and debt in response to early adjustments to globalisation. Reduction of government housing spending, the switch of subsidies from dwellings to households (means related), the shift to "off –budget" investment and ownership and a new penchant for market oriented subsidies and systems dominated policy change for much of the period 1980 to 2000 (and still does in some countries, for instance Canada and Australia into 2007).

This paper does not revisit debates about market versus non-market strategies for policy. Rather it argues that Wave 1 shifts in housing and related policies led to significant contraction in not just the scale but in the understanding, scope and vision of housing policies. In consequence, in numerous countries, housing policy expertise increasingly became focussed on the interface of income related housing subsidies and more general social security systems, so that low-income affordability, narrowly defined, rather than housing system performance, became the focus of 'housing' policies.

Within governments, particularly at national levels, political and bureaucratic power, and policy paradigms, shifted away from housing systems and their diverse outcomes to social security ministries. This was true of the UK for some of the 1990's and presently prevails most obviously in Australia and Canada where federal level understandings of what housing systems and policies are for have narrowed sharply over the last decade.

A review of housing policy trends within the EU suggested, at the start of this decade (Maclennan, Fitzpatrick and Stephens, 2000), that a number of countries had passed beyond Wave 1 policies and were beginning to re-expand housing policies and thinking within governments. The UK, Ireland and Spain were obvious cases in point at that time. In these countries, and in a wider set of European nations, as well as New Zealand and, for some time the US pursued, what might be termed Wave 2 policies. Wave 2 policies made much of the role of housing reinvestment in neighbourhood renewal and of addressing the rental burdens facing low-income households.

Nations without significant renewal efforts, and some that have, are now involved in two "housing" discussions, namely "homelessness and affordability" and " house price booms, bubbles and busts". The first of these policy themes has largely been the domain of social policy Ministries, lobbies and academic researchers with a focus on "affordability", see Carter (2003). The second has been an interest of the macroeconomic policy community, involving central banks, some finance ministries and financial institutions as well as academic economists. The issues have been about "stability"; see Case et al (2003), Maclennan (2007). Affordability and stability have not been the only housing policy debates of recent times but they have been the issues that have dominated the interests of the public sector and the general public. They are often discussed as if they are unrelated issues, not just in the press but also within policymaking processes. That separation of interests, and the implication that the causes and policy solutions are unrelated, emerges from the fragmented nature of housing thinking within modern governments.

A number of years ago Chris Hamnett (Hamnett, 1992) used the metaphor a of a blind man and an elephant, to try to show how partial approaches to understanding neighbourhood change led to unnecessary debate and a failure to grasp the scope of the problems involved. Without any comment on the aptness of Hamnett's metaphor for gentrification studies it is however appropriate for thinking about how housing policies have to change. Macroeconomists have seized on the trunk, social policy affordability specialists are grasping at the tail of the same beast. The beast that has to be understood is the elephant. Pulling on the trunk and pushing on the tail will not best address issues of affordability and instability, not least as the two issues are strongly, causally connected. The housing system as a whole has to rest at the centre of housing policy making and in wider government policy strategies too.

This paper makes this case in three steps. The next section sets out some of the general housing market changes across the OECD in the last decade or so. Then, in heuristic fashion, in Section 3, housing price and volume changes are connected to possible sets of consequences for different policy domains. Section four sets out some of the policy challenges that governments now face and some brief conclusions are offered. The aim of the paper is to suggest a mind map for policymakers to exploring more effective strategies for managing national and city housing systems to achieve major goals.

2. Changing Housing Markets

Housing systems are largely local in their functioning but there are at least two kinds of commonalities that connect change patterns across different systems. First, there are key housing demand drivers such as interest rates and income changes that may operate nationally or even globally. The macroeconomic environment can have local effects. At the same time housing systems may have characteristics that, though variable in their empirical parameters from place to place, have a general presence. For instance, housing supply invariably lags behind demand changes but the duration of that lags and the extent of response varies locally. That is, all housing supply systems are 'sticky' but with local differences in stickiness.

Through the development of Wave 1 and Wave 2 housing policy responses to globalisation, as noted above, the main shapers of policy change were, first, the needs to trim budgets and, then, subsequently, to deal with the policy fundamental that income inequalities invariably come with the income and employment growth opportunities that globalisation bring to nations and cities. What these responses lacked, see for instance Maclennan and Pryce (1996), was the recognition that a likely 'fundamental' of globalisation would be that the recurrent growth of income and employment, migration and immigration ahead of supply side change would be so persistent. That recognition, which directs our attention to how the housing system is functioning and why and where it is sticky, requires a change in the emphases and instruments of housing policies. Neither pro-social nor pro-market choices in housing policies are likely to be well designed if the 'fundamentals' that bring stickiness prevail. Looking only at affordability outcomes may chase supply side problems with more, and wasted, tax revenues. Looking only at instability ignores some of the key distributional outcomes of housing systems and their recursive effects that may shape long-term growth prospects for an economy.

In order to illustrate these arguments, and set housing policy in the context of wider economic policies, it is useful to assess the ways in which national housing markets have changed over the last decade and to start from the macroeconomic perspective. Over the last few years the path of US housing market activity has raised debates about bubbles, booms, fundamentals and crashes, see Case and Shiller (2003), Catte et al (2004), Del Negro (2005), Girouard (2006), Himmelberg (2005). The current downswing in housing market sales, prices and construction is having significant effects on consumption, not just in the US but on trading partners with stronger currencies. The rising rate and volume of sub-prime mortgage defaults, allied to the globally distributed ownership of the mortgage-backed securities underpinning lending growth, has also contributed to significant losses within the banking and real estate finance sectors. These losses have prompted wider concerns and precautionary lending behaviours within the broader international banking sector so that there is a wider "credit-crunch" across the linked economies of the OECD.

The US housing crisis and its global effects will be at the forefront of much policy discussion over the next few years. However this article resists being diverted to that specific case, where obvious mis-design of mortgage market regulation has had such negative effects. Nor is it appropriate to focus on the policy debates that emerged in the EU around ECB interest rates, the euro and implications for house prices, volatility, housing debt exposures and growth. These US and EU issues are both of great significance, but they are only particular examples of pervasive, major changes in housing markets that have followed globalisation and that are only now being recognised as key issues for national economic and housing policies. That wider pattern of change, and the policy issues arising, are the focus here.

