Channelling money flows away from land and housing

Discussion note by Michael Edwards for Highbury Group 12 September 2022

A special meeting of the Highbury Group on Housing Delivery on 12 September is to consider a paper on taxation by Pete Redman. Duncan Bowie asked me to contribute a discussion note on 'How investing in owner occupation damages investment in productive industries'.

Writing at the end of the summer 2022 I am finding it hard to focus on the right scale and grain because of a feeling that we are at the end of times, globally and nationally, with all established certainties dissolving. The *ceteris paribus* assumptions which we all use, implicitly or explicitly, in discussing taxation, saving, investment, incomes and prices feel insecure. However I'll do my best.

The question I raise here – or which Duncan has asked me to raise – is whether and how taxation should aim to halt or reverse the long-established switch of the economy from a focus on production to a focus on rentier activity, and within that the flow of capital into land and real estate, especially housing. The UK is not alone among nations in having this experience but the British version seems in some ways especially severe and it certainly has some distinctive features.

This question is not one of those which Pete Redman's paper lists when he – so wisely — says we must be clear what we want taxation to achieve. His list is

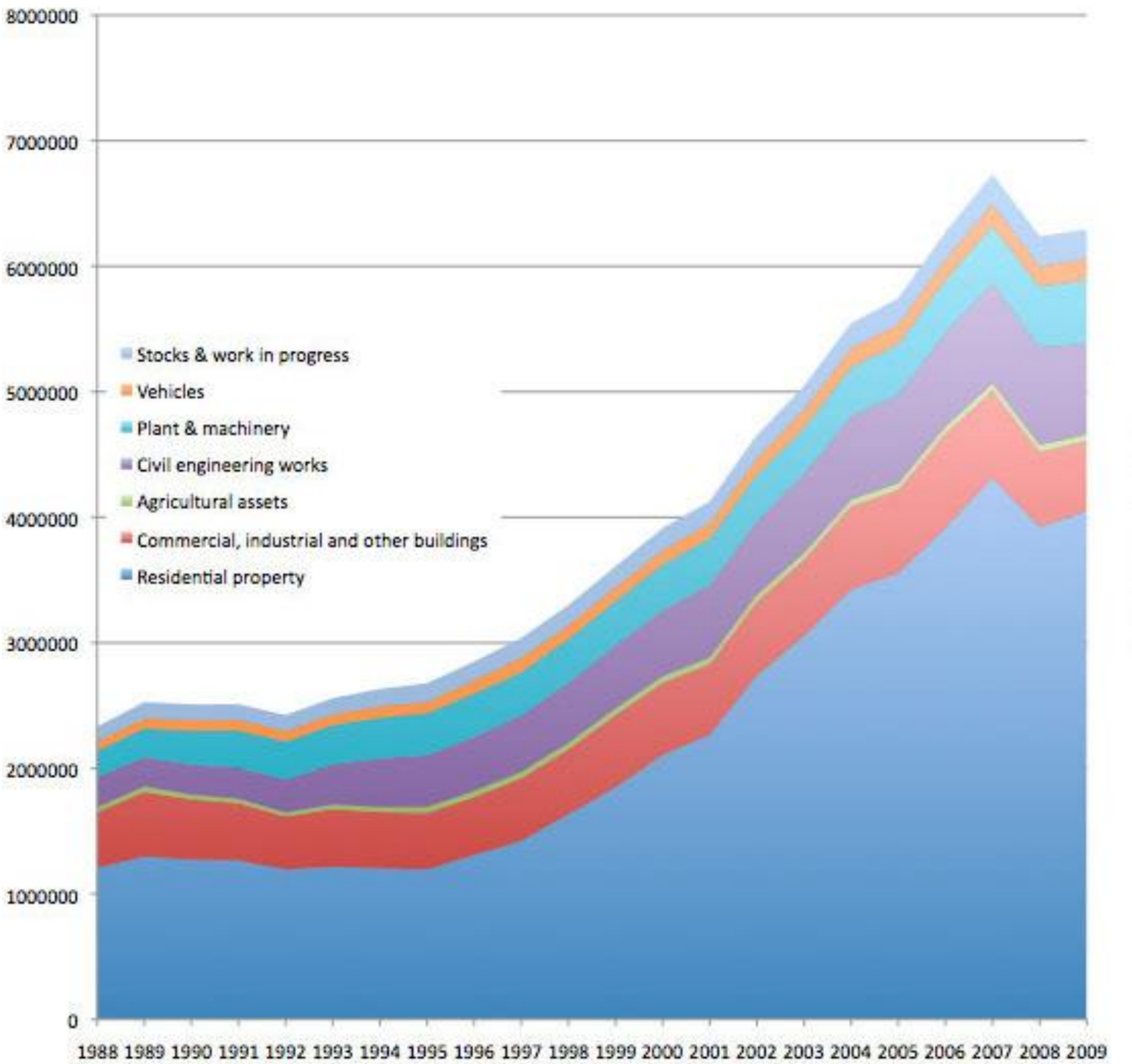
- Increasing the quantum of new housing supply
- Increasing the affordability of new and existing housing supply
- Improving the effective use of existing and new supply
- Recovering excessive asset value growth
- Ensure the rich pay a fairer share and the poor pay less
- Reducing the intergenerational divide
- Paying for local government services (not in his list but prominent in the subsequent text)

