



Mystery of the missing land data

WHAT has happened to the Irish economy? Good times were enjoyed in the last three years of boom, but will they continue? The Dublin government could have as much as £10 billion to spare over the next three years when receipts from privatisation are taken into account.

Too good to be true? Is the Irish economy really paying its way, or is it a bubble waiting to burst?

Irish citizens have certainly enjoyed a free ride on Europe's taxpayers. In the last five years Ireland has received £8 billion from the European Union in structural funds. While basking in the good news, the Dublin government was worried about one of the symptoms of success – or was it a harbinger of horrors to come? That was the escalating cost of housing.

The government commissioned a firm of economic consultants, Peter Bacon & Associates, to analyse house prices. They produced two weighty reports which included an econometric model which sought to isolate the influences at work.*

Unfortunately, one piece of the puzzle was missing. The first report admitted: "In practice, it is hard to pin down all the cost factors econometrically. In particular, no time series of residential land prices are available". Undeterred, the consultants built their model which they then sent out for assessment by experts and interested parties in the construction industry. What did they make of the model?

The builders were not impressed. One question asked whether the results explained house completions in relation to the "forces driving house completions". The builders replied: "Without the inclusion of land supply and the cost of building land the equation seems of limited value".

On whether there were other statistically measurable variables that ought to have been included in the house price equation, there was unanimous agreement among the planners, estate agents, mortgage lenders and builders that the cost and availability of land ought to have been included.

The model claimed to explain 89% of house price variations. The builders replied that, intuitively, the equation did not afford a satisfactory explanation. One builder said the model failed to explain how a 3% rise in income in 1997 was accompanied by the increase of 20% in Dublin house prices.

When asked whether the magnitude of any of the estimated coefficients caused surprise, one builder said: "Without taking account of supply of land the supply equation is of limited value".

The consultants were not embarrassed by the consistent criticism concerning the failure to factor in the cost of land. Evidence had been received from the Irish Home Builders Association which demonstrated that land costs represented an increasing proportion of the housing costs. But was the absence of data really an analytical problem? The experts were not convinced.

For, from an economic point of view, they insisted that "A key issue is the direction of causation between land prices and house prices". Was it the supply and demand for housing that was raising land prices, or were higher land prices pushing up housing costs? On a balance of probability, said the experts, the former explanation was probably correct. The contention that land costs were a rising proportion of total housing costs could reflect the relative inelastic supply of serviced land in the

locations where people wanted to live. "Data are not available which could indicate the impact of this on the trend in profitability in the home building industry, or for that matter, on what that trend is."

THE POLITICIANS were evidently uneasy about escalating prices, and the Minister for Housing called for the second report. Remedial action was required.

The experts recognised the need to increase the supply of land, but they emphasised the need for more infrastructural investment – which (they failed to note) would raise the value of land even further!

That prices were being recognised as the problem is not surprising given that rents in Dublin rose by 24% in 1998. The price of apartments leapt by 30%, and second hand houses rose by 30%-40%. The consultants reported that the usual argument for reducing prices was to reduce land prices. They were worried about such a proposal, even though "If

such an outcome could indeed be brought about affordability for first time buyers would be improved."

But a reduction in prices would "risk creating a negative equity problem for many house purchasers and most new house purchasers over the past two years or so". The likelihood was that this would create a greater problem than the one that would be resolved.

The consultants were worried that declining prices would trigger a "spill-over into wider economic recession". As a result, their policy prescriptions are necessarily suspect. Their primary concern was to avoid what had happened in the

UK in the late 1980s, where a housing boom was followed by the recession of 1992. "Therefore, it is not considered that an attempt at engineering a broad reduction in new house prices should be contemplated."

So the Minister for Housing was encouraged to believe that the aim should be to achieve stability, by a greater spending on infrastructure and new financial arrangements to help first time buyers. One strategy would be to double the number of units built on each acre.

The experts failed to analyse how their proposals would help to further stoke up the price of land. Nor did they offer a macro-economic analysis that alerted the government to the inevitability of a recession in Ireland on the back of the land price boom which no-one could monitor because the data was not available.

GOVERNMENTS are part of the housing problem, but this fact does not feature in the Irish studies. The way governments use fiscal policy tends to defeat their intentions by making homes more expensive. Take, for example, what happened in Ireland in 1977. First-time buyers were given a grant (which now stands at £3,000) which was supposed to reduce the cost of acquiring homes. Instead, report the Dublin consultants, "It is accepted widely that the impact of this grant has been reduced, over time, as it has been capitalised in the prices of houses catering to this segment of the market".

Taxpayers' money, instead of making houses affordable for families, ends up in the pockets of landowners. But governments escape indictment for employing perverse policies because the evidence is missing from the records...

* Peter Bacon & Associates, An Economic Assessment of Recent House Price Developments, April 1998; The Housing Market: An Economic Review and Assessment, Dublin, March 1999.

