Housing: HUD commission slams speculation

HOUSING in the USA continues to reflect the state of the economy. New homes sales dropped 6.6% in December, dragging 1991's total to the lowest level in nine years.

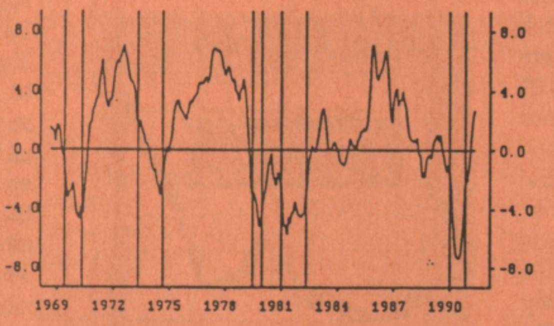
In an effort to stave-off disaster, families are refinancing their homes, attracted by interest rates which are now at an 18-year low. The rate on a 30-year, fixed-mortgage has dropped from 14.7% (1984) to 8.3% last month.

◆ *In January, over 70% of mortgage applications were refinancing deals.*

Last year, 1.5 million households saved $3 billion by refinancing their mortgages, and another 3 million are expected to do so this year, which will provide households with an additional $6 billion in spending power.

The scramble to lower monthly outgoings from the budget has rammed home the painful message that family wealth has declined drastically. As many as half of the applicants are confronted with the news that the value of their homes has dropped by as much as 25% to 30%.

Real House Price Appreciation



Weighted average of median prices of new and existing homes sold deflated by consumer price index.
Three month moving average of year-over-year percent change.

The fall in residential land values has caused havoc. For example, small construction firms are unable to borrow money from banks to finance new output. The credit crunch is estimated to have prevented the start of about 150,000 residential units last year.

◆ *According to the Commerce Department, 1991 was the worst year for housing starts since World War II.*

The construction industry is being decimated, with smaller builders being wiped out to the advantage of the bigger firms, which are increasing their market share.

The macro-economic implications of the housing tragedy are not yet reflected in policies in Washington, DC, even though the evidence - that downturns in the housing market point to (indeed, cause) recession - is unambiguous.

The graph (inset) tracks the weighted average of median prices of new and existing homes which have been sold, deflated by the consumer price index. Similar graphs could be constructed for other aspects of the housing market, but they are all no more than proxies for the real story: it is the downturn in the value of land beneath the buildings that registers the dynamic impact on tthe rest of the economy. The sequence is now a classic one: a downturn in land values precedes a downturn in the housing sector, which in turn precedes recession.

It is the failure to maintain a stable relationship between incomes and house prices that generates the instability. That havoc is caused by speculation in the land market, a damaging activity which governments have consistently failed to address. One result: according to the Census Bureau, last year 91% of America's renters could not afford to buy a median-priced house.

The facts are not in dispute, and have been documented in voluminous reports over the past 20 years. The latest is last year's report commissioned by Jack Kemp, Secretary of the US Department of Housing and Urban Development. This affirms the role of the property tax as contributing to both the cause of - and solution to - the problem of unaffordable land. The report acknowledges that a single tax on the value of both land and buildings rewards the holding of land in an undeveloped state.

The property tax (called rates in Britain - until Margaret Thatcher abolished them!), "encourages land price inflation, by encouraging land holding and speculation. It also penalizes investment that would improve and maintain existing housing, by imposing relatively high property tax rates on land improvements."*

The Commission was attracted by the two-rate tax, which placed the burden on land values and reduced the tax rate on buildings. Pittsburgh is among the 15 Pennyslvania towns that employ a two-rate tax. Would this fiscal policy reduce land prices and make houses affordable to all levels of incomes?

Studies have proved that the switch to a two-rate tax encourages faster construction of homes, relative to trends in neighbouring communities. Good. But in economy-wide terms, the municipal-level strategy is hopeless. Here, again, the evidence is unambiguous. As the HUD Commission noted, the two-rate tax operates "in other parts of the world" - for example, throughout New Zealand and Denmark. Better still, most municipalities in Australia and South Africa even benefit from a land-value only tax. Alas, none of these countries has been exempt from land speculation. All of them have been driven into recessions when the price of land was raised to commercially unaffordable levels. The land-tax rates were too low to abolish the propensity to speculate in the prospect of huge capital gains.

Ultimately, there is one way only for the market economy to be released from the constraints of land speculation: when central governments use land-value taxation as a macro-economic tool to achieve full employment. That entails the imposition of a very heavy tax rate on land rents, with offsetting cuts in taxes on other forms of income.

* Advisory Commission on Regulatory Barriers to Affordable Housing, *Not in My Back Yard* (1991), Report to President Bush and Secretary Kemp, Washington DC, pp..8-10.

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