



Breaking the housing-finance cycle: macroeconomic policy reforms for more affordable homes

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Abstract

This paper argues that the housing affordability and wealth inequality crises facing advanced economies are driven by the emergence of a feedback cycle between finance and landed property. The cycle has been created by the increasing policy preference for private home ownership coupled with the liberalisation of bank credit and accompanying financial innovation. Under such conditions, landed property becomes both the most attractive form of collateral for the banking system and the most desirable form of financial asset for households and investors. The housing-finance cycle emerged in Anglo-Saxon economies in the 1980s but has since spread to most advanced economies. Demand-side reforms, more than supply-side reforms that dominate policy discussion, are required to break this cycle. Two reforms are discussed: 1) structural and institutional reforms to banking systems, including central banks; and 2) land policy reforms targeted at reducing the potential for rent extraction and speculative profits from property ownership.

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For Review Only

1. Introduction

This paper argues that the advanced economy housing affordability crisis has its roots in the interaction between the strong policy preference for private home ownership, realised through various state subsidies and fiscal advantages and a deregulated and (globally) liberalised financial system. Their interaction creates a positive feedback cycle that drives up property prices at a much faster rate than incomes, ultimately makes housing increasingly unaffordable for a large proportion of the population.

The essential economic dynamics of the housing-finance cycle are simple. It involves the interaction of two commodities with diametrically opposed properties: land (upon which all housing must be situated) and bank credit. As was recognised by the classical political economists (Ricardo, Smith and Mill), land is unique as a 'factor of production', being inherently scarce, fixed and irreproducible. Whilst not all land is equally scarce, desirable land (i.e. attractive location near to decent paid work and other amenities) is inherently limited in supply. In contrast, the creation and allocation of bank credit and money is relatively unconstrained in modern economies (Ryan-Collins et al 2012; Turner 2017). The deregulation and liberalisation of advanced economy

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3 banking systems in the 1980s and 1990s led to an explosion in the quantity of
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6 credit (relative to output and incomes), most of which was concentrated in
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9 domestic property loans rather than the textbook model of bank lending
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11 supporting business investment and working capital (Jorda et al 2016).
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16 Since the majority of mortgage loans finance the purchase of *existing* rather
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18 than new property, the inevitable result is house price inflation. With the
19
20 support of bank credit, households bid up the price of land as they compete
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22 for property in more desirable locations. This creates even more demand for
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24 mortgage debt which then flows in to existing property and so on. In other
25
26 words, the supply of bank mortgage credit can be seen to create its own
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28 *increased* demand – via rising property prices - for ever more mortgage credit.
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38 Broader changes in bank business models and financial innovations – in
39
40 particular the emergence of mortgage-backed securitisation – and the
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42 increasing involvement of other non-bank financial institutions in property
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44 have amplified the cycle, in particular in the decade running up to the
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46 financial crisis. Post-crisis, whilst new macroprudential regulations have
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48 repressed mortgage credit in some countries, monetary policy has played an
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50 amplificatory role, with the ultra-low medium to long term interest rates
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52 generated by central bank Quantitative Easing programs increasing the
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3 attractiveness of real estate as a financial asset - relative to other safe haven
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6 assets – for capital market investment.
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11 None of this is to say that finance has been the only driver of rising house
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13 prices in the last few decades. Supply side factors – a collapse in public
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15 affordable housing provision, inelastic planning regimes, inefficiencies in the
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17 construction industry and national and local housing policies – have
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19 important effects in particular economies and in particular regions within
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21 those economies. But policy debate – outside the academies of political
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23 economy and economic geography - has largely focused almost exclusively
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25 upon supply-side dynamics, neglecting domestic and international demand
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27 for property as a financial asset (Gallent et al 2017).
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38 Both the left and the right of the political spectrum have been guilty of this.

