Barker Review

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The volume of housing supply that comes from new building as opposed to turnover in the existing stock varies significantly between countries. In Britain where new building constitutes only a very small proportion of supply, changes in planning that bring about changes in house-building will have only a very small effect on total housing supply and thus only a small effect on house and land prices. It might be argued that the effects are greater in the long run than the short run but prices are determined in the short run.

These points are elaborated in an extract from my forthcoming book:

From ***"Economics, Planning and Housing***", by Michael Oxley, to be published by Palgrave Macmillan.

The Economic Consequences of Planning:

House price effects

If planning acts as a constraint on the supply of new housing one might expect this to have consequences for land prices and house prices. If the supply of house building land is less than it would be without constraints then, other things being equal, one would expect land prices to be higher as a result of planning constraints. Similarly, if the supply of housing is reduced as a result of planning one would expect house prices to be higher. However the occurrence and the magnitude of such price effects depends on the processes of price formation in the land and housing markets.

In the housing market any restriction on new house building is an influence on one source of housing supply. The other source of supply, determined by the turnover in the existing stock, is unaffected. A significant empirical question is 'What are the relative magnitudes of these two sources of supply?'. If 'new supply' is very small relative to 'supply from the stock', large changes in new supply may have small impacts on total housing supply. In practice, the significance of 'new supply' varies from country to country and region to region. There may also be important temporal variations.

According to the Land Registry, in the two years from January 2000 to December 2001 around 11 per cent of the 180 000 dwellings sold in the English East Midlands were ‘new’. The remainder were ‘old’ properties and thus supplied from the stock. Over the same period around six per cent of the dwellings sold in Greater London were ‘new’.

Thus in the mixed urban and rural East Midlands 89 per cent of dwellings sold were a result of turnover in the existing stock. In urban London 94 per cent of dwellings sold were a result of turnover in the existing stock. Very large changes in levels of new house building will have only small impacts on these proportions. If twice as many new dwellings had been built and sold in the East Midlands without any change in the number of ‘old’ houses traded from the existing stock, 80 per cent of supply would still have consisted of sales from the existing stock. A doubling of house building in London would on a similar assumption have resulted in 89 per cent of dwellings sold being ‘old’ properties. Of course a doubling of output is highly improbable even with a doubling of planning permissions because the capacity of the industry would be limited. Internal constraints would restrict output even if external constraints were removed. There would, furthermore, be some increase in trading within the existing stock to accompany the increase in sales of new properties. A significant proportion of households buying a ‘new’ property would have to sell an ‘old’ property. This would limit the significance of ‘new’ sales as a proportion of total sales.

The supply of dwellings for sale is thus likely to be dominated by sales from the existing stock. This dominance exists in highly urbanised and less urbanised areas of England. The dominance will continue under any plausible assumptions about an increase in the supply of new housing. With only six per cent of all houses in London being newly built, the idea that the price of houses generally in London would fall if there was an increase, even a massive increase, in house building is highly implausible. It is also improbable that a large increase in the 11 per cent of houses supplied from new construction in the East Midlands could result in reductions in house prices in, for example, Leicester, Derby and Nottingham.

The market in new houses is not a separate market from the market in ‘old’ houses traded from the stock. Within limits, ‘new’ houses and ‘old’ houses are substitutes for each other. House builders cannot simply increase the price of their dwellings by whatever percentage they choose and have buyers coming forward to make purchases. Prospective purchasers will in these circumstances demand relatively ‘old’ houses. Of course new houses will be able to command some sort of ‘newness premium’ but given an adequate supply from the stock, buyers will turn elsewhere if this premium is too high. What would happen if the cost of building houses fell? Would house builders reduce the prices at which they sell houses? They may not. If the prices of ‘old’ houses have not fallen they will have no need to reduce their prices in order to attract buyers.

The essence of the arguments above is that in large measure house building firms are ‘price takers’ rather than ‘price makers’. The central proposition is that the price of houses is determined principally by the interaction of the demand and supply of houses traded within the existing stock. House builders have to accept price levels determined by this interaction. They do not have the power to charge what they like for their dwellings nor the incentive to reduce their prices when prices generally remain high.

The degree to which house builders are price takers is subject to limits and caveats. A limit is determined by the degree of substitutability between old and new dwellings and the caveats relate to understanding this substitutability in specific market circumstances. A new three bedroom detached house may attract more demand and a higher price than an old three bedroom detached house in a similar location because it has new applicancies included, is better insulated and has prospectively lower maintenance costs. However it is sometimes the 'old' property that demands the higher price because is has architectural features that are highly valued and it is in an established neighbourhood with desirable characteristics.

