

How to build our way out of the recession

By Fred Harrison

THERE WAS a crude surplus of nearly 1m houses over the number of households in Britain in 1980. In the United States, the crude surplus was about 9.6m.

How, then, can the house-building sector be the trend-setter in a "bootstraps" operation to pull the economy out of the worst recession since the 1930s?

The figures imply that the demand for new houses would be inadequate to generate the level of activity that would spill over into other sectors.

This pessimistic conclusion rests on two assumptions:

- Families are content with the buildings in which they are housed; and

- There is little scope for a dramatic expansion of activity in the building industry.

Both these assumptions are false, and the conclusion of this enquiry is that house-building *can* lead the economy out of the recession, if certain crucial steps were taken. Britain is taken as a case study.

ACCORDING to an all-party Select Committee of MPs, the measure of a "crude housing surplus" is an unreliable guide to housing policy.



● SIR PETER TRENCH

It disguises the true position. For example, in 1976, 2.2m dwellings either lacked basic amenities or were totally unfit for habitation. It also fails to take account of "concealed households" (estimated in 1977 to be 250,000).¹

Sir Peter Trench, the chairman of the National House Building Council, states that a total of 250,000 dwellings per annum on average are

needed as the minimum requirement for the 1980s if people's aspirations are to be met.

Sir Peter is a director of Nationwide, one of the largest mortgage-lending societies, and chairman of Y.J. Lovell, a firm of private housebuilders.

His figure is an irreducible minimum calculation of "need."² If house builders could supply this number of new houses, it would represent an increase in the housing stock over the decade of something like 10 per cent.

The economic activity represented by this investment would be worth a minimum of £21 bn for housing alone (at constant 1975 prices), and would have important consequences:

- **IMPROVE** the quality of the household living environment, as people moved out of slums;
- **STIMULATE** the demand for skilled workers and labourers, as entrepreneurs expanded their operations;
- **GENERATE** benefits for the rest of the economy, as labour mobility increased in response to the supply of houses in locations where jobs could be created but for the want of employees for hire.

THERE IS a strong latent demand for new houses in Britain.

In the face of this, we would have expected the building industry to respond to the challenge of the marketplace. Instead, however, construction has slumped into one of the deepest troughs in living memory.

And the main explanation can be summed up in one word: land. The supply and price of the site is the major brake on new investment.

House-building collapsed in 1974, after land speculation in the early years of the 1970s pushed prices well above what the builders and house-buyers could afford.

The price of housing land steadied through 1975 and 1976, and building recovered (Table I)

The recession did not destroy all expectations about making large unearned profits out of land, however. By the end of 1977, the price of land started to recover, and in 1978 the

**TABLE I:
BRITISH HOUSING SECTOR, 1975-1981**

		Housing land prices (1975=100)	Building (wages & materials) costs (1973=100)	House building starts (private: 000s)	Domestic furniture: orders-on- hand
1975		100	149	149.1	100
1976		100	177	154.7	87
1977	1st half	102	193	134.8	75
	2nd half	109			
1978		118	209	157.3	85
		142			
1979		168	241	144.0	91
		202			
1980		243	279	98.0	59
		238			
1981		247	302	117.0	52
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SOURCE: Department of the Environment, London.

TABLE II:
ABILITY TO BUY: Britain 1974-1981

This index takes account of the deposit which first time buyers must pay as well as their income and mortgage repayments. The higher the index, the greater the ability to buy.

	Q1	Q2	Q3	Q4
1974	46	50	58	69
1975	71	77	82	84
1976	89	93	91	87
1977	88	90	96	101
1978	107	103	99	90
1979	88	86	79	63
1980	62	67	72	78
1981	82	90	89	91

SOURCE: *Private House-Building Statistics*, London: National House-Building Council, No. 1 (1981).

price of a plot of land had regained the speculatively-high levels achieved in 1973,³ far outstripping the rate of increase in the price of building materials.

As a result of this, new building was severely curtailed; and the rest of the economy suffered, as the demand for goods – such as furniture – simultaneously declined. All this happened before the second major OPEC oil price rise, which occurred at the end of the decade.