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40 On the Left, a consensus has grown around the need to build more
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42 (affordable) homes with little consideration as to the implications of such a
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44 large expansion in terms of land availability in desirable locations.
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49 Meanwhile, the Right has tended to focus on liberalising planning
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51 frameworks and removing other market ‘frictions’, neglecting the fact that
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53 planning rules only exist because of the scarce nature of desirable land. This
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55 failure to consider demand-side policy developments reflects the dominance
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57 of conventional, neo-classical economic theory in framing policy challenges.
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3 This, broadly speaking, assumes land and credit are essentially subject to the
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5 same, equilibrium-based rules of supply and demand as any other
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7 commodity in the long-run, neglecting their unique properties of scarcity
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9 (land) and elasticity (credit). Excessively high house prices are, according to
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11 the supply-side approach, mainly due to artificial constraints (e.g. planning
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13 and zoning constraints or related government interference) that prevent
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15 efficient market clearing (see, *inter alia*, Glaeser et al 2005; Glaeser et al 2008;
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17 Hilber and Vermuelen 2010). The role of economic rent is also largely ignored
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19 in this narrative. Land rent extraction via capital gains by homeowners or
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21 investors and via interest charges and securitisation fees flowing to banks and
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23 non-bank financial institutions are neglected.
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36 *Related literature*

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41 This paper aligns with the economic geography and political economy
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43 literatures on land and housing as a financial asset and urban land rents
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45 (Coakley 1994; Harvey 1978, 1982, Haila 1990). Harvey, building on Marx,
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47 argued that the built environment is drawn in to the capitalist profit seeking
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49 effort as a result of 'capital switching' that occurs once the primary,
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51 productive circuit of profit is exhausted due to overaccumulation. This is
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53 only possible with the emergence of mature credit markets - indeed, Harvey
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3 argues there is a parallel between land titles and interest-bearing bank loans
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6 which are both forms of 'fictitious capital'.
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11 Harvey's work stimulated debate on the nature of urban land rent in the
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13 1980s and early 1990s (King 1989; Haila 1990 and see Ward and Albers 2016
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15 for recent overview). A number of scholars have argued Harvey's theory was
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17 economically deterministic, neglecting important institutional, cultural and
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19 socio-economic and spatial dynamics that mediated the relationship between
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21 (finance) capital and property (Ball 1985, Haila 1988, Katz 1986; King 1989).
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26 One contribution of this paper is to provide some institutional and historical
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28 fleshing out of the property-finance relationship that emphasizes the
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30 differences, rather than similarities between property and credit-money, and
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32 how macroeconomic policy choices can shape their interaction to generate
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34 different outcomes.
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44 More recent, post-crisis interventions have focused on the financialisation of
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46 housing as a key channel for the transmission of neoliberal dynamics in late
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48 modern capitalism (Seabrooke and Schwartz 2008; Rolnik 2013; Aalbers &
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50 Christophers 2014; Aalbers 2016), in particular as a means via which capitalist
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52 economies can maintain demand in the face of stagnating wages and
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54 productivity. The deregulation and liberalisation of mortgage finance enabled
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56 households to borrow against the increasing rise in the value of their homes
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3 to fund consumption, a form of 'privatised Keynesianism' (Crouch 2009;
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6 Watson 2010) that enabled the boom of the 1990s-2000s to last so long. Rising
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8 house prices and widespread home-ownership – both enabled by
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10 financialisation – is also tied to the neo-liberal concept of 'asset-based welfare'
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12 (Doling & Ronald 2010; Watson 2009) where the state withdraws from
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14 provision of economic support for the under- and un-employed and
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16 pensioners, with (liquid) property wealth taking its place as a new, but rather
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18 uneven safety net. The housing financialisation literature
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20 emphasizes the diversity of forms of 'residential capitalism' (Seabrooke and
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22 Schwartz 2008; Aalbers 2017) but also postulates a general tendency in
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24 advanced economies of housing becoming more tightly interwoven in to
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26 banking systems and financial markets and housing policy being increasingly
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28 determined by the needs of those markets rather than supporting access to
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30 housing (Aalbers 2016; Rolnik 2019).
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44 The additional contribution of this paper is to provide a theoretical and
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46 historical elaboration, accompanied by recent data, of the housing-finance
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48 cycle as a critique of conventional neoclassical economic theory and its neglect
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50 of the key properties of credit and land. In doing so, it draws on
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52 Schumpeterian and post-keynesian economic theory which emphasises the
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54 role of credit-money and uncertainty in determining the trajectory of the
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56 macroeconomy and its effect on asset prices; and links this to the classical
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3 political economists' concern with land rents as a key constraint on capitalist
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6 growth. Secondly, the paper develops a broadbased macroeconomic policy
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8 reform agenda targeted specifically at breaking this cycle and reducing the
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10 speculative demand for housing.
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17 Breaking the housing-finance cycle, it is argued, will require structural
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19 political economy reforms that go well beyond the standard supply-side
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21 measures currently on offer. The paper focuses in particular on: 1)
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23 institutional and structural reforms to banking systems, including central
24
25 banks; and 2) reforms to the distribution of land rents (or land value capture),
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27 best addressed by changes to fiscal policy, land-ownership and housing
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29 tenure. In both cases, examples can be found in modern capitalist economies,
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31 suggesting change is possible, despite the likely strong resistance from vested
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33 interests.
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44 The remainder of this article is structured as follows. Section two outlines the
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46 dynamics of the housing-finance cycle in terms of theory, history and
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48 macroeconomic policy developments. Sections 3 and 4 examine financial
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50 reforms and reforms to land value capture that might be effective in breaking
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52 the housing-finance feedback cycle respectively. Section 5 concludes.
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2. Dynamics of the housing-finance cycle