Patterns of Price Change

Price changes are a critical indicator of how housing markets are changing. A cautious approach to cross-national house price analysis is always essential, if rarely practised. First, not all nations collect price data in the same way. Some countries have statistics that derive from national land registry and transfer records, such as the UK, and others, such as Canada, have data that is supplied from the financial sector, based on lending, or from developers, related to dwelling completions. Secondly, observed "total" housing prices are a product of the set of attributes traded and their implicit hedonic prices. This means that at a single point in time cross regional or cross national price studies need to adjust for dwelling quality to identify true price differences. Over time, quality standardisation of total prices becomes even more essential as the mix of homes traded within a market usually shifts systematically over that cycle and of, course, new construction may add different kinds of stock.

Without standardisation for the changing composition of housing attributes then true changes or differences in the underlying price of housing are not revealed. There is also a likely probability that house prices increases are being overstated because the size and quality of housing, including new energy technologies, has increased in most

OECD countries over the last two decades. A further complication in interpreting market prices is that Wave 1 expenditure cuts have greatly stimulated, the use of inclusionary zoning policies that seek to cost local infrastructure provision, previously provided from public tax revenues, into house prices. In some instances, see below, where landowners carry this cost through reduced land values the price effects will be neutral, but not where consumers pay some or all of the infrastructure charge. Such charges then inflate house prices. This policy change as well as size and quality change is likely to have raised 'total' house prices leading to upward bias in unstandardised price rise measures.

House price changes play an important part in "instability' analyses but they have also a crucial role in "affordability" studies. Without well standardised data on houses and households, simple measures of affordability, such as price and rent to income ratios, are also affected by unmeasured quality improvements and decreasing household size, see Demographia (2007). 'Affordability' indicators may then appear to deteriorate without any contribution from real house price inflation. At the same time, price and rent to income ratios are no guide for even clearly specified affordability programmes if interest rates are changing, so that measures of mortgage or rent outgoings to household incomes are more relevant, see Luffman (2006), Robertson (2006). Over the longer term it is also arguable that measurement of the real user cost of housing capital [1], that emphasises the long term returns to households from housing decisions rather than the short term cash flow effects picked up in short term rent to income measures, should be used as a measure of affordability, see Government of New Zealand, (2008).

The assessment of whether or not there has been a growing, pervasive crisis of affordability in OECD housing in the last decade depends on the measures used. Price to income ratios proclaim a crisis (Demographia, op cit). Measures of outgoings suggest a much more mixed position and no general pattern of crisis until very recently as interest rates started to rise. User cost measures suggest the problem was not affordability but entry problems or capacities, for once owning, the real user cost of housing capital was markedly lower that historical averages for most of the last decade (Government of New Zealand, 2008). Understanding that "affordability' pattern needs an understanding of the housing system and why global growth was locally transformed into price effects.

Notwithstanding the measurement difficulties, there is wide agreement that national economies have, over the last thirty years, have had different house price histories with important similarities[2]. Similarities have arguably become more apparent over the last decade, the temporal focus of this paper and these are illustrated in Figure 1 for a small set of countries. Real house prices have risen over time and patterns of real and nominal house prices have been strongly cyclical, see Barker 2005. A number of recent multi-country studies, OECD (2006), Mishkin (2007) and Egert and Mihaljek

[1] The real user cost of housing capital is an important concept, as it suggests what the cost of owning is over the long term to rational choosers. It embodies not simply interest rate costs but tax effects that increase or decrease housing investment and borrowing as well as maintenance, depreciation and the expected rate of house price appreciation. The latter term is important, as increased real or expected real house gain rates will reduce the real cost of housing capital whilst price to income ratios will suggest that housing is becoming less affordable as house prices rise (Poterba, 1984).

[2] Since 1970 the EU has had an average real rate of house price of 1 percent per annum, though some countries such as the UK have had markedly higher rates (2.5 percent per annum).

(2007) and Haibin (2006), Ayuso et al (2005), have presented insights on patterns and drivers of house price changes. Over the last decade or so real and nominal house prices have risen significantly in most countries.

The patterns of appreciation and instability are illustrated in Table 1(page 21) and in Figures 1(a), for non-European ECD countries and in Figure 1(b) (page 22)for the leading Asian economies. Most countries have experienced at least a 25 percent increase in real values and most of the OECD nations more than 50 percent. Some nations experienced fast growth: the UK, Australia and Spain are all significant scale systems that manifest high rates of price growth and instability. House prices in the UK and Australia more than doubled between 1999 and 2004. New Zealand had a later, 2001-6, boom with a similar doubling of real prices. Transition economies of Eastern Europe had a similar later but somewhat smaller set of booms.

North American national experiences were relatively moderate. US house prices, at the heart of global concerns by 2006, actually rose more modestly than in many of the advanced economies and increased by a half in the decade 1995 to 2005. Canadian prices were flat for much of the first half of that decade and then rose by a quarter by 2005. In Switzerland and Germany, where the tax and subsidy system has always been more neutral in housing tenure choices, and Japan, where real price deflation of the late 1980's boom continued into this millennium, the growth of real house prices has been negligible.

Smaller economies have had less stable patterns of price expansion. Larger systems such as the US, the EU area (taken as a whole) and Canada, all show price growth patterns with steadier upward shift. The relationship between system scale and price instability is likely to reflect the fact that shocks to demand, in large systems, apply at different time intervals to different metropolitan and regional economies. There are then a series of overlapping supply and price effects with larger systems more diversified, and smoother in the pattern of price appreciation.

OECD (Girouard et al, 2006) has presented evidence across countries indicating that the drivers of real price changes are, as expected, real income growth, household formation (and immigration) and interest rates (or more generally the real user cost of housing capital), see also Tsatsaronis and Zhu (2003).

