

Housing Supply, Affordability and Land Use Regulation and Planning: Lessons From the United Kingdom

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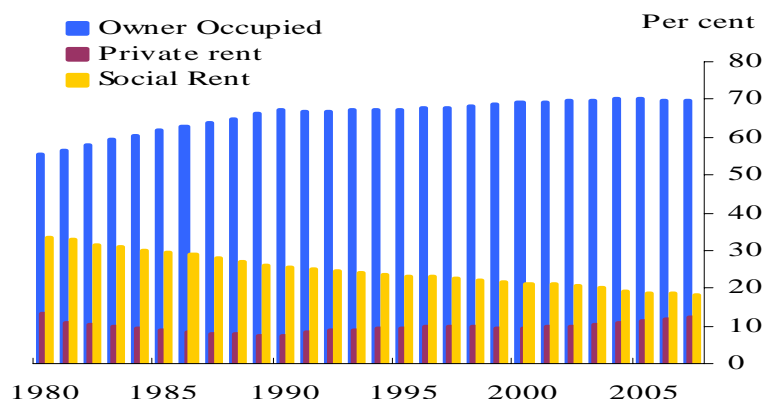
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It is a great pleasure and privilege to have been invited to talk here about the work on housing supply and planning which has recently been going ahead in the United Kingdom. I am sharply aware that the scale of the issues which we confront there is in many respects completely dwarfed by the problems which you face in India. Nevertheless, as I have prepared for these lectures by learning just a little about how your thinking is developing, there are some similarities of among the issue we face, and I am certainly taking back some points from India to apply to the U.K.

In this talk, I will describe the background to the recent heightened policy concern in the U.K. around issues of housing supply and planning, briefly discuss the history of planning policy in England and outline the main conclusions of the work I carried out. I will then talk about some key principles in planning policy, touch on some questions about market sector housing, the environment and taxation, and say a little about subsidised housing in the U.K.

Housing supply and links with the wider economy

My own involvement with housing in the U.K. began in 2003 when I was asked by the Government to review why U.K. housebuilding has been growing so slowly¹, in the face of sharply rising house prices. One reason for concern about this was that the Government believed that the sluggish response of supply was contributing to rising house prices and that this would tend to make the housing market itself volatile (by encouraging expectations of yet higher house prices based on extrapolating present trends). The U.K. has quite a high rate of owner-occupation, around 70% of households, about 60% of whom have a mortgage, and at that time the majority of these mortgages were financed using short-term interest rates. So it was suggested that there was a line of causation from weak housing supply, to volatile house prices, to volatile household spending driven by wealth effects as house prices rose and fell, to a volatile economy more difficult for the Bank of England to keep on an even keel.²



Source: Department of Communities and Local Government

¹ Although the review was for the U.K. much data and analysis is in fact based on England, as Scotland, Wales and Northern Ireland have separate planning systems. So many of the detailed references in this talk will be to data for England

² HM Treasury (2003)

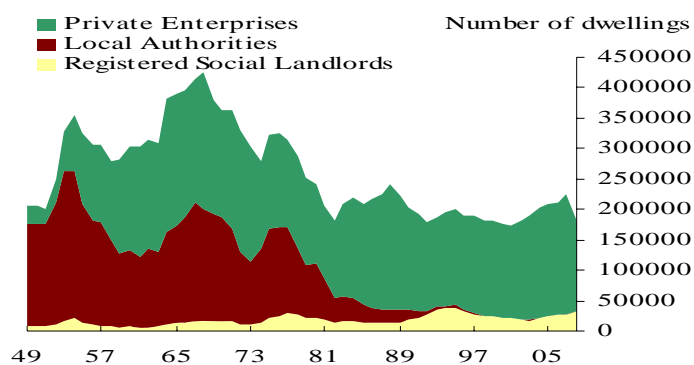
Although I accepted these suggestions at the time – there are at least two places where, on reflection, it seems possible to challenge this causal chain. Firstly, in the U.K. new supply generally fluctuates at around 1% of the existing stock of dwellings. While the shortfall in supply will affect house price changes relative to incomes, even if this rate of new supply were only half of the ‘correct’ rate, it seems unlikely that this would be sufficient to create the large rise in house prices experienced in the U.K. in the mid-2000s. Indeed, counterexamples can be found in Spain and Ireland, where rapid growth in supply over broadly the same period was not sufficient to prevent a large rise in house price to income ratios; in both cases the booms in residential prices and construction have subsequently turned into severe busts. Secondly, given the delays inherent in bringing forward large-scale building projects, it does not seem likely that supply could ever respond rapidly enough to take the heat out of a rapidly-rising market (although on the downside the ability to reduce the rate of new supply quickly is much greater).

This doesn’t mean there is *no* connection between housing supply, house prices and economic volatility. Even though in each year the shortfall may be small, an expectation that the rate of new supply is likely to remain inadequate in future years would provide a strong reason for prices to rise today. But this relationship between house prices and supply would tend to be apparent over long periods, driving the house price trend. Large cyclical movements are more usually the result of changes in the price and availability of credit for house purchase (and this was the key factor in Ireland and Spain). It is an illusion to think that cheaper financing can improve access to housing, if supply is not allowed to respond.