2.1 Economic theory and evidence

Banks create new credit, money and purchasing power in the act of lending – money is not borrowed from elsewhere in the economy (McLeay *et al.* 2014; Ryan-Collins *et al.* 2012). When a bank makes a ‘loan’ it creates a new, income-generating asset for itself alongside a mirroring liability (the deposit) which is effectively money since, in normal times, it is accepted at par with cash and central bank reserves and thus can be used to discharge tax obligations to the state. The making of a loan places no significant limits on a bank’s ability to make future such loans in modern economies where central banks ‘accommodate’ expansions in the money supply by providing reserves on demand to the banking system. In this sense, bank credit is highly elastic and able to adjust rapidly to changing economic conditions.

Schumpeter (1934) viewed banks as the ‘ephor’ of the capitalist economy.

Credit creation enabled entrepreneurs to obtain a share of the economy’s resources prior to production, allowing them to ‘carry out new combinations’ (innovation) and thus compete effectively with incumbent firms. This is key in enabling the process of ‘creative destruction’ that is a feature of dynamic capitalist economies. Similarly, Keynes described capitalism as a system of ‘monetary production’ in the sense that ‘[bank] Credit expansion provides not

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3 an alternative to increased saving but a necessary preparation for it' (1939 p.
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6 572).
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11 Credit is thus key to innovation and economic growth. But there is no
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13 guarantee that credit will always be allocated efficiently to support economic
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15 growth. Broadly speaking, credit creation in support of goods-and-services
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17 transactions leads to GDP growth, whereas credit flows to asset markets raise
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19 asset prices relative to output prices, encouraging more speculative financing
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21 and becoming the fuel for capitalism's instability (Minsky 1975; Werner 2005;
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23 Bezemer 2014). The theory is supported by a range of empirical studies (see
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25 Bezemer et al 2018 for a review).
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36 Even without expectations of rising future asset prices, however, a
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38 deregulated banking system is likely to develop a preference for mortgage
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40 lending (Ryan-Collins et al 2017). Due to asymmetric information between
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42 lenders and borrowers, banks develop a preference for collateral to secure
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44 loans, rather than raising interest rates – as standard economic theory would
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46 have it - to high levels for fear of attracting risky borrowers in an adverse