The logic flow of the broad processes involved in the house price booms of the last decade can be summarised as follows. Demand increases stemming from global economic changes, reduced interest rates and household growth (with immigration rising over time) are mediated through tax structures to shape housing and tenure demands. Deregulation of financial systems has ensured a closer match between latent demands for housing and their ex post realisation, with implications for housing demands and prices. Sluggish supply inelasticities, associated with shortages in land, infrastructure and construction labour markets, induce significant real price increases as demand growth unfolds.

The new features of this heuristic, in contrast to earlier decades, are three reinforcing dynamics. First, mortgage finance is less strictly quantity rationed than in the past, with higher loan to value ratios and more generous interpretations of income allowed, so that demand peaks at higher levels, see Debelle (2004), Dynan and Kohn (2007), Ong (2005). For instance, when mortgage markets were largely based on national or regional deposits there would be limits to funding growth in any upswing. Such constraints are irrelevant when lenders can access wholesale global money markets. Secondly, deregulation has also made it easier for households to withdraw housing equity and re-inject it into other asset purchases and household consumption, see Klyuev and Mills (2006), Greenspan and Kennedy (2007). The latter effect raises aggregate demand and complicates the setting and implementation of interest rate policies for macroeconomic policies. Thirdly, the reinforcing demand led process has been sustained by global growth for protracted periods.

Housing demand can respond quickly to changes in interest rates and tax arrangements but housing supply is relatively fixed in the short term. As a market starts to expand there may be increases in turnover supply and this may boost movement related equity withdrawal and the demand for the white goods, furniture and fittings that are associated with house purchase. This feedback loop also boosts economic activity and housing demand. As new supply comes on stream, increased employment in the design, planning, construction and finance sectors can add significantly to the cyclical rise in employment and incomes, see Maclennan, (1995) and Maclennan (2008).

Many of these effects will be reversible as the boom somehow peaks and a widespread policy concern for most governments is whether the present boom will come to and end without sharp downswings in house prices and economic activity. Housing booms may be bad from a policy perspective but the bust generates even stronger societal and political aversion. Through and beyond the upswing there will be feedback effects on wealth patterns, savings, incentives and indeed consumer and investor expectations for the future (Muellbauer (2005)).

Bubbles and Fundamentals

OECD, Girouard, (2006) also argue that in some countries house prices lie above the price levels that ‘fundamentals’ warrant. There is however an emerging debate both about the range of causalities in econometric models and the estimation of ‘fundamental’ versus ‘bubble’ effects.

Some cross national studies have related house price inflation, and mortgage equity withdrawal, post 1995, to deregulation in the financial sector. Mills and Klyuev (2006) and Debelle (2005), for instance, have made convincing contributions on how more efficient capital markets facilitated borrowing and had house price effects. A problem in the cross national analyses of house prices, for domestic and international policy purposes, is that they are uneven in the extent to which there is precise modelling of the different sectors of causality. Models are often only partially specified in a context where there are multiple, connected causal factors. Paradoxically international studies of housing markets now have relatively well specified labour market and finance sector sectors and statistics but have no well defined set of housing, land and planning sector indicators, see for instance Ahearne et al (2005).

These difficulties stem from the inherently local nature of housing systems allied to the need to connect them to demand and supply processes that also operate at national and international levels. National and local level data on incomes, unemployment and population change exist in most countries, so that key demand drivers can be effectively measured. In relation to the financial system effects on demand, indices of deregulation and capital market integration can also be identified and have been used in comparative fashion, although are often omitted in cross-national house price studies.

As indicated in studies of the effects of tax policy on user costs (see for example Poterba op cit) the effects of housing policies vary markedly from nation to nation and even region to region. However there are few studies that seek to systematically capture housing policy effects in synoptic measures[3], so that variation in national housing systems and policies is little used as an explanator of change. Paradoxically, when policy turns to addressing real house price issues at the microeconomic level it is however housing policies that are aligned for change. And even more so the scrutiny falls on the planning system and housing supply. “Large-Number” cross national studies, such as the OECD work referred to above, have simply failed to grasp this issue and there is a yawning gap between models of explanation and the policy wisdoms that emerge for further analysis.

Some recent cross-national studies of different kinds have addressed these issues with somewhat different results from the conventional wisdom emerging from OECD. Egert and Mihaljek (2006) contrast real house price changes across the OECD economies and the transition states of Eastern Europe. They identify different groups of countries on the basis of price histories (that largely matches the broad classification above) and then model the effects of income growth, population, interest rates and credit availability. Their focus is on the transition states and they highlight how real income growth and financial sector change impacted through significant price booms in housing after 2000. They also stress that the broad patterns of change they observe across economies appears, through 2006, to have been driven by fundamentals rather than expectational bubbles and that emphasis differs from some observations by the OECD.

The evidence that bubbles have existed in local systems over the last decade is quite compelling (Case, Shiller and Quigley). The evidence that they have characterised national change is not. A recent detailed, rigorous study of national to metropolitan regional change in two papers by Anton and Muellbauer (2006), Muellbauer et al (2007) makes clear the limitations of simple statistical contrast across countries and the split of effects into fundamentals and over-valuations on the basis of explanators that omit important potential housing market influences. In the context of the UK, Muellbauer at al construct detailed regional level models of house prices and allow interactions between regions to occur and they include supply as well as demand and credit effects. They use such models to show that 2005-6 house prices in the UK were at levels the model would predict, rather than, as suggested by OECD, overvalued by some 30 percent. In their further comparative work on the UK and South Africa the careful, detailed data research and modelling is reflective of what this critical set of issues requires for the future.

The international agencies, such as OECD have done fundamental work in persuading governments to address the issues involved. The next step for more solid policymaking must be to extend the rigorous approach of Muellbauer and others across the OECD and related economies.

[3] Over the longer term nations and international agencies such as the EU and the OECD have been unwise to have avoided the housing indicators work that the late Steve Mayo pioneered (Mayo, 1995)

Looking at short term, cycle and growth effects it is clear that price increases and instabilities across housing markets are near ubiquitous fundamentals of the housing policy context. What consequences do they have and how can policy better manage these effects.

3. Multiple Outcomes, Crossing Silos

From Instability to Obesity!