However, in a housing system dominated by the market such as the U.K., house price volatility does tend to have damaging effects. Periods of rapidly rising house prices driven by unrealistic expectations of further rises, followed by house price busts, will inevitably leave many households either in the position of inability to move because of negative equity, or repossessed and forced to move to less suitable accommodation. While this is painful for individuals, the past two years has also made it clear that in countries with high mortgage debt (mortgage debt is equivalent to around 120% of U.K. annual GDP), a downturn linked with a house (and also commercial property) price collapse can bring problems for the financial institutions and therefore the wider economy.

Beyond volatility, there are other good reasons to worry about the functioning of the housing market. Undersupply leads to both social and economic ill-effects – although I am sharply aware that the problems we face in England are insignificant compared with the acute issues here in India. The social issues are easy to illustrate. Children living in overcrowded, or poor housing are four times as likely to have mental problems, and twice as likely to leave school without formal qualifications, or suffer bad health generally. 2.2 million households spend more than half their income on housing costs, and have to cut back on other vital items.

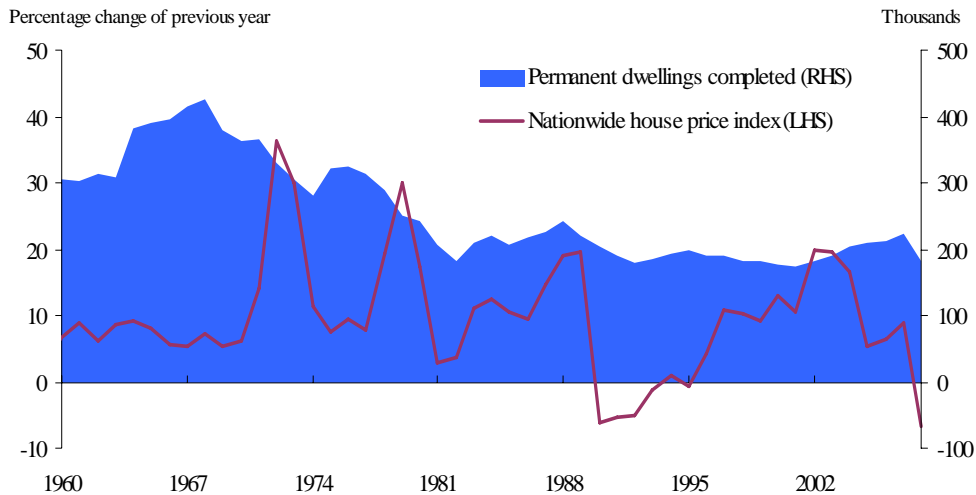
The economic ones are less obvious, but are also compelling. Apart from the impact of life chances from poor health and education, increased difficulty in forming a separate household for the young is likely to limit work opportunities, particularly for those in the group just above the level that would qualify for social housing. 2.9 million young people, between the ages of 20 and 34, still live with their parents – here this might seem very usual, but in the U.K. until recently this was not the usual pattern. And there is an overall loss of welfare, if a good is priced systematically at a level which is driven by an artificial constraint on supply, rather than resulting from unfettered market interaction.



Source: Department of Communities and Local Government (UK)

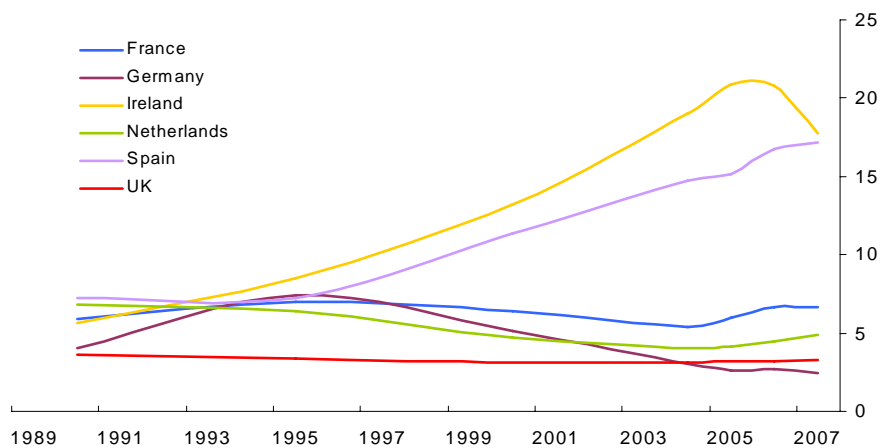
The housing supply issue

The chart shows how new housing supply in the U.K. was strong in the post-war period, and then broadly flattened out after around 1980 when the new supply of local authority subsidised housing declined sharply. More recently, the bulk of social housing supply has come from private organisations, registered social landlords, who develop with the aid of government grants supplemented by finance from the capital markets. Some caution is need with regard to this picture, as it overstates the building rates of the past since the 1950s and 1960s also saw considerable demolition of old housing stock. However, it raises the question of why the rate of new dwellings didn't rise as prices picked up in the recent boom, even to the extent of the rise in the late 1980s, particularly as population data suggests that, unconstrained, the number of households would have been accelerating in this later period. This chart shows how house price rises compare to completions.