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48 selection process (Stiglitz and Weiss, 1981). Banks will discriminate against
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50 debtors whose assets cannot be collateralized, many of them in non-financial
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52 business who typically have limited liability. Landed property is one of the
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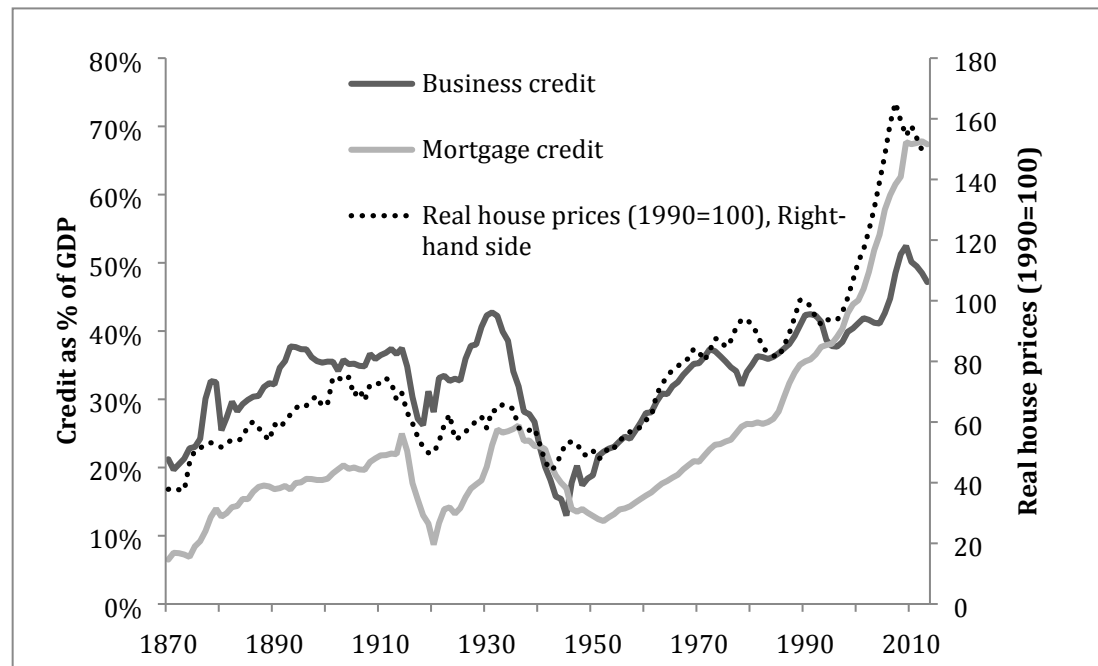
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3 most desirable forms of collateral as it is virtually impossible to hide and
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6 tends to appreciate over time.
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11 Until recently, mainstream macroeconomic policy models largely assumed
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13 that the majority of bank credit supported non-financial investment and it
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15 was widely held that deeper financial markets would enable more efficient
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17 capital allocation and hence growth (King & Levine 1993). But a remarkable
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19 transformation in the allocation of bank credit has occurred over the past 3
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21 decades. Today banks in advanced economies lend significantly more to
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23 households for the purposes of buying existing housing and real estate than
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25 they do for either business investment or consumer purchases, as shown in
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27 two recent comprehensive empirical studies (Jordà *et al.* 2016; Bezemer *et al.*
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29 2017).
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41 Figure 1 shows outstanding business and mortgage credit and, on the right-
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43 hand axis, house prices, averaged across 17 advanced economies since 1870.
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45 Up until the 1990s the two credit-series move broadly together but, as a
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47 proportion of GDP, banks lent more to firms than they did for domestic or
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49 commercial real estate purchase. But in the early 1990s, a dramatic change
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51 occurs. Mortgage lending in advanced economies increases from about 40% of
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53 GDP to 70% in the space of 20 years whilst the stock of non-mortgage loans
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flattens, rising by little more than 5%. During the same period, average real house prices followed a similar path to mortgage credit, increasing by 50%.ⁱ

Figure 1: Business credit, mortgage credit and real house prices in advanced economies since 1870



Source: Data taken from Jordà-Schularick-Taylor Macrohistory Database, available at <http://www.macrohistory.net/data/>; see Jordà et al (2017) and Knoll et al. (2017).