The previous section established the broad pattern of price changes that, with associated 'quantity' shifts in turnover and construction, have been characteristic of most OECD economies over the last decade. These changes had have implications not just for affordability and stability but a wide range of housing and related policy goals and outcomes.

The evidence of the last decade is that high and volatile house prices have clear macroeconomic effects, see Alexander and Torsten (2005), Aron and Muellbauer (2005), Carroll et al (2006), Case et al (2005), Dvornak and Kohler (2003). Changing house prices affects household net worth, ability to borrow and spend and can have important implications for wider economic activity. The effect of rising housing prices on owner consumption and equity withdrawal is no longer doubted, though the scale of effects is contested (estimates lie in the range 0.03 to 0.12 percent of housing wealth gains withdrawn), Maclennan (2007). Equally falling home values reduce consumption, and these behaviours both reinforce the amplitude of economic cycles and make economic management via interest rates more difficult for national economic policymakers. There is some limited evidence that volatility in house prices is detrimental to wider economic performance.

Fluctuating house prices and turnover rates may also have implications for the fiscal positions of national and sub-national governments. Rising housing and land prices raise the costs of delivering any intended volume of housing, and induced land price increases may raise fiscal costs of transport and infrastructure programmes. If rising prices translate into rising rents then the costs of operating income related support schemes for lower income tenants would also rise. At the same time increased property values could make property tax takes more buoyant. Stamp duty taxes on sales rise with the turnover rate, and they have been important sources of unpredicted increases in State budgets in Australia, for example. Rising estate and inheritance tax payments in the UK have been the subject of significant political dispute (as rising home value shifted more middle income households above inheritance tax thresholds). Tax, inflation, savings and loan effects house prices changes can limit the ability of governments to set preferred fiscal policy objectives and complicate the coordination of monetary and fiscal policy.

The emerging, challenging questions regarding how housing impacts economic growth are old issues. There are a growing number of questions around how housing outcomes affect the wellbeing of households and their capacity to work (with effects ranging from suburban obesity to social housing dampness and chest illnesses), the ability of children to socialize and learn (and this reflects the spatial concentrating effects of housing systems reinforcing or creating neighbourhood effects) as well as the possibility of housing; job mismatches in large metropolitan areas, see Jackson (2004), Maclennan (2008).

There are a number of possible pathways through which house prices could affect productivity; the operation of labour markets is probably most important. There is an accumulating body of evidence that housing has become an important factor in firms' ability to attract migrants moving within countries. Though there is as yet limited evidence to suggest that the rising tide on international migrants select countries on the basis of housing costs it is evident in Canadian and Australian research that house prices and rents have major impacts upon where migrants select homes within regions Suttor (2007). It seems likely that unless more affordable housing is supplied in critical, core areas of metro- regions, that future economic growth will be adversely affected.

Housing prices impact not only the income prospects of citizens but their wealth positions too. New Zealand is not so far out of line with international experience, and there one half of the rise in household wealth over the last three decades has come from the rise in real house prices – wealth per capita doubled between 1980 and 2001 and doubled again from 2001 to 2006 as a result of the property boom. Rising house prices have therefore been associated with a large increase in the net worth of a large proportion of people in New Zealand. The same holds true in Australia, UK, Ireland, and Spain and to a more limited extent the US and Canada. Typically housing wealth forms 40 to 60 percent of the net worth of households, Mishkin (2007).

In consequence, the emerging evidence suggests that the wealth distributions of households are now becoming even more unequal than income distributions and, in the main, this reflects the propensity for lower income households (the elderly excepted) to be renters and therefore not share in housing asset gains. This poses a fundamental dilemma for policies that aim to raise the capabilities and incomes of poor households through subsidised rental homes. It runs the risk that any such income gains will be outweighed by the relative wealth losses that will apply to tenants. An additional twist to this dilemma arises as experience in some countries indicates that the price of land has increased much more rapidly than the price of homes, so that landowners (usually even wealthier than average home-owners) gain even more from the stickiness of local systems facing global growth.

Rising land and house prices are often most marked in core urban areas. New ways of living and working (as well as higher fuel costs, and the likelihood of future energy price rises and carbon taxes) seem to be placing a new premium on accessibility. However past traditions, planning processes and non-transparent infrastructure pricing still encourage middle- income households, with families, to commute longer within and across metropolitan regions. Rising core city land and housing costs lead to greater energy costs and negative externalities for natural capital. Instability, affordability and sprawl are often interrelated outcomes.

Outcomes of macroeconomic policy, labour market strategies, regional and neighbourhood programmes, environmental programmes and a range of key public services (including health, schooling and security) are all mediated by house price effects. Stability effects touch upon not just affordability but the factors that shift both the numerator and the denominator of typical affordability measures. That is why system links and changes should be at the core of housing policy formation.

From Affordability to Social Change

Previous sections of the paper noted the difficulties of modelling affordability with any precision. But that is not to suggest that the essential idea of affordability is unimportant, especially where a standard of decent housing and an interest in low-income households is explicitly pursued.[4] In all of the OECD countries affordability tends to be a problem for lower quartile income households who are buying or renting. Where detailed studies have been completed it is apparent that there has been a shift in the income distribution from younger to older workers so that a larger proportion of poorer individuals and households are now young and not without human capital.

Almost all governments steadfastly proclaim the virtues of home ownership and aim to expand the ownership share. In numerous countries, including the UK, Canada, Australia and the US, the greater number and longevity of older households have maintained recent ownership growth. Age specific home-ownership rates for the 25 to 35 year old cohorts have fallen in these countries over the last two decades. In New Zealand these falls have been so significant that the overall home-ownership rate has declined since 1991 after steadily rising for the previous 40 years, see Table 2 (page 20). The biggest falls have been in the 25-29 and 30-34 groups. There is also evidence that some of the households 'deflected' into renting are now unlikely ever to become homeowners, Government of New Zealand, 2008.