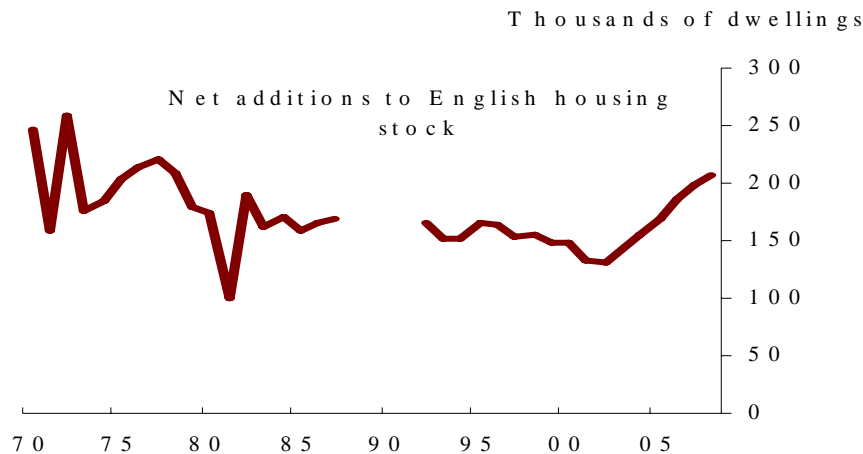
Source: Department of Communities and Local Government and Nationwide (UK)

Another set of data which suggests that there might be something odd about U.K. supply is the comparison with other European Union countries. This chart suggests that since 1990, the U.K. has had relatively slow growth of housing per head of population, relative to our EU neighbours. It is certainly arguable that the rates of build in Spain and Ireland were disproportionate, but harder to suggest that about France and Germany, whose housing markets are relatively stable.



Source: Calculated from housing statistics in the European Union, 2006 and Eurostruct data, 2007.

The broad conclusion of the housing supply review was that, with unconstrained household formation in England running at around 180,000 each year, the rate of new supply, then averaging less than 140,000 each year, was clearly inadequate. This chart shows how, following the review, net additions to the housing stock (which accounts for demolitions and conversions) rose quite sharply up to around 200,000 each year³. Unfortunately the financial crisis has more recently caused the rate of new supply to fall back, as constraints on mortgage borrowing have had a large impact on demand. The financial crisis has hit the U.K., where output has declined by around 6%, far harder than it has India. In 2009, new supply on this basis dropped back to around 160,000.



Source: Department of Communities and Local Government (some data unavailable)

But the estimate for population growth has since risen sharply. The National Housing and Planning Advice Unit, set up as part of the response to the review, now estimates that, on the basis of projections for unconstrained household formation in the U.K., between 238,000 and 290,000 new dwellings are needed each year. And even this ignores the pressure for more space per person which is driven by rising real incomes. So if new supply does not recover rapidly, clearly there is the potential for considerable strain in the housing market.

Broad conclusions

The housing supply review was as thorough as possible during the limited time period allocated – and I can frankly admit that at the start I completely underrated the complexity of the question. But the main conclusions were clear, and it is pleasing that almost six years after they were published there seems little reason to rethink their broad thrust. These were:

- House prices in the U.K. were unusually volatile, and some of this volatility was due to relatively inelastic supply, with little link from prices to a supply response. This echoes findings comparing different cities in the U.S.
- That planning policy and practice in England was too separated from any interest in developments in the market – planners did not look at price signals to assess demand in different areas. One once asked me: ‘why would we want to look at the market?’ Higher prices were taken to indicate that planners were creating value, not constraining demand. Of course, that can sometimes be true – so any analysis of prices needs to be sophisticated. An example is that there was a preference by planners prior to the crisis to give permissions for flats, even though their relative prices were falling – too many new flats were supplied and their prices fell most sharply when the market overall declined. This failure was also found in looking at commercial developments for the second review, where the conclusion was that insufficient weight was put on economic benefits.
- Too much energy was expended on arguing about housing numbers and their desirable distribution. We need better, simpler information and advice.

³ Barker (2004)

- Planning processes were too long and too costly for the applicant – despite further attempts at reform since the review this remains the case.
- The incentives in the market were incorrect. For present homeowners, for local authorities and for developers, the incentives were stacked against increasing development. It was not surprising that the young and those with lower incomes were effectively priced out of the market.
- That the supply of new social housing was inadequate to meet the newly-arising demands – waiting lists for subsidised housing in England were rising then, and are still rising now.
- New policies and regulations were introduced without sufficient thought to their costs and benefits.

English planning policy – a brief history

How did planning policy become so divided from the needs of both households and businesses? The basic structure of planning was set in 1947, with a parliamentary act which effectively nationalised development rights and introduced a plan-led system for development control. Despite many subsequent modifications, particularly to the way in which, and by whom, plans are developed, these elements remain at the heart of planning policy at the start of the 21st century. It is perhaps surprising that under Mrs Thatcher's government, when deregulation occurred in many industries, in the financial sector and in the labour market, there was so little deregulation in this area. Indeed, the primacy of the plan as a factor in planning decisions was actually strengthened, and a system of planning obligations was introduced (which meant that planning authorities could agree charges for infrastructure with developers, as a condition for granting the permission).

Bureaucracy has meant that under a system which is supposedly 'plan-led' many authorities do not have up-to-date plans, and subsequent amendments to the system of producing plans, often intended to remedy this situation, have nearly always ended up slowing it down further. In recent years, and I have to plead guilty to adding to this myself, the pace of change and reform in planning has increased, and has probably not helped to provide the stable framework which developers might prefer.