The visual evidence in Figure 1 is backed by a number of single country and cross-country statistical analyses of the causes of house price growth. In a study of 19 countries between 1980-2005, the OECD estimates that financial deregulation enabling an expansion of mortgage credit has increased real house prices by 30%, far more than other variables demand and supply variables (Andrews *et al.* 2011). A similar study by the International Monetary

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3 Fund (IMF) but extending to 2010, found that a 10 per cent increase in
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6 household credit leads to a 6 per cent increase in nominal average house
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8 prices (IMF 2011 p. 150). Single country studies of the U.S. (Duca *et al.* 2011),
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11 Ireland (Kelly *et al.* 2018) Japan and the UK (Aron *et al.* 2012) and Germany
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13 (Muellbauer 2018) equally find a key role for credit conditions in explaining
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16 house prices and household consumption.
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22 The danger from a macroeconomic perspective is that credit creation for the
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24 purchase of existing property increases land and house prices and household
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26 debt without stimulating investment or productivity growth. This means
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28 there is insufficient funds to pay back the interest on the loan, meaning
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30 households must either take on more debt or reduce their spending,
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32 repressing demand. This will lead firms to cut back on investment, leading to
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34 lower profits and stagnating wages. In turn, this feeds in to more demand for
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36 mortgage debt as house prices continue to rise relative to incomes. Indeed, a
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38 study of 46 economies over 1990–2011 found a negative relationship between
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40 the stock of bank lending to domestic real estate and economic growth but
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42 positive growth effects of credit flows to non-financial business (Bezemer *et al.*
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44 2016).
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57 The housing-finance feedback cycle runs against standard economic theory
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59 where an increase in the supply of goods, all else being equal, should
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3 eventually lead to a fall in prices. An 'equilibrium' price will be reached at the
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6 point when the quantity of goods supplied exactly matches the demand for
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9 them. But with bank credit and land, we have two phenomenon that are
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11 quite unlike standard commodities. Bank credit is highly elastic and
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14 essentially infinite; in contrast land is inherently inelastic due to its scarcity
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17 (Gaffney 1994).
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22 The housing-finance cycle also has important implications for our
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24 understanding of economic rent, in particular land rent. Since the 1970s,
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27 wealth accumulation in many capitalist economies has largely been driven by
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30 increases in property prices via capital gains, rather than increases in profits
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33 from the production of goods and services (Rognlie 2014; Stiglitz 2015). This
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36 is a return to a form of '*rentier-capitalism*', where life chances are determined
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39 not by hard work, innovation or entrepreneurial endeavor but simply by
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42 whether one is lucky enough to own a piece of land in the right part of the
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45 country (or city) or invested at the right time in the housing-finance cycle.
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49 In much of the literature rent is viewed as accruing primarily to the land-
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52 owner, following the classical economists' writings (George 1879; Ricardo
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55 1817). Whilst, as noted in the introduction, economic geographers have
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58 provided a more sophisticated treatment of (urban) land rents, emphasising
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61 how social, cultural and political dynamics mediate rent creation and

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3 extraction (King 1989; Ward and Aalbers 2016), less attention has been given
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6 to the institutional dynamics of the banking system and financial and
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9 macroeconomic policy more generally, including fiscal policy, in determining
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11 rent extraction dynamics. But the housing-finance cycle implies the financial
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14 sector is able to generate and monetize – in the form of interest on mortgage
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17 debt - a significant proportion of land rents via credit creation (Hudson 2010).
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19 The phenomenon of securitisation further complicates matters as non-bank
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22 institutional investors who purchase such mortgage-backed securities from
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25 banks (and the flow of interest payments that accompany them) can be seen to
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28 further amplify the cycle and absorb a part of the land rent.
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34 *2.2 Potential critiques of the housing-finance cycle hypothesis*