HOUSE-BUILDERS had once again fallen victim of the land monopolist.

This is an age-old but neglected story. Yet on the basis of Ricardian theory, the underlying economic processes ought to have been translucent.

The dynamics of the land market as it is at present structured enables monopolists to capture new wealth by increasing the price of land (by capitalising economic rent, which measures the value of land in its unimproved state).

This theory can be related to the UK economy in the 1970s. After the land boom which terminated in 1974 with the great crash, land prices remained stable for two years.

Then, early in 1977, the economy recovered. A rise in people's disposable incomes increased their ability to buy new homes (Table II).

Had the costs of production remained stable, the housing sector would have accelerated its output to meet this new effective demand.

But in the second half of 1977, just as people's ability to buy new homes increased markedly, so did the price of land. Although there was an increase to 157,300 starts on new housing in 1978, the rate of increase in land prices squeezed builders and buyers alike.

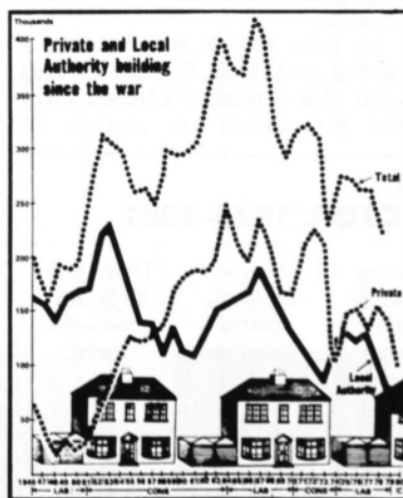
The recovery was stillborn. The construction industry was the first to turn downwards (Table III), thereby

helping to drag the rest of the economy on a steep slide back into the economic trough, the prosperity of the 1960s receding further into distant memories.

A FLOOD of reports ought to have alerted the authorities to the critical shortage of reasonably-priced land.

The information came from official sources, charities and organisations concerned with the environment.⁴ These were reinforced by the housebuilders.

In April 1981, 445 firms provided detailed answers to a survey which revealed that 85 per cent of them were suffering from an acute shortage of land. Half of the builders said that their supplies, at existing levels of production – the lowest since the 1920s – would last for less than one year.



If, however, there was an upturn in the demand for houses, over 60 per cent of the builders said that their land supply would last for less than one year. The Federation of Master Builders issued its grim warning:

"No one wants a repeat of the serious and sharp increases in prices which occurred in 1972/73. Yet that may happen if action is not taken to ensure



● Richard Dibben: "Reduce land prices."

that sufficient land is available at a reasonable price. If builders are as hard pressed for land, as shown in the survey results, they will obviously step up competition for whatever land is available in order to keep their firms in existence. This competition will intensify with any growth in demand for housing. The implication for housing costs is quite clear. On a rough average about 25 per cent to 30 per cent of the selling price relates directly to the cost of the building plot on which the house stands. Any serious increase in land prices would therefore reflect heavily on the final selling price."⁵

DESPITE THE weight of evidence, however, the British government continued to believe that there was a five-year supply of land available to builders. The main thrust of official policy – persuading public authorities to sell off surplus land – was considered to be sufficient to meet all needs. There were two defects with this policy.

● The flow of publicly-owned land into the hands of builders was at a derisively low level, wholly insufficient to meet production needs.

● This was a once-and-for-all policy: when the authorities had released as much land as they were prepared to sell, the public sector as a source of supply would come to a dead end.

The government, while acknowledging the key role of the construction industry,⁶ treated this sector in a cavalier fashion. As a result, it was attacked by the all-party Select Committee of MPs for depriving itself of information necessary for sound decisions.⁷

House-builders want to assume the role of leading sector in the strategy for economic recovery. Their leaders have repeatedly pointed out that, given a chance, they could expand output and employment. The most recent statement was from Richard Dibben, President of the House-Builders Federation. In January he said that private house-building

output could be increased by at least 20 per cent in 1982.