House builders might engage in marketing techniques that concentrate on 'product differentiation'. That is they emphasise the positive differences between their new dwellings and old dwellings. They may reinforce them with glossy new fittings and 'trade-in deals' that give sellers of old dwellings buying new dwellings a guaranteed immediate sale of their property. The more successful the positive product differentiation, the higher the demand and the higher the price that can be achieved for new dwellings.

House building may create new products and establish new housing markets in which there are few competing substitutes from the existing stock. For example, conversions of factories and warehouses in inner city locations to luxury apartments can respond to a demand for high quality inner urban dwellings that is not being met from the existing stock. In these circumstances house builders may be able to demand high prices for a specific sort of dwelling that is in limited supply. If there is sufficient new housing production in a given location, whether it be in the centre of a city or in a rural haven, the new building can transform an area, create new neighbourhoods and establish new products for which there are new demands. However, there will still be limits on the demand for these new products because ultimately there will be housing elsewhere that can be a substitute. If the inner city apartment or the new five bedroom, two bathroom rural detached property is too expensive buyers will opt, for example, for old suburban alternatives. The degree of substitutability between types of dwellings and locations is crucial to the power that house builders have over house prices and consequently the relationships between 'old' and 'new' house prices.

With this notion of substitutability in mind, it can be argued that it is not just the volume of new house building but the physical and locational characteristics of new building that has to be considered to ascertain the likely effects on house prices. New houses that do not have good substitutes in the existing stock but meet specific demands may sell at prices that reflect their scarcity. Large volumes of such building will not have significant downward effects on prices. New houses that are good substitutes for existing housing and compete with that housing will have different effects. The extra supply of such housing might if it is on a sufficient scale have, without any increase in demand, a dampening effect on prices. The sale of the extra supply would, however, have to be very large for the price effects to be significant.

Land price effects

An increase in the supply of house-building land may be expected to have some downward effect on land prices. However, an examination of the demand for house-building land is essential to an understanding of the possible land price effects. House-builders' willingness to pay for land depends on how much they can afford to pay for land and still expect to make profits from house-building. If we think of the willingness to pay as a residual, it is a function of revenue from house sales minus non-land costs. In this approach land is treated as a factor of production and its demand is derived from the demand for the final goods, in this case houses that the land helps to produce. If house-builders expect more revenue from house sales, without any increase in production costs, they will be will to bid more for land. If they expect less revenue from house sales, without any reduction in house-building costs, they will be willing to bid less for land. If house prices fall or house-builders expect house prices to fall, other things being equal, they will be willing to pay less for land. If an increase or an expected increase in house-building, as a result of an increase in the supply of house-building land, does reduce house prices it may have a downward effect on house-builders' willingness to pay for land and consequently a reduction in land prices.

The direction of cause and effect in the argument above is from house prices to land prices. Changes in house prices may have consequences for land prices. It does not follow that changes in land prices will necessarily have consequences for house prices. If land prices fall how will house-builders react? Will they lower the prices of the houses they sell? If they can continue to sell at the previous prices the answer may be 'no'. They will instead increase their profit levels. We can think of the residual referred to above as a sum to be shared between the landowner and the house-builder. The relative shares will depend on the relative bargaining strengths and skills of each party. An increase in land supply will tend to reduce the relative bargaining power of the land-owner and from this point of view some reduction in land values may follow. This is more likely to be accompanied by increases in house-builders profits than reduction in house prices unless there are other factors at work that are depressing the demand for new houses.

If the housing market is dominated by sales from the existing stock, large increases in the supply of house-building land are unlikely to have significant downward effects on either house prices or land prices.

The argument presented above is close to the position presented by Grigson (1986) who argued that the operation of the planning system cannot increase land or house prices because house prices are demand determined and housing land prices are determined as a residual. The analysis is also in line with the view of Barlow, Cocks and Parker (1994 p. 11) that 'the price of new housing is essentially determined by the market in second hand housing, with the land price representing a residual after the developer has carried out a financial appraisal of the scheme'. Monk (1999) characterises the Grigson position as 'extreme' and posits the 'Evans-Grigson' debate, citing Evans (1983, 1988, 1989, 1996) as the key proponent of the opposing view that the planning system operates to push up land and house prices and reduce the quantity of housing built. Evans' argument that planning increases the price of land with permission for house-building significantly above alternative agricultural values is supported by clear empirical evidence. What is less clear is that the high land prices are the cause of high house prices.