So why was planning not part of deregulation, and why it has been allowed to become such a complex system, costly in terms not just of the sheer bureaucratic burden now surrounding development, but also in terms of delay and in some cases developments which simply don't go ahead? The answer to the first part may well be politics. In the period of Mrs Thatcher's premiership, the extension of homeownership was one of the government's policy objectives, and the unpopularity of extra development with the majority of homeowners may have been a factor.

The response to the second relates to the nature of the process of passing legislation. In the House of Lords, the Upper House, the influence of both landowners, and environmental lobby groups has had considerable sway. I would like to be clear that I am not opposed to environmentalism, but in England there are groups whose views are anti-development as much as pro-environment. Consequently, in order to get planning legislation passed, governments have had to make concessions which have often complicated and to some extent frustrated the overall intention.

What are the objectives of housing policy?

The Government's officially stated policy is: 'we want everyone to have access to a decent home at a price they can afford, in a place where they want to live and work.'⁴ Here in India, this must sound hugely unrealistic. But even in England it seems far from clear that this is achievable – even once you have discounted the fact that not everyone wants to live and work in the same place (and even if they did, London, which benefits from a strong centre with a high job density, could not possibly provide sufficient dwellings near to these jobs). Most of us strike compromises around affordability, distance to work (often of course for both people in a couple) and desirability of place.

But the inherent tensions in our policies run much more deeply than that. The U.K. has a tax system which favours home ownership. There is no tax on the flow of services from living in one's home, nor is this compensated for by any payment of capital gains tax on the profits made from it. These factors give larger subsidies to the better-off. A home occupied by a spouse is discounted when assessing the financial contribution to be made towards health care for the elderly, encouraging older people to remain in larger homes. This all seems perverse in a country where we have

⁴ Department for Communities and Local Government (2007)

overcrowding for the less well-off, and where the thrust of policy is often about ‘using land efficiently’ which generally means higher density places and more open green fields. (Whether this is ‘efficient’ in the sense an economist would use the word is rather less clear).

Further, despite strong arguments from central Government, it has been hard to convince the regions to plan for the housing supply numbers which the national advice unit estimates is needed. So the plans which we do have are often inadequate from the start, and Government has met with considerable political resistance and legal challenge in its attempt to direct the regions to plan for higher numbers. Since net inward migration is a considerable part of the upward rise in population, accounting for around 40% of projected household growth, there is some discussion about limiting it further. But it isn’t possible to limit inward migration from the rest of the recently-enlarged European Union, while limiting migration from outside the EU raises uncomfortable issues around race and discrimination.

Principles for planning policy

At the start of the review I undertook on planning, an open question was whether to start with a blank canvas, and think afresh about how planning policy would be tackled from first principles. But this would have meant been stripping away much of the present panoply in a short period, and so represented a theoretical ideal, and not a practical proposition. Planning may be an activity where policy is set by central government, but it is also about local decisions where local politicians will want to exercise their discretion in the light of local opinion. So in order to change what happens at this level, we need to change not just the system, but also public opinion and the factors which influence decision-takers, including finance for their local area.

Inevitably, many planning decisions will not be easy in the sense that a definitive answer can be obtained by taking the local plan in one hand and government planning policy in the other. Most applications will be in line with some policies, and run counter to others. So central diktats will always struggle to drive decisions that run counter to local culture and indeed local wishes. I concluded from this that efforts at planning reform need to proceed cautiously. It is right to have in mind a strategy for the direction of travel, but to get to a full reform in one step is highly ambitious. In consequence, I have been pleased to see that in England reforms have continued to come forward beyond the response to the initial review, and generally these have followed this direction of travel.

Were I to be designing a planning system from first principles, these are the main points I would seek to include:

- Flexibility

The concept of flexibility perhaps sits oddly with that of planning. But I believe that working out how to incorporate flexibility is really vital. Of course it is important to have a plan (in the same way that a firm, or any other organisation, will have a long-term strategy). However, it is also important to recognise that over the time period of the plan economic and population pressures are inevitably going to change and the plan will need to respond. This can of course lead to issues for developers, who often argue that certainty about what can be developed is important. Yet developers can also be the first to say that an existing plan is no longer workable. And what matters is the right outcome for the place, not carrying out a plan. Success should not be judged simply in terms of whether a plan is carried out, but rather in terms of the ultimate outcomes – better employment, better housing, better public services – that matter to people. Otherwise planning can become a self-referential, and indeed self-congratulatory, activity.

However, the system of plans and public consultation in England makes flexibility difficult to achieve. Our regional and local plans are agreed after painful processes (recently made more complicated) in which efforts are made to interest the public. This means that changes provoke another round of consultation, and can take quite a time to put into place. The ways in which the review suggested this problem was tackled included making the plans more contingent, so that some alternatives could be included in the first place, and making the plans themselves simpler and more strategic, so that flexibility was more consistent with the plan itself. In any case, despite the weight placed on consultation, it remains the case that it is specific development proposals that spark public interest (and, all too often, opposition particularly from those who will lose out, frequently the better-off). As yet, this is an unresolved issue.

- Right spatial level

In order for planning to maintain integrity and command respect, it is generally best done at a reasonably local level. But not all decisions can be taken locally, and the local context inevitably sits within a set of regional decisions about where infrastructure is located, and indeed national plans about major infrastructure and concerns over regional income distribution. The best way to determine what should be done at each level is to consider whether or not there are spillovers. So decisions about the detail of design, or the exact site of new residential development are only of interest to the locality, and should be left at that level. At the other extreme, large energy installations, airports and ports are all of national significance, and the national interest would need to have a strong role.