These shifts have major implications for the wealth and family formation propensities of generation X and there is little evidence that policy, politics and politicians have grasped the extent and depth of this change. It has major implications. Do the commitments of governments to higher home-ownership rates now make sense? Do income measures for affordability have either explanatory power re tenure choices or validity as a basis for subsidy support when transfers of family between wealth between generations, as much as current incomes, shape the timing and quality of home-ownership choices. How has the globalisation mantra of 'education, education, education', and with charges, eaten into the deposit capacity of younger households as prices rise away from them. At present the proportion of students returning to parental homes after higher education is rising significantly, and in Canada is close to 50 percent. These trajectories have changed so that inflation has not only changed the interfaces possible between social tenants and eventual ownership but it has pervaded the decision possibilities of all but the most affluent of younger households.

Rising real house prices with falling real user costs of housing capital encourages those who can to own more housing assets. Some households choose not to trade up to larger or more valuable homes, they may already be at peak housing consumption, and instead maximize their housing returns, often leveraging borrowing on existing housing assets, by purchasing units to rent. The most recent global boom has seen an international spread of above average income households buying homes to let. Recent work in New Zealand suggest that these effects raise prices for homes and that further displaces new first time buyers from owning options. Declining home ownership has

---

[4] Since 2000 new concerns about middle-income affordability have often muddied or displaced policy efforts for lower income households (the first home owner grants used by state and federal governments in Australia are an obvious example of that process).

been widely matched by a rise in the number of people renting and the number of houses owned by investors with small portfolios.

Booms may now change the nature of the rental market. Buy-to-let investors are arguably more drawn by capital gain rates rather than, as in more traditional long-term rental systems, rental yields. At the same time the scale economies in financing and management that exist in more centralised systems of rental ownership can become fragmented. This raises important issues about the future quality, stability and efficiency of rental systems, just as more households are required to live in them.

Housing policy analysis has to quickly move beyond ’affordability’ to the wider effects of family wealth dynamics, the trajectories of households as owners and savers and to the functioning and fairness of the rental housing system. As for “stability”, housing system effects and wider consequences soon come to the forefront of the analysis. The limitations of the stability and affordability, rather than housing system, perspectives become all too evident. Focussing simply on either, or even both, of these sets of outcomes as the framework for coherent housing actions is misplaced. The last decade has changed housing systems and their outcomes and required a refocus on the housing system and its connections and outcomes. But what does this mean for how housing policies should now unfold, what does Wave 3 look like?

4. Changing Policies: Capacities, Goals and Instruments

Housing systems in many of the advanced economies are entering a period of uncertainty and cyclical downturn. The credit crunch and widening economic downswing effects from the still deepening US sub-prime mortgage market will test the stability features of most national systems. That set of downswing issues is important and is likely to dominate political thinking for housing policies until 2010 and the aspects of the housing-economy recursive relationship stressed will be economy to housing effects. However in dealing with these difficulties governments should also be recognising the deeper, longer-term structural changes that have unfolded over the last decade and that will probably reappear in the future. Growth, inequality and rising scarcity rents in housing, with strong housing to economy effects, are the long-term setting for policy and policy change should address them.

Recognition of the changed, key ‘stylised facts’ of housing systems for the globalised economy requires considerable rethinking of housing policy. The vision of what housing sector action is for may need to be revised. The governmental, organisational and individual capacities to design and deliver appropriate policies may have to be re-examined. The nature and balance of the instruments used to pursue policy goals has to be reassessed. Ten key issues for the modernisation of policies are set out below.

Remaking Housing Policy Capacity and Competence

Some governments have already moved beyond a ‘social security’ based vision and management for housing policy. For instance, the UK government, since 2000, has developed better understandings of the recursive relationships between housing and the economy, Maclennan (2005). Housing systems and outcomes have a place in the core of policy thinking. New Zealand has recently made major efforts to review housing sector roles, their wider effects and to develop a new emphasis in policy for the current times. These wide visions and understandings for housing policies are in stark contrast to policy debates and thinking in, say, Canada and Australia at federal levels. European governments, in broad terms, have a strong sense of the social policy roles of housing, a growing sense of housing impacts on the environment, but little understanding of the housing-economy nexus over the longer term.

Capacities to understand housing sector effects at national levels appear to have atrophied. Three developments would reduce this difficulty. At the international scale, The OECD, and the EU in Europe, could lead high level reviews not just of price outcomes but of why housing policies matter and how they might be modernised for nations and cities. At the national scale, one of the central agencies of government, a Prime or Finance Minister's Department, is needed to drive a review of how housing effects disappear in the cracks between departmental silos and set a new vision for policy. There is the a strong case for a Housing Ministry at Cabinet level that, perhaps associated with planning and infrastructure, to deliver the vision and to set enabling supply side change as its key concern for the next decade or two. This observation applies to Federal as well as two-level national systems.

Subsidiarity, Autonomy and Funding

The other shifts in housing government and governance need to rest at more local scales. Housing systems, like labour markets, transport and infrastructure systems have some coherence at metropolitan rather than municipal levels. It is at the metro scale that key supply side effects need to be captured and aligned to other economic policies, Maclennan (2008). Many nations fail to make that integration effectively and, even worse, vision and development capacities for housing have atrophied in some places. In Australia and Canada respectively, shrinking state and provincial housing services have struggled to maintain a vision and scale for development activity. It is only in the last two years that Victoria has broken out of a decade of declining social rental provision and begun to develop policy approaches with mixed tenures, area effects and environmental consequences in the policy debate. Within organisations there can be deficits of new staff with new ideas, for instance four-fifths of the senior managers in the beleaguered social housing sector of Ontario, will retire within the next decade. Stripped down and tired housing policy provision systems are left to face the consequences of growth with inequality and scarcity rents. Realistic alignment of devolved responsibilities with devolved revenues is required.

Supply-Side Emphasis

Subsidiarity is partly to be favoured because long-term policy has to focus on the relative sluggishness of supply. Few nations or metro regions have even basic estimates of supply elasticities. Governments are often quick to pinpoint 'planning' as the constraint, and some emphasise planning delays and 'red` tape as the source of difficulty (even where land, infrastructure and construction labour shortages are apparent). Planning is an issue for consideration but not primarily as red tape. Vision based metropolitan plans, including land use statements of intent, need to incorporate market views, and align them with public interests, (Barker 2005). But without some place based notion of where development is to serve the public interest and shape new futures, housing policies cannot be well aligned to either other sectoral policies or economic developments. In the Netherlands, or the UK, for instance, planning processes lie at the core of housing development and housing and planning professions are closely linked. That arrangement is far from universal and outside of

Europe spatial development plans, setting a frame for vision-based fixed investment in places, are often missing.