To these I would consider adding

- Incentivise insulation and decarbonisation (or perhaps upgrading & maintenance generally)
- Incentivise reductions in car travel via location & urban structure
- **Reducing wealth inequality**
- **Directing savings away from land/housing to more productive investment**

And the last 2 of these are the pertinent ones for this discussion. I group them together because the mechanisms are so intertwined, though the motives we may have for pursuing each are distinct.

As more and more physical production activity has been switched to low-wage and/or more authoritarian countries, some reduction in investment in production industries was to be expected. Britain has a long history of relatively low investment levels in manufacturing and other production branches but the recent acceleration of flows into land and property have been very marked. For some years I did annual updates of this chart on the composition of the national stock of tangible (i.e. non-financial) assets:

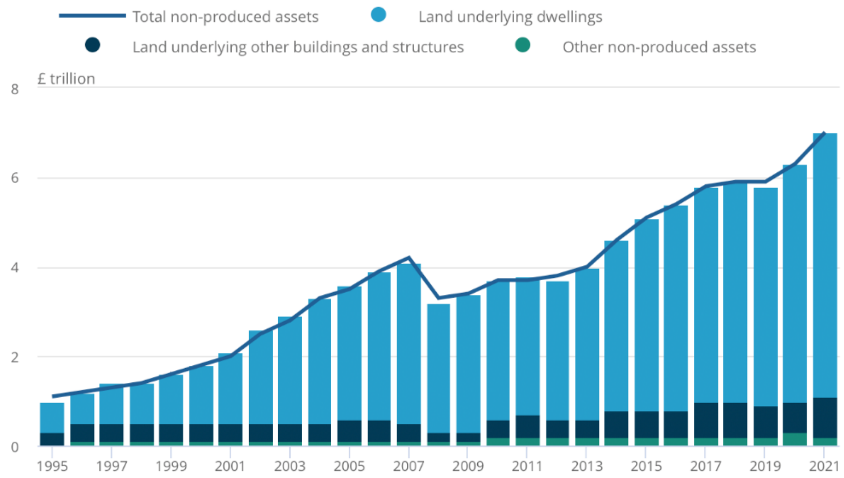



Source: compiled from ONS annual data.

Then the ONS stopped publishing that series and switched to an attempt at land value, or at least the residual value of housing land after deducting from house prices the estimated costs of replacement.

We can see from the first chart the remarkable extent to which infrastructure, real estate, and especially housing, came to dominate the national asset stock – adding up to over 80% by the end of the series, dwarfing machinery, aircraft and other productive equipment. While a bit of the growth was of course additional buildings, most of the growth was in price. Investors (including households) have been chasing prices up. The second chart shows how this process has unfolded since the GFC.