This seems straightforward, but becomes more contentious with projects which affect the relative position of regions. Decisions on the position of ports, and indeed on the line of the new high-speed rail line proposed, have locally negative impacts on the environment, but may have positive impacts on the economy of the region. They may also (since England is relatively small) have major effects on our economic geography.

Planning affects economic geography, and arguably productivity, in other ways. In the 1980s and 1990s, manufacturing production fell sharply as a share of overall output, partly reflecting a move of production to Asia. In England this resulted in a number of cities in the North and Midlands becoming 'hollowed out' as old established production, often near the centre of the city closed, leaving areas of dereliction and poor quality housing. Meanwhile the better off moved to newly-built suburbs or sought to move to a more prosperous region.

However, in the more prosperous parts of England around London, several towns have found themselves under the opposite pressure of rapid in-migration. The university and high-tech industry town of Cambridge is the most-frequently cited example of this, and a recent paper⁵ looking at spatial inefficiencies argues that the average size of cities need to rise in response to rising skill levels, dual income households and service-sector growth if they are to be able to operate at the most productive level. Further, they argue that some cities, whose economic strength is now diminished, ought to be allowed to decline.

These views are subject to strong challenge, particularly with regard to the issue of managing decline as the less successful and elderly will tend to be those left behind in the northern cities. But it is rather harder to challenge the arguments around the importance of sufficient size of city to maximise productivity growth. Places full of excitement and technical innovation in the past seem more often to have occurred in unplanned and slightly chaotic environments. Clusters of industry, often important sources of growth, are not easy to plan for, and the reasons they emerge can appear quite random. As Sir Peter Hall comments, in his epic and fascinating book about the history of cities: 'the generation of successful innovative milieux still presents a considerable degree of mystery.'⁶

However, in deciding at what level to put different types of decision, it is vital to ensure that the finance is available to support the decisions taken at different levels. In England this has not always worked well. At the regional level, there are demanding objectives for the regional development agencies, but in order to achieve these much of the funding has to be bid for from central government according to their priorities for different sectors. This has meant less differentiation between regional strategies than might have been expected, and may have made it harder to move towards the levelling-up of productivity that was intended.

At the more local level, the planning authorities also derive much of their funding from central government, in a way which only recognises additional population with a lag. This is an added disincentive to allow rapid development to take place. Both of these illustrate a tension in England between empowering subsidiary bodies to develop strategy, but a reluctance to trust them with the freedom over the funding to carry their purposes out.

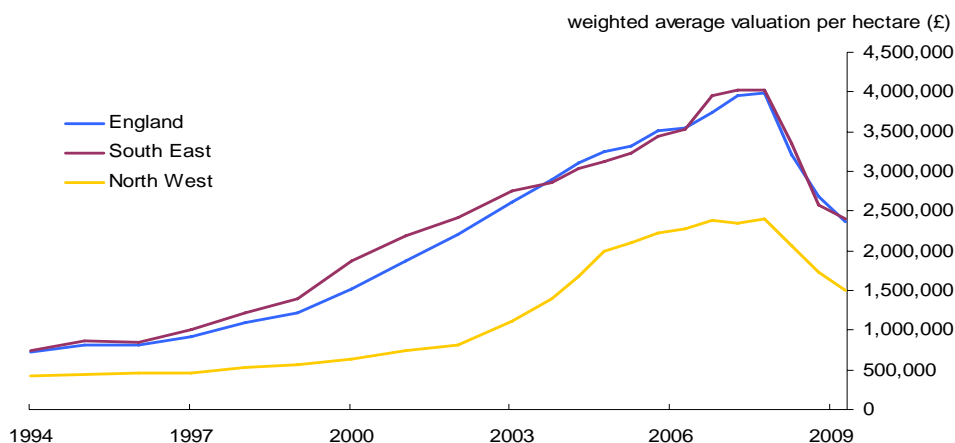
- Costs and benefits of policy

In developing a coherent and robust policy framework for development, there are evident dangers which derive from the fact that where planning regulation brings costs, these are generally hidden from the public. Few really understand

⁵ Leunig and Overman (2008)

⁶ Hall (1998)

the link between planning restrictions and high land prices. In England areas around some cities are protected from development by what is known as the ‘green belt.’ This in fact covers almost 13% of England’s land area. To gain permission to carry out developments in this area requires a high standard of proof of necessity and lack of alternatives. Present planning policy states ‘the fundamental aim of Green Belt policy is to prevent urban sprawl by keeping land permanently open’. And undoubtedly there have been many positive results from this policy – in particular it has been used to keep towns separate, and to encourage reasonable density of development within existing urban areas which brings benefits around the ease of providing services and the reduction of the need to travel.



Source: Department of Communities and Local Government.

But there is a wealth of argument that these restrictions in England have large effects on prices. The amenity value conferred on housing near to green belts is very significant, and generally accrues to the better-off as they can afford these houses.⁷ The same authors argue that land-use restrictions around Reading, a large town near London, produced net welfare costs, by pushing up house values, equivalent to an extra 4% income tax rate. Similarly, work on the regulatory cost of land-use restrictions on office space in U.K. cities suggested a regulatory ‘tax’ equivalent to three or more times construction costs in some locations, and rarely, in large cities, less than twice construction costs.⁸ The costs of imposing higher or lower densities, or different urban forms, than those that would result from the market are all too often paid by the poor. If we want to distort the market, for environmental reasons, or because there are concerns about congestion in cities, then this cost must be factored into the decision. Either the decision is then revised (if the cost is found to be high) or policymakers should think about compensating those who lose out. Sadly this is rarely done.