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39 One concern with the housing-finance cycle hypothesis is causation. A bank's
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42 decision to lend is naturally affected by the demand for loans which in itself is
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45 driven by what is occurring in the wider economy (most obviously rising
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48 incomes or increasing populations relative to the supply of new homes). This
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51 creates endogeneity bias and means that correlations discussed in the
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54 previous section may not equate to causation from bank credit to house price
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60 growth.

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3 Financial deregulation can be seen as a natural experiment to test this
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6 hypothesis, since it is largely a political rather than economic (and thus
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9 endogenous) phenomena. A number of studies show that the Anglo-Saxon
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12 economies that deregulated their mortgage markets in the 1980s saw faster
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15 rises and more volatility in house prices than those economies that did not
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17 (Aron *et al.* 2012). One study of the US looked at the impact on house prices
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20 of bank branching deregulation which benefitted only certain types of banks
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23 but not others in the same U.S. states between 1994-2005 (Favara & Imbs
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26 2015). The increased funding enjoyed by the first group of banks from the
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29 deregulation led them to increase their mortgage lending by between one-half
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32 and two thirds, which explained between one-third and a half of the observed
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35 increase in house prices. However, the banks in the same areas that did not
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38 benefit from the deregulation did not increase their lending. This provides
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41 strong evidence that increases in bank credit drive up house prices
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44 independently of demand-side/endogenous factors.

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47 Despite the above evidence, the dominant focus in much of the economics
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50 literature on house prices is on the supply side (Glaeser et al 2005; 2008).

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53 Some scholars have noted that those Anglo-Saxon countries that deregulated
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56 their financial systems most rapidly – the UK, US, Australia – also have less
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59 flexible planning systems and a less elastic supply of land. It does appear to
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be the case that Britain and Australia have less flexible planning systems than,

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3 for example, continental Europe (Cheshire *et al.* 2014; Gurran & Whitehead
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6 2011). However, the legislative changes that impacted on planning in these
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8 countries mainly took place in the 1950s and 1960s, so they seem less useful in
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10 explaining the more recent explosion in house prices since the late 1990s.
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17 There are also examples where very rapid increases in housing construction
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19 (allowed by highly elastic planning regulations) did not temper house price
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21 booms. The experiences of Spain and Ireland in the run-up to the financial
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23 crisis show why 'building more homes' can never be the simple solution to
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25 housing affordability problems. Irish house prices doubled in the space of a
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27 decade between 1997 and 2007, whilst Spanish prices increased by 50% in just
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29 6 years whilst both countries were undergoing huge construction booms.
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35 Prices continued upwards until 2007 when the crisis hit, defaults started and
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37 property values collapsed. Australia has undergone a similar experience
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39 more recently, with Sydney and Melbourne undergoing massive
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41 constructions booms in new apartments in the last five years accompanied by
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43 increases rather than decreases in prices (Scutt 2016). However fast you can
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45 build, banks can create new credit faster.
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54 Furthermore, research shows that increases in land and house prices may
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56 have a 'crowding out' effect on bank lending to non-financial firms in favour
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58 of mortgage lending. A study of bank lending in the US found that increases
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3 in house prices led banks to substitute away from commercial lending
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6 towards mortgage lending (Chakraborty *et al.* 2016). The authors found that
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9 this resulted in a decrease in the investments of firms that had a relationship
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11 with the affected banks. In other words, increasing land prices negatively and
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14 potentially permanently effected business investment via reduced lending.
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19 Finally, one argument commonly made by economists is that the rise in
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21 mortgage debt and hence house prices is attributable mainly to low and
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23 falling real interest rates experienced in advanced economies since the 1990s
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25 rather than primarily due to other forms of financial liberalisation and
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27 deregulation. Low rates have certainly been a contributory factor. However,
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29 interest rates on their own do not help explain the exceptions to the general
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31 rule of rising house prices in advanced economies in this period: for example,
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33 the falling house-price-to-income ratios experienced in Germany, Japan,
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35 Switzerland and South Korea which had the same falling real interest rates.
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43 As we shall discuss in section 4, it was policy choices by these countries
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45 unrelated to interest rates that made them exceptional.
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52 ***2.3 Historical emergence of the housing-finance cycle***