**Non-produced asset value in the UK, current prices, 1995 to 2021**

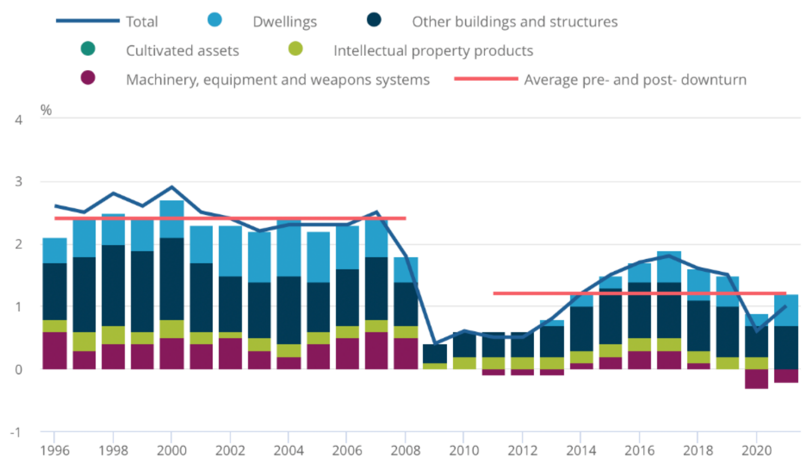



**Source: Office for National Statistics – National balance sheet**

https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/improvingestimatesoflandunderlyingotherbuildingsandstructuresinthenationalbalancesheetuk/2022

We can put all this in context by looking at the overall picture of changes in the produced capital stocks, leaving out the land values. We can see (i) how low is the growth overall since the GFC, (ii) how dominated it is by construction, both housing and other and (iii) how minute is the contribution of machinery, equipment and weapon systems, this last even turning negative in the last couple of years.

**Growth in UK net capital stocks, chained volume measures, 1996 to 2021**




**Source: Office for National Statistics – Capital stocks**

https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/improvingestimatesoflandunderlyingotherbuildingsandstructuresinthenationalbalancesheetuk/2022

My purpose in so emphasising this British property fetish is to emphasise the magnitude of what has been happening to us. It could equally be framed, following Piketty (2013), as the major mechanism driving the concentration of wealth within the population. The gulf between owners of homes and non-owners has been widening, not merely in directly measured wealth but indirectly as an influence on the next generation: who can manage to start a business, take unpaid internships, raise the deposit for their own first home or cope with the student loan system (ref ? ). The most recent critique along these lines is from Brett Christophers (2022) and the Resolution Foundation (July 2022) is also helpful.

It is now more than 30 years since David Harvey introduced the idea that, as the profitability of investment in production dwindled, capital would tend to switch into other forms of accumulation strategy, of which real estate was likely to be the leader. Interestingly his theoretical deduction was rarely empirically tested until Brett Christopers undertook a careful study of the UK data from 2000 to 2007, charting the lead-up to the great financial crisis, thinking this would be a good test. His paper (Christophers 2011) is a great vindication, demonstrating that there was a massive expansion of investment flowing into real estate in the UK in the run-up to the 2007 crash.

**So my argument is that, in scanning potential tax changes we need – as the Highbury Group – to add to our toolbox the criterion that tax changes should reduce the tendency for more money to be directed into the purchase of homes, or at least not encourage it to grow.**

This affects owner-occupiers, potential small landlords and institutional investors and we would need to consider each separately.

For all 3 groups, this will include the need to stabilise house prices in real terms, or at least influence expectations downwards, to remove one motive for spending more on house purchase – the prospect of future capital gain. Elsewhere I called this ‘laying the housing ladder flat on the ground’ (Edwards 2015).

Of course households have other motives for buying (as distinct from renting) a home. Some of these reflect the pressure to escape from the worst features of renting, features which are absent or better managed in so many other countries: insecurity of tenure, pettifogging restrictions on DIY, sub-letting, pets. Any campaign to ‘lay the housing ladder flat on the ground’ would have to be waged on many fronts including these reforms of renting.

For institutional investors we can presume that there are two kinds of motive for acquiring or building homes for rental: prospects of capital gain and prospects of rental income. If public policy could succeed in stabilising prices then that element of attraction for landlords would dwindle. So far as rental incomes are concerned, there are two avenues to be pursued: (i) rent control or regulation alongside tenure improvements mentioned in the previous paragraph and (ii) reduced demand as more would-be owner-occupiers are able to enter the market at more affordable prices.

Finally we should note that this malaise, and these proposed reforms, stretch throughout the economy and society. For example to make 'investment' in housing less attractive to workers, pensions will need to be improved and to make it less attractive for institutions, more productive avenues for investment will need to come into existence. These are all big changes, but then the problem being tackled is now so pervasive that there is little choice.

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