Gain Capture

Planning also matters in creating vehicles and partnerships to maximise spillovers between uses and capture some of the gains. Gains in development arise both from land use planning decisions and from the design of projects and their interface with a range of regeneration and other programmes.

The new urban context of growth management is replete with these possibilities. The fundamental problem for city housing systems is the growing scale of scarcity economic rents passing to passive landowners and existing property owners. Scarcity rents are, by definition, supernormal economic profits that arise when rising prices induce no or little market supply response. Reducing them, by taxation or regulation, does not curtail economic activity or productivity. Governments are faced with rising numbers of lower income households unable to afford housing costs embodying these scarcity rents. Policies can either chase the affordability problem with increased government spending, usually based on tax revenues on labour incomes that do have negative growth effects, or they may choose to tax rising land and property values. In the absence of tax arrangements they can also capture gains through regulatory, planning and pricing devices, Dwelly and Cowans (2006).

In the decade ahead, in the likely absence of tax changes on land and housing, the ways in which inclusionary planning arrangements can be used to redistribute scarcity rents from landowners to poorer households will become a crucial element of national and local housing policies. So too will the capacity of cities and governments to run land development and master planning vehicles to leverage housing and other policy gains in the growth management process. In the way that 'private finance' became the mantra of much policy change in the 1990's, 'leveraging development gains' will now become a central part of housing policy.

Family and Household Wealth

There have been new pressures to expand concerns about affordability from renters with low permanent income to groups with better long-term income prospects, such as younger homeowners, or potential owners, at the early phases of the life cycle or to 'key workers'. Most of these schemes are badly designed and ignore the displacement effects on poorer households. More attention in policy thinking should be given to the ways in which family wealth, often based on parental housing gains, is passed across generations. It may be that the rising public costs of longer periods of old age will induce governments to find ways to encourage older owners to use their past housing gains to pay for old age, through reverse mortgages. Larger inheritances, driven by rising housing values, now often flow past peak housing consumption parents to grandchildren in market entry stages. There may be ways for government to encourage grandparent to make early transfer of equity for housing entry purposes. Put crudely, why should the declining proportion of workers in OECD economies, in the future, pay the housing entry costs of those who will shortly receive inheritances based on housing assets? These are difficult social and family issues but a well targeted housing policy for the emerging times will have to face them.

Demand and Tax Changes

Taxes on land value gains could have a supply side role but are less likely to emerge than regulatory approaches. More generally, the last decade has illustrated well the effects of the distorted tax treatment of, especially owner-occupied, housing in most of the OECD economies, Muellbauer (2005). Demand surges pushing on inelastic supply systems trigger price changes, but the absence of taxation of the consequent capital gains ands higher imputed incomes from housing ownership then reinforces demands for housing. It is notable that the European systems that have been closer to neutrality in tax treatment across tenures, such as Switzerland and Germany, have been less affected by the boom of the last decade. That said, it is clear, even in those countries where housing is taken seriously and the issues are technically understood, that governments are not prepared to address the issue of capital gains taxes on housing. There are simply too many households who see house price rises as an unambiguous gain (in much the way that pervasive inflationary wage gains in the early 1970's were widespread and damaging to long term growth) and political fear precludes good economic policy. As mortgage deregulation has largely removed finance constraints on demand it is likely that the policy structures for housing demand will not change significantly in the immediate years ahead and will, perhaps five year ahead, reinforce the next boom too.

Rethinking Rental Markets

The changes of the last decade have meant lower and middle-income households spending longer periods in rental housing, and this applies to potential, eventual homebuyers and immigrants. More and more of these households are being housed in the buy-to-let sector. Governments need to reassess whether the frameworks for household security are adequate to these tasks and whether the amateur investor sector has the stability and efficiency characteristics that will serve nations well.

Remaking Social Rental

Stocks of private rental housing for poorer households have been reducing in many metropolitan areas, whilst more households have faced stagnant incomes in the poorest quintile of the income distribution. In many countries the non-market rental sector has been in steady decline as a sector. In the UK there have been a vigorous debate about the need for a non-market sector. There is growing agreement that a sector of non-market provision will remain significant, and indeed be an important base for community capture of the gains from urban development, Hills (2007), Maclennan (2007). The debates are not about whether to help social housing provision but about how it should be provided and by whom.

Re-Connecting Tenures

The sections above have pointed to changing patterns of tenure advantage and dynamics. The growing gap between the housing costs and incomes of owners and renters, the sustained detachment between ownership prices and market rents for example, means that the ways in which households move through tenures over time have changed. That is the boom of the last decade has shifted the operational structure of housing markets. This is a critical issue in policy design, not least where policy has wider asset-based approaches to welfare provision in mind. Most obviously, if social and economic policy is to be based on assumptions about how ‘income classes’ are likely to accumulate wealth over time, the disconnecting flows from renting to owning will confound such expectations. Households are allocated social housing at below market rents because they are poor and, for some, in the hope that better housing will enhance their capabilities and, in time, incomes. But in globalised cities social tenants see house prices rise as incomes remain flat (the globalisation consequences for their lives). Then the state can be said to be leading poorer households into permanent wealth disadvantage. Ways to share housing and land asset gains with social tenants must become a more considered part of housing policies to raise social mobility and prevent permanently reinforcing separated trajectories for the wealth for rich and poor.

5. Last Words

Housing systems will continue to change and there will be unfolding demands for policy frameworks and evidence. It is unlikely that governments that have de-emphasised housing policies will continue to do so as the wider, systemic effects of poorly configured systems become more apparent. When the desire to change comes housing policy thinkers will have to provide a new systems understanding and not old evidence for older policy fashions. Low income housing issues and housing market instability are important issues that will not fade away but they have to be understood, and changed, in the context of more widely conceived housing systems and policy frameworks.