A different issue is that the lack of transparency about costs encourages the use of planning policy and the related building regulations as a means to tackle other objectives, even when this may not be the most efficient way to do it. An example is:

- The use of planning to try to prevent excess travel. Policies on the minimum density of residential building, and on limitations of building shopping centres out of town, both have the aim of the reducing travel and its associated CO2 emissions. However, there is insufficient analysis of either whether this is actually likely to occur in any given example, nor very much analysis of whether planning policy is the most efficient way of achieving this goal, as opposed to higher taxes on vehicles, motor fuel or congestion; with the revenues used to fund better public transport.

The overriding point here is the need to ensure that there is much more transparency and awareness about different costs and benefits of well-meaning policies. Hidden costs are ultimately paid by all of us, and there are also frequently

⁷ Cheshire and Sheppard (2002)

⁸ Cheshire and Hilber (2006)

adverse unintended consequences – such as the limitation on out-of-town retail leading to a lack of effective retail competition in some locations.

- Land ownership

It was suggested by a colleague that, rather than writing 100 plus pages of housing supply review, I should simply have put on the first page – ‘it’s land supply’ and left it at that. The comments above covered issues around the effect of planning restrictions. But of course this links to the volatility of house prices and thus to volatile land prices. The chart indicates that land prices in England for residential development more or less quadrupled from 1995 to 2007, before falling back sharply in the financial crisis.

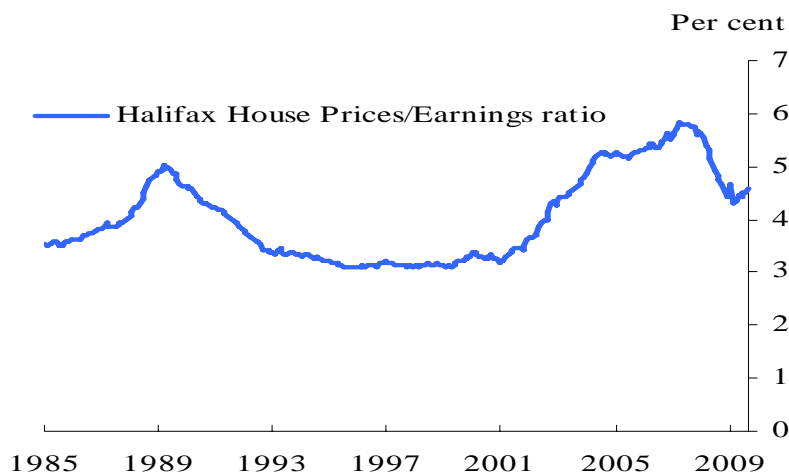
Discussions with planners and politicians often reveals suspicion of developers, who are thought inclined to delay building out permissions in order to benefit from rising prices. But of course this is a risky strategy. Much will have been invested typically in getting the permissions, and the value of planning obligations agreed. The more the market rises, the riskier this is likely to be. And there is good evidence that developers, once they start the process, wish to develop, unless conditions turn against them badly.

However, landowners (and landownership in England is not always transparent, partly as developers may have options on land) do have much more of an incentive to restrict supply. Some towns and cities have quite concentrated land ownership, or optioned land. And at present many landowners are hoping (perhaps unrealistically) that land prices will rise again and are reluctant to sell at what they perceive as low prices (even though, by a longer historical standard, these are quite high).

Solutions to this might be either rather stronger powers of compulsory purchase (although there would need to be a good overriding reason) or taxation of land, particularly within city boundaries. Neither seems politically feasible at present. Nevertheless – a failure to tackle the issue of getting land into the market in England over the next few years could be highly damaging. More use is presently being made of public land, but of course these land-holdings are not necessarily in the best place for development, so this is a second-best solution. And more generally, in some places it is easy to think of local councillors and landowners as being in at least implicit collusion to keep supply constrained, so that land profits rise and more infrastructure payments can be sought.

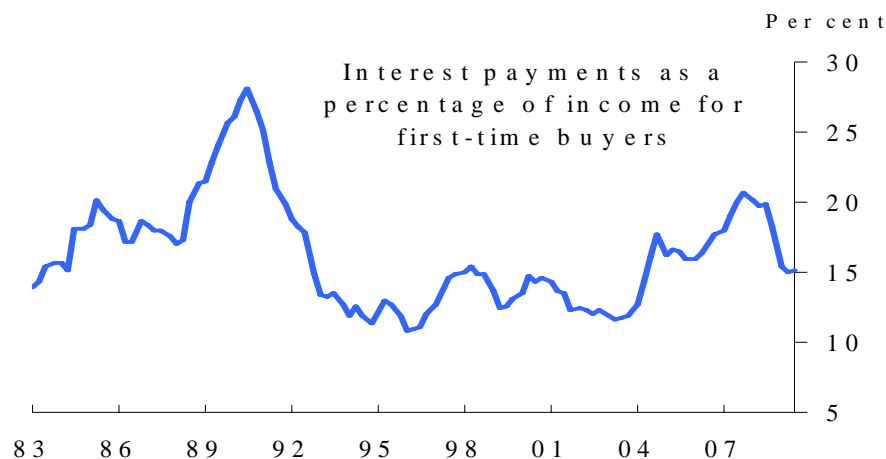
Why is housing unaffordable?