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3 The emergence of the housing-finance feedback cycle was driven by the great
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5 home-owning democracies, the U.S. and the U.K. following the collapse of the
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7 Bretton-Woods fixed exchange rate regime in the early 1970s. This led to a
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9 rapid liberalisation of banking systems in these countries, spurred on by
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11 ferocious competition between the two nations' financial centres: New York
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13 and London (Krippner 2011; Ryan-Collins 2018). Prior to the 1980s, mortgage
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15 credit was restricted to conservative mutuals (the Thrifts in the U.S. and
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17 Building Societies in the UK) by a combination of formal and informal
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19 regulation. Mortgage terms were long with fixed interest rates and, in the US,
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21 often insured and guaranteed by the Federal Housing Administration and
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23 Veterans Administration. By the 1950s, 40% of all mortgages were federally
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25 subsidized (Jorda et al 2016: 122).
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Innovations in the financial sector and the internationalization of capital flows
that followed the breakdown of Bretton Woods weakened these regulations.
There was also liberalisation and innovation on the liability side of bank's
balance sheets. Whilst traditionally banks' funding was limited to domestic
retail depositors, from the mid-1970s U.S. banks were able borrow funds from
outside the U.S. to fund their mortgages, in particular from the largely
unregulated 'Euro-dollar' market. Domestic financial innovations also
enabled banks to attract deposit funding away from the Thrifts (Krippner
2005).

1
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3
4
5
6 The neo-conservative administration of Margaret Thatcher responded to the
7
8 resulting growth of the New York financial sector by liberalising the UK
9
10 banking sector and encouraging it into the mortgage market. As with the U.S.,
11
12 foreign exchange controls were lifted allowing UK banks to also access the
13
14 Eurodollar market. As part of the 'Big Bang' financial reform of 1986, Building
15
16 Societies were permitted to borrow on wholesale markets and quantitative
17
18 restrictions on mortgage lending for banks and mutuals were eased. The
19
20 result was an explosion in domestic mortgage credit from just over 20% of
21
22 GDP in the late 1970s to 55% a decade later; house prices doubled over the
23
24 same period.
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36 The internationalisation and harmonisation of financial regulation along the
37
38 lines of the Anglo-Saxon model following the collapse of Bretton Woods,
39
40 along with the liberalisation of capital controls and the emergence and
41
42 globalisation of residential mortgage-backed securitisation (RMBS), saw
43
44 advanced economies in Australasia and Europe gradually embrace the US-
45
46 UK feedback cycle. Under the auspices of the Bank of International
47
48 Settlements (BIS), a new regulatory framework was created – the “Basel
49
50 Accords” - that introduced minimum capital requirements for all Banks
51
52 related to the type of assets they held. Loans secured by mortgages on
53
54 residential properties only carried half the risk weight of loans to non-
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1
2
3 financial firms (50%) in the original Basel Accord. Furthermore, securitized
4 mortgages, which were viewed as more liquid and thus even less risky, only
5
6 carried a 20% risk weight. The effect of these reforms was to allow banks to
7
8 earn fees and net interest margins on holding 2.5 times more credit risk in real
9
10 estate than they had before without any increase in their capital requirements
11
12
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14
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16
17 (Persaud 2016 p. 5).
18
19
20
21