Significant contributions to the empirical evidence on the relationships between planning, land prices and house prices have been provided by the work of Bramley (1993a and 1993b). Cross-sectional analysis using data for English local planning authorities suggests fairly modest price and quality effects from planning controls. With land allocation doubled the long run reduction in house prices is estimated at less than ten per cent. In an extension of the research to Scotland, Leishman and Bramley (2001) suggest that a 50 per cent reduction in land supply would lead to private sector completions falling by 13 per cent after two years and 27 per cent after three years and house prices would rise by two per cent after two years and four per cent after three years. If land supply was doubled a 15 per cent increase in completions with two per cent reduction in house prices is predicted after two years with a 36 per cent increase in completions and 4 per cent fall in prices after three years.

Evans (1996) argues that the approach used by Bramley (1993a; 1993b) understates the likely changes in house prices and housing output as a result of the land made available for possible development through the planning system. The under estimation is (1) because Bramley uses a cross sectional approach to predict changes that will occur over time and (2) because of the use of 'structure plan provision for housing' as a predictor of output. There is, Evans argues, an extremely weak relationship in practice between structure plan provision and housing production. In responding to the first of these criticisms Bramley (1996) argues about the nature of the equilibrium or disequilibrium that Evans assumes to exist in a cross sectional situation and distinguishes between stock and flow equilibrium. On the second criticism Bramley acknowledges the historical weakness of the plan provision / housing output relationship but argues that the strength of the connection has grown as changes in the planning system have increased the probability of land allocated in plans getting developed. Further discussion of empirical studies of the effects of planning constraints on housing markets can be found in Adams and Watkins (2002, pp. 247-61).

'New' and 'old' housing transactions

If the supply of new housing is small relative to the supply of housing from the stock, the impact on house prices of any change in the supply of new housing is likely to be small. Thus even if planning brings about very large changes in the supply of new houses, the change in the total supply of housing may be small if much of this total results from turnover in the existing stock. Where turnover in the existing stock is high, house prices determined by the interaction of the demand and supply of ‘old’ houses are likely to influence new house prices and house-builders are likely to be price ‘takers’ rather than ‘makers’. Table 11.1 shows that turnover in the existing stock is particularly high in the UK with nearly six per cent changing hands in a given year. Comparable data for other European countries is difficult to obtain. However estimates for Belgium and Germany show lower rates of turnover in the stock in these countries. ‘Old’ dwellings sold as a result of turnover in the stock are higher as a proportion of total private housing transactions in the UK than in either of these countries. With only 11 per cent of housing transactions sales of new dwellings on the UK compared to 72 per cent of transactions in Germany the UK housing market is significantly different. In Germany with a large proportion of housing on the market coming from new production, new housing output will have a much bigger impact on total supply and on house prices than is the case in the UK. In Germany an argument that changes in the volume of new house-building will have significant consequences for house prices is much easier to sustain than is the case in the UK.

Table 11.1 'Old' and 'new' transactions in housing

Numbers of dwellings, 000's, 2000.

	New private dwellings sold	**Old private dwellings sold**	**Total private housing transactions**	**Total private housing transactions as percentage of housing stock**	**Old dwellings sold as percentage of total transactions**
Belgium	36.177	72.013	108.19	4.3	66
Germany	393.39	156.61	550.00	1.4	28
UK	153.28	1277.72	1431.00	5.8	89

Estimates based on data from United Nations Housing and Building statistics for Europe, Eurostet Housing statistics in the European Union, and European Mortgage Federation.

Conclusions

It has been argued that the economic consequences of planning can be considered by evaluating the micro-economic impacts, the macro-economic impacts, the welfare impacts and the market specific impacts. In principle the most comprehensive approach is to evaluate the welfare impacts. This involves a consideration of all the costs and benefits as an aspect of public policy would be seen as promoting a series of social costs and social benefits which may or may not bring about a net social benefit. Identifying and measuring these costs and benefits does however involve complex challenges and practical attempts at such evaluation are sparse.

Whilst there are claims about the impact of planning on individual behaviour, specific markets and the macro-economy, such claims are difficult to evaluate because of the lack of clear evidence. Planning is but one part of a complicated economic system and isolating its particular contribution requires more sophisticated modelling than has been yet developed.

Many of the impacts of planning are assumed to take place through housing and land markets with planning influencing levels of house-building and house prices. Because of the significance of these claims, much attention has been given to the relationships between planning and housing markets. It has been argued that planning affects mainly the supply side of the market. The volume of housing supply that comes from new building as opposed to turnover in the existing stock varies significantly between countries. In Britain where new building constitutes only a very small proportion of supply, changes in planning that bring about changes in house-building will have only a very small effect on total supply and thus only a small effect on house and land prices.

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