Turning to some general remarks about why, in England, housing has become unaffordable; and the role of taxation in the policy framework. It might be thought surprising that housing should become ‘unaffordable’ in a market housing system such as the U.K. – on the grounds that price is set by the balance of supply and demand, and if the prospective buyers can’t afford it, the price would be likely to fall until they could, or until it fell below the cost of construction. Of course, there are always those on low incomes who cannot afford to buy, but during the recent house price boom there was significant evidence of a rising number of households too well-off to qualify for social housing (of which there is inevitably a restricted supply) but unable to afford to buy.



Source: Halifax and Bank calculations

Simple measures of the house price/earnings ratio are sometimes used as in this chart to diagnose this problem. This would suggest much less affordability in recent years. But this is clearly inadequate.



Source: Council of Mortgage Lenders

The chart shows how interest payments for first-term buyers as a proportion of income tell a different story. So a major reason behind the rise in house prices was as part of a generalised rise in asset prices due to lower real interest rates during the period of the great stability (a time which already seems a long ago). The more recent fall in prices has reflected the tightening of credit conditions following the banking crisis, and once that is taken into account housing is now even less affordable for first-time buyers.

It seems plausible to argue that the emergence of this squeezed out middle group was a result of the period of undersupply. The government response has been to provide more subsidies for these households to buy. This is a reasonable solution, if it could be targeted on those disadvantaged by having less well-off parents, so they can neither receive help with a deposit today, nor can expect to receive an inheritance in the future. But it is impossible to target policy in this way, and so many young, single people are helped who might have been able to provide their own deposit if they remained a little longer in private renting. Further, because this is a demand side measure, at the margin it risks pushing prices up for others. As a solution, it tackles the symptoms, rather than getting at the root cause

The other reason why housing might have become less affordable, of course, would be if overall construction costs had risen relative to incomes. Here, of course, I am not referring to the simple cost of putting up the dwelling. These costs tend to rise sharply at the peak of construction cycles due to shortages of skilled labour and to some extent construction materials. But house prices themselves are set primarily in the second-hand market, and in general the impact of the rise and fall in the overall level of prices is passed through to the more dramatic movements in the level of land prices.

High house prices relative to the costs of construction clearly increase the opportunity for landowners and developers to make excess profits. To some extent policy can and should tackle this situation by ensuring planning policy drives an adequate rate of supply, but this is not achievable in the situation where the rise in prices is driven primarily by changes in credit conditions and speculation, as prices move for a time far above construction costs. Consequently, high house prices have encouraged a different government response, which is to seek the funding of subsidised housing and infrastructure as a condition of development. It also encourages more onerous and costly building regulation, such as the decision that all new supply should be zero carbon by 2016, where it may turn out that the last piece of carbon reduction to achieve this goal is unduly expensive. Both of these are worthwhile objectives – but when prices are temporarily high, it is easy to drive up the cost of construction, relative to incomes, by adding in these regulations. When the market weakens, much development then becomes unprofitable. Regulations need to be carefully thought through to ensure that the total costs of building do not become too high, so that developers pay for infrastructure, and then government has to subsidise house purchase.

At the height of the housing boom, it is estimated that planning authorities raised £3-4 billion a year (or about 0.25% of GDP) from planning obligations (contributions to the supply of subsidised housing and to infrastructure negotiated as conditions for granting planning permission). However, this system is not proving very responsive as the market weakens, so that where planning authorities have been reluctant to reduce these obligations, developments have been made unviable. In my original review, I proposed a taxation system of development which aimed at taxing the rise in land value which arises from the granting of planning permission. This is the kind of tax beloved of economists, since it would effectively be attempting to tax a windfall gain. But this turned out to be difficult to implement, not least because the scale of the windfall might well fluctuate during the course of the development. In addition, this form of tax is very vulnerable to political change – if a possible incoming political party can be persuaded to oppose it, then the tax will fail and landowners do nothing in the hope of selling out in better times.

A full discussion of the issues around development taxation is large enough to be the subject of another lecture. But the English experience here suggests to me the following conclusions:

- It may be preferable to shift the weight of taxation more towards commercial and residential development in use. This could be done on the basis of rentals, capital values or even the land value of the site. Land value taxation would have the benefit of encouraging land into use, and into more intensive use in more valuable locations. But valuations themselves are complex, so this might prove costly to assess and collect. This form of taxation would of course affect developers' profits by impacting capital values.
- In setting standards and looking for value out of development, it is also useful to think about what the costs of a new dwelling are, including all these standards and infrastructure payments. If the answer turns out to be that the effect of all this is to take house prices out of the reach of too many households, then Government faces a choice between: more funding for subsidised housing (and creating more need for subsidy by infrastructure charges seems curious); reducing the planning obligations or costs of regulation; or accepting the social costs of a number of households being priced out of the market.

In response to the Review, Government (after 18 months) produce a number of positive measures, and also engaged in an effort to 'sell' the basic ideas of the review. Planning authorities were asked to identify more available land supply, and more affordable housing was built. More work has been done on the details of planning processes, and of development control. But there is a risk that a change of Government could mean ground is lost here.