References

Ahearne, Alan G., John Ammer, Brian M. Doyle, Linda S. Kole, and Robert F. Martin (2005). "House Prices and Monetary Policy: A Cross-Country Study," International Finance Discussion Papers 841 (Washington: Board of Governors of the Federal Reserve System, September).

Ayuso, J, R Blanco and F Restoy (2006): "House prices and real interest rates in Spain", paper presented at the BIS Autumn Economists' Meeting, Basel.

Alexander, Ludwig and Torsten, Loft (2005) The Relationship between Stock Prices, House prices and consumption in the OECD Countries. Berkeley Electronic Press Vol 4 (1)

Aron, J and Muellbauer, J. (2006) "Housing Wealth, Credit Conditions and Consumption," unpublished paper.

Balazs, E. and Dubravko, M. (2007) Determinants of House Prices in Central and Eastern Europe BIS working Paper 236 Basel Switzerland

Barker, K (2004) Review of Housing Supply, London: The Treasury, The Stationery Office.

Carroll, C., M. Otsuka, and J. Slacalek (2006). "How Large is the Housing Wealth Effect? A New Approach," NBER Working Paper No. 12746 (Cambridge, Mass.: National Bureau of Economic Research, December).

Carter, Tom, Polevychok, Cheryl (2004) "Housing is Good Social Policy" (Ottawa: Canadian Policy Research Networks), December.

Case, K.E., and R.J. Shiller (2003). "Is There a Bubble in the Housing Market?" Brookings Papers on Economic Activity, vol. 2, pp. 299-342.

Case, Karl E., Quigley, John M., and Shiller, Robert J., (2005) "Comparing Wealth Effects: The Stock Market versus the housing Market," Advances in Macroeconomics, Vol. 5, Issue 1.

Case, Karl., Quigley, John.M., and Shiller, Robert, J. (2003) Home-buyers, Housing and the Macroeconomy Paper presented to the Reserve Bank of Australia Conference on Asset Prices and Monetary Policy

Catte, Pietro, Girouard, Nathalie, Price, Robert and Andre, Christophe (2004) Housing Markets, Wealth and the Business Cycle Economics Department Working Papers No 394 OECD Paris

Debelle, G. (2004) Housing Debt and the Macroeconomy. BIS Quarterly Review, March pp 50-64

Del Negro, Marco and Otrok, Christopher (2005) Monetary Policy and the House Price Boom across the U.S. States Federal Reserve Bank of Atlanta Working Paper 2005-24

Demographia (2007) International Housing Affordability Survey: Ratings for Major Urban Markets.

Dvornak, N., and M. Kohler (2003). “Housing Wealth, Stock Market Wealth and Consumption: A Panel Analysis for Australia,” RBA Research Discussion Papers No.RDP2003-07 Sydney: Reserve Bank of Australia.

Dynan, K.E and Kohn, D.L (2007) The Rise in U.S. Household Indebtedness: Causes and Consequences Finance and Economics Discussion Series 2007-37 Federal Reserve Board, Washington, D.C.

Dwelly, T and Cowans, J (2006) Rethinking Social Housing The Smith Institute London

Girouard, Nathalie., Kennedy, Mike., van en Noord, Paul and Andre, Christophe.(2006) Recent House Price Developments: The Role of Fundamentals. Economics Department Working Papers no. 475

Jackson, Andrew (2004) Home Truths: Why the Housing System Matters to all Canadians Ottawa: Canadian Housing and Renewal Association and Canadian Centre for Policy Alternatives.

Government of New Zealand (2008) Final Report of the House Prices Unit: House Price Increases and Housing in New Zealand

Greenspan, A. and Kennedy, J. (2007) Sources and Uses of Equity Extracted from Homes Finance and Economics Discussion Series 2007-20 Federal Reserve Board, Washington, D.C.

Haibin, Zhu (2006) The Structure of Housing Finance Markets and House Prices in Asia BIS Quarterly Review (December).

Himmelberg, C., C. Mayer, and T. Sinai (2005). “Assessing High House Prices: Bubbles, Fundamentals and Misperceptions,” Journal of Economic Perspectives, vol. 19, pp. 67-92.

Hills, J.(2007) The Future for Social Housing in England. CASE Discussion Paper LSE London

Klyuev, Vladimir and Mills, Paul (2006) Is Housing Wealth and ATM? IMF Working Paper 061/162 IMF Publication Services Washington

Luffman, Jacqueline (2006) Measuring Housing Affordability. Perspectives, November. Statistics Canada, Ottawa.

Maclennan, Duncan (1995). A Competitive UK Economy: Issues for Housing Policies. Joseph Rowntree Foundation, York.

Maclennan, Duncan and Pryce Gwylim (1996) Global Economic Change, Labour Market Adjustment and the Challenges for European Housing Policies. Urban Studies vol 33, no 10: 1849-1865.

Maclennan, Duncan (2005) Housing Policies: New Times, New Foundations. CPRN, Ottawa and Joseph Rowntree Foundation, York, England.

Maclennan, Duncan (2007) Housing, Wealth and the Economy: So Far, So Good. ESRC/ Rowntree International Symposium on Housing Wealth, University of Durham, England.

Maclennan, Duncan (2008) Housing for the Toronto Economy Toronto Community Foundation Toronto

Mayo, S (1995) The Housing Indicators Program New Directions for Program Evaluation, vol 67, pp119-131.

Mishkin, F.S. (2007) Housing and the Monetary Transmission Mechanism Finance and Economics Discussion Series 2007-40 Federal Reserve Board, Washington, D.C.

Muellbauer, J (2005) 'Property taxation and the economy after the Barker Review', Economic Journal, vol 115, pp 99-117.

OECD (2006) Competitive Cities in the Global Economy. OECD, Paris.

Ong, S E (2005): "Mortgage markets in Asia", presented at the European Real Estate Society Conference 2005, Dublin.

Poterba, J (1984) "Tax Subsidies to Owner-Occupied Housing: An Asset-Market Approach," Quarterly Journal of Economics, vol. 99 (November), pp. 729-75.

Robertson, R (2006). "Thinking About the Big Drop in Australian Housing Affordability" (Sydney: Macquarie Bank, December).