But one of the conditions for achieving this result, according to Mr. Dibben, was a reduction in the price of land, which had doubled as a proportion of housing costs over the last 15 years.

Appeals for action from the housing industry have been stone-walled. John Stanley, the Housing Minister, declared in January: "The message for the construction industry . . . is that competitiveness is both the key to success and the only certain guarantee of survival."

In fact, competition between builders – which is what the Minister meant – cannot *begin* until the industry has wrested land from its owners; and that struggle has to take place on unequal terms, in an uncompetitive market.

This was the point driven home by builder Tom Baron, a former adviser to Minister of the Environment Michael Heseltine, when he declared: "If land was more readily available and consequently cost less, we would be competing for customers instead of competing with each other to buy land."⁸

HOW CAN the land market be transformed to ensure that the supply and price was consistent with demand and the level of people's incomes?

The socialist alternative, vigorously promoted throughout the postwar years in Britain, has been an acknowledged failure. The so-called "free market," however, has likewise yielded anti-social results, but this is because the monopolistic structure of the land market has impeded competition.

Of all the policy options available, only one of them can produce an efficient, free and competitive market: the imposition of a high annual tax on the rental value of unimproved land. Two of the benefits will be itemised here.

First, the owners of vacant land would be induced to release their holdings. They could not continue to meet their fiscal obligations for long out of previously-accumulated capital. With an increase in the supply of land, prices would come down, thereby enlarging the number of people who could buy houses. This would have a multiplier effect on the building industry, and would improve both the quality of home life and the rate of growth of the economy.

'If I have dwelt so long on this thorny question of land it is because I sincerely believe it to surpass in complexity any other constraint on housing supply that might exist. Of course there are others . . . but they can be overcome, whereas with land the chances of winning are remote mainly because the odds are in favour of the philosophy. "I am all for housing needs being met, but not at the bottom of my garden."

'It has also been argued that the housebuilding industry will be hard put to find its work in progress, particularly if the price of land continues to rise – which it will! To my mind there is nothing particularly new about this proposition: for as long as I can remember we have had to find more money to finance the same number of units.

' . . . my crystal ball tells me that in the early part of the decade demand will increase slowly, supply will lag behind but will eventually increase to match it; both will fall far short of need. By 1984 demand will be drawing closer to need, but supply will be faltering. By the end of the decade annual need will be reducing, demand will depend on many factors incapable of prediction today and supply, because of land, will be in a thorough mess.'

– Sir Peter Trench

Second, increased revenue from the tax on land values would enable the government to reduce the burden of taxes on incomes and production. Either way, the real value of

household incomes would rise, thereby improving living standards and further stimulating economic output.

Such a transformation would be welcomed by both builders, tenants and owner-occupiers.

The only losers would be the land-owners, who are not able to pass on a tax on land values – a well-attested economic fact that was reaffirmed as recently as last year by Prof. Prest: "So the ultimate result, given the change in the nature of the tax, is a tendency to an increase in building and a reduction in landlord incomes net of tax."⁹

The Conservative Government's recent Green Paper on the property tax did not contain one word on this policy option.¹⁰ This deafening silence reinforces the suspicion that the Government, for all its rhetoric about the importance of the construction industry, is unwilling to inform its policies with the facts.

Thus, the nation's builders are helpless and the Government is useless. The construction industry is prevented from discharging its historic role of coaxing life back into the rest of the economy on the basis of a rational plan that coordinates the industry's resources with the government's political leverage, leaving us with little more than bleak prospects for the future.

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TABLE III: Index of Industrial Production (1975=100)

	Total all industries	All industries other than oil and gas	All industries other than construction	Broad industry groups		
				Total manufacturing industries	Mining and quarrying	Construction
1976	102.0	100.7	102.7	101.4	126.1	98.6
1977	105.9	101.9	107.5	102.9	188.4	98.2
1978	109.8	104.1	111.0	103.9	233.1	104.9
1979	112.6	104.3	115.2	104.4	295.7	101.3
1980	105.3	96.7	107.5	95.3	301.3	95.9
1981	99.7	90.3	103.1	89.3	319.8	85.0