Subsidised housing

It is more usual in England to refer to affordable, rather than subsidised, housing. I prefer subsidised – in some sense every house bought or rented is affordable to the individual buyer or tenant. The main method of housing support used to be the provision of social rented housing, owned by local authorities and let at cheap rents. This has changed, mostly under Mrs Thatcher's government. Firstly, there was encouragement for local authorities to sell on stock to registered social landlords (RSLs) and these then became the recipients of housing grant to build new stock. The advantage of this was that they were also able to borrow development funding on the private market, away from the government's balance sheet.

The second change was that existing tenants were able to buy at discounted prices. This 'Right to Buy', combined with a cut in new development grants, has led to a large fall in the stock of social rented housing, down 25% since 1981. One consequence of this is that waiting lists for social housing has risen, and prospective tenants have to be in greater 'need' to qualify. So the mix of people has moved towards the unemployed and disadvantaged, away from the 'working poor' – leading to the emergence of estates where worklessness appears to be inherited.

A major aim of policy today is to turn around these areas, and to avoid building new areas of disadvantage by developing social housing alongside market housing. And the supply of new social housing has recently risen – but only to around 30,000 dwellings a year, whereas the need is estimated to be nearer to 50,000. However, we have not really found a way to ensure that social housing is an enabler for tenants, as in principle it ought to be. The alternative form of support – Housing Benefit to subsidise rents, has clear disadvantages here as often when people move into work they lose benefit and work is therefore not valuable. Yet social tenants, who are shielded from this to some extent, do no better in the labour market. And it is increasingly clear that the high costs of housing in England means rising

subsidies, not just in social rents, but also higher benefits and more schemes aimed at subsidising first-time buyers, as discussed earlier. The most recent initiative is to try to stimulate the private rented sector – which is today often of poor quality, to try to fill the gap between social renting and home ownership. But if the overall level of supply is not right, all these schemes will see rising costs, and there will still be unresolved pressure points in the market.

Conclusions

Planning and housing policy offer Governments the chance to make a difference to people's lives. They matter very much both to welfare, and to the good functioning of the economy. In this lecture, I have talked about some of the key ideas which several years of working around these issues in the United Kingdom have prompted. If we want to get places right, then the incentives have to be right for developers, for planning authorities, and for the people who already live and work there. And it is important that decisions are taken by the lowest possible level of government, so that people feel close to the decisions and that they can make an impact. That matters if places are to remain communities. Planning should be connected to the rest of local government, so that we are thinking about places, not building sites.

In policy terms, we need to avoid over-estimating the benefit and under-rating the costs of regulation. The cost of planning – in terms of moving development away from where a market economy would put it, or in terms of affecting what is built, is generally hidden from tax-payers. The association between restricted supply and high house prices is far from obvious, as it is only apparent over long periods. In the cyclical to and fro of the economy its impact is obscured by variations in financial conditions.

So it is important to be very specific about what problem a particular aspect of planning policy is meant to address, clear that it does actually address it, and have thought through the potential for unintended consequences. Focus also needs to be kept on the outcomes of any planning activity – avoiding the mistake of believing that success is delivering the plan, rather than the ultimate outcomes in terms of better, thriving places with satisfactory living conditions for all residents.

In England, planners have also tended to take the view that the market is uninteresting – because they know better and have the wider interest at heart. That is true up to a point, but alongside this view can come a disregard for normal market signals around demand and supply. There is a misinterpretation of value, rising prices don't always mean a planning success – it may be good planning, or it may be poor planning leading to scarcity. There is also a tendency to overrate the ability to foresee the future – in carrying out the planning review I was surprised when planners suggested that economists should just tell them what the future would hold, and they would plan for it. The financial crisis has probably led them to realise the futility of that suggestion – but it has to be hoped that this will not lead them to make the error of becoming further entrenched against the market. Good information, including economic costs and benefits, are needed to take wise decisions.

But planning is also a deeply political process. Since local government responds to its electors, there is a big task to be carried out in explaining why new development is needed, why it matters to provide the less well-off with decent housing, and how, in the right context, this can make an area better. There is a real uphill battle on this in England, where opposition to activity is rife – more so than either the United States or Canada. A recent survey⁹ suggests that a net 55% would oppose industrial development in their area, with only a net 8% supporting subsidised housing, and 19% private housing (although this latter category is also the most opposed when a proposal is actually put). Perhaps more tellingly, 21% of people questioned had actively opposed a development in the past year. This is especially discouraging at a time of recession, when development related to employment might be thought more welcome. Part of the reason for this may be that English people have an exaggerated view of how much development there is. While only about 13.5% of England is developed, 54% of people think it is 50% or more.¹⁰ Following the housing review, there was a concerted effort to persuade people of the role of housing supply and planning policy in driving up prices – and this met with some success at least in the media, although rather less in the wider public.

⁹ Saint index (2009) The Saint Consulting Group

¹⁰ Survey cited in Barker (2006)

However, if public opinion cannot be persuaded, then there is a great risk that planning policy will replace market failure, with government failure. An analysis of government failure in policy terms suggests that this is more likely where policy makers are corrupt, influenced by major lobby groups, or inadequately informed about the consequences of their decision.¹¹ While planning decisions lend themselves from time to time to outright corruption in most countries, it is the influence of lobby groups and weak information that seem to me more pervasive as weaknesses in the system. We ought to care about finding a better balance between market and government, if in the long-run we are to find a route to development that best serves our peoples.

¹¹ Besley (2006)

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