Suttor, Gregg (2007).Growth Management and Affordable Housing; Exploring the Links in Greater Toronto. Canadian Housing Vol 23.1

Tsatsaronis, K., and H. Zhu (2004) "What Drives House Price Dynamics: Cross-Country Evidence," BIS Quarterly Review (March), pp. 65-78.

Table 1. Price Changes, Cycles and Rental Shares

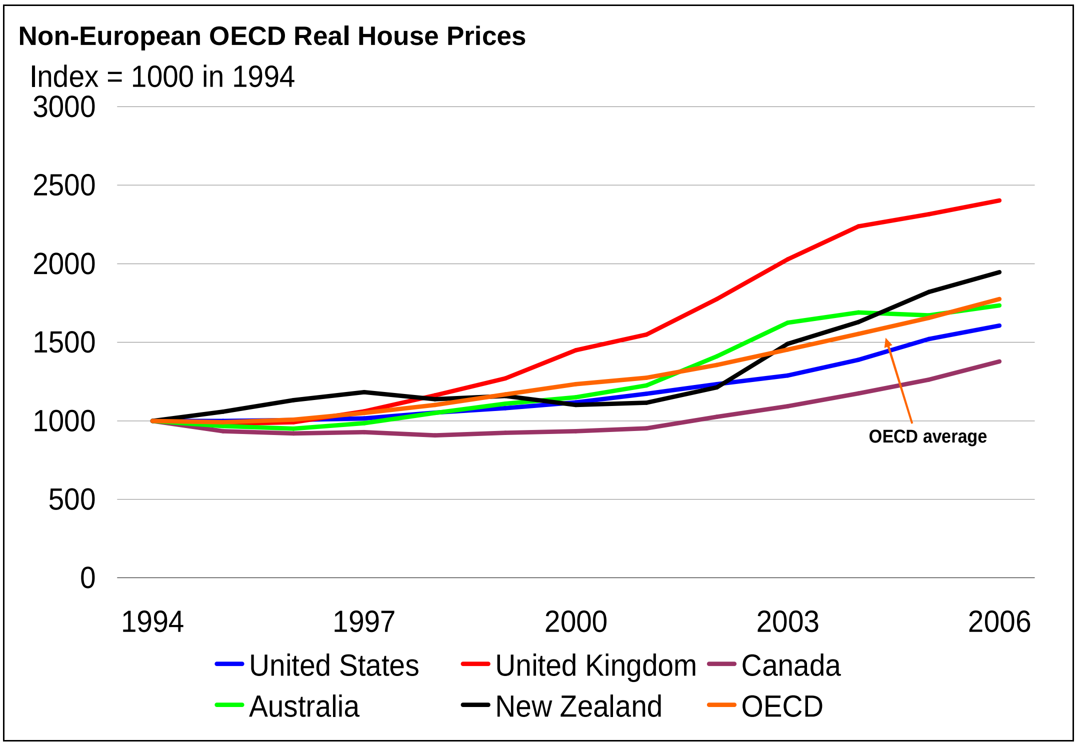
Country	Share of rental sector, % (various dates mid-late 90s)	No. of House Price Downturns 1970-2005	No. of House Price Downturns >15%	Annual Real House Price Changes 1995-2004, %
Germany	58	5	2	-2
Sweden	57	5	4	6
Netherlands	47	2	2	7
France	39	4	4	4
Canada	36	8	3	3
USA	34	6	1	3
Great Britain	32	6	5	10
Australia	26	11	3	7
New Zealand	22	8	5	5
Ireland	19	4	3	13

Table 2: International Rates of Home Ownership

	1960-1970	**1980-1990**	**2000-2003**
NZ	68	72	67
Australia	65	69	71
Canada	53	61	67
France	43	53	57
Germany	33	39	40
Ireland	66	78	80
UK	36	63	68
USA	64	66	68

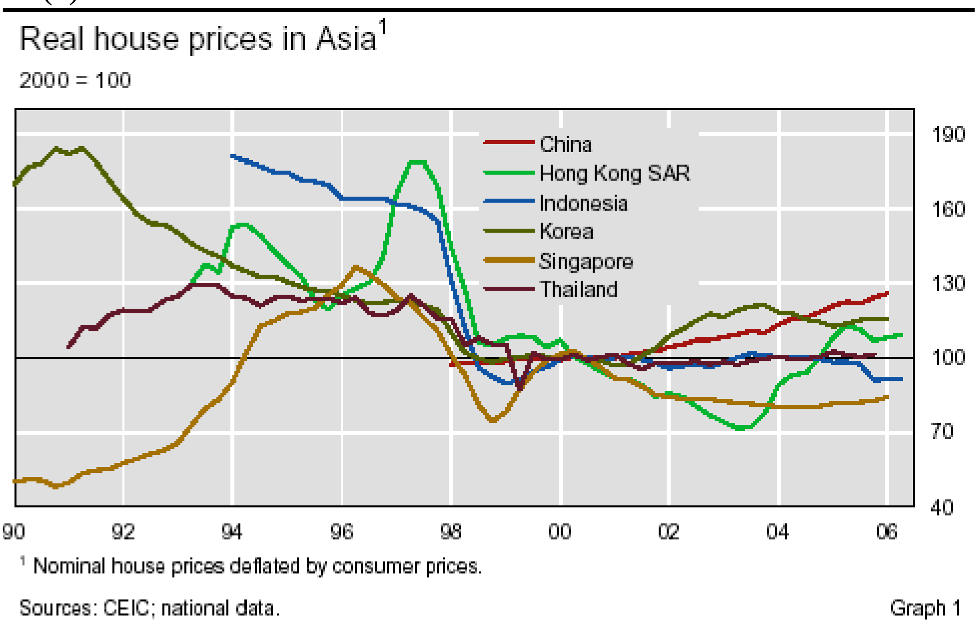
Figure 1(a) and (b). Recent House Price Changes in Non-European Systems (UK excepted).

Figure 1(a)



Source: Government of New Zealand,(2007)

Figure 1(b)



Source: Haibhin, Z. (2007)