22 The key financial innovation was RMBS. This transformed a geographically
23
24 fixed and illiquid asset – a traditional 25 year fixed-rate mortgage loan – into a
25
26 liquid and transparent financial asset which can be bought and sold almost
27
28 anywhere in the world (Gotham 2009). By opening up housing finance to a
29
30 vast global investment sector it broke down previous national and local
31
32
33 institutional barriers over the funding of home purchase and transformed the
34
35
36 banking system.
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44 In Europe, the combination of low and stable interest rates - a requirement of
45
46 single market membership - and the acceptance of higher levels of debt over
47
48 longer durations by households and regulators in the 1990s made mortgages a
49
50 more attractive form of asset for institutional investors seeking secure, long-
51
52 dated assets. This coincided with the introduction of the Euro in 1999 which
53
54
55 saw an explosion in capital market activity with the establishment of a Euro-
56
57
58 denominated bond-market. This was more stable than single country bond
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60

1
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3 markets and provided access to lower cost, long-term funding which helped
4
5
6 develop wholesale market instruments as alternatives to retail deposits as a
7
8
9 source of funding for banks, including covered mortgage bonds and RMBS.

10
11 As with the U.S. model, banks would originate loans but then package them
12
13
14 up in to securities and shift them off their balance sheets to either Special
15
16
17 Purpose Vehicles (SPVs) sponsored by banks or directly to investors.
18
19

20
21
22 RMBS became an important source of funding in the UK, Australia and
23
24
25 Ireland in the 1990s and Europe during the early 2000s (Lunde & Whitehead
26
27
28 2016 p. 25). Securitisation enabled mortgage issuers to offer a wider range of
29
30
31 mortgage products, to offer mortgages at much lower rates of interest and
32
33
34 offer them at higher LTV ratios. This in turn enabled larger numbers of
35
36
37 people to access home ownership at higher price to income and mortgage-
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39
40 debt to income ratios. The latter ratio increased by a third or more in many
41
42
43 countries between 1998 and 2009.
44
45
46

47 *2.4 The post-crisis feedback cycle*

48
49
50 Post-crisis, while maintaining Consumer Price Inflation as their primary
51
52
53 target, central banks have begun to take a closer interest in monitoring house
54
55
56 prices and introduced policies aimed at restricting real estate credit to address
57
58
59 'systemic risks' across national economies; so called 'macroprudential' policy
60

1
2
3 (Cerutti *et al.* 2017).ⁱⁱ Regulators have imposed limits to loan-to-value and
4
5
6 loan-to-income ratios for mortgages and also targeted buy-to-let and interest
7
8
9 only mortgages in the UK, Australia, Switzerland, New Zealand and Hong
10
11 Kong.

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14
15
16 Such policies are welcome but there is little sign as yet they are strong enough
17
18
19 to overcome the strong incentives banks have to lend against landed
20
21
22 property. After previous house price bubbles, the house price to income ratio
23
24
25 has generally returned to somewhere near its long-term average. Not so this
26
27
28 time (Ryan-Collins 2018: p2). Instead, some of the richest and most
29
30
31 sophisticated economies in the world have become caught up in another
32
33
34 mortgage credit/house price bubble. House prices in Toronto, capital city of
35
36
37 Canada, have doubled in the last 5 years. Total outstanding US mortgage
38
39
40 loans are now back at nearly \$15trn, the same as at the 2008 crisis peak. In
41
42
43 Sweden, the household debt to income ratio reached 179% in 2015, a higher
44
45
46 rate than the crisis peak in the U.S. in 2008 (Andersson & Jonung 2016).

47
48
49 A similar story applies in Canada, the Netherlands, Norway and Belgium.
50
51
52 Meanwhile Australia and New Zealand are the champions of the post-crisis
53
54
55 house-price boom, seeing the value of property increase from 3 to 4 times
56
57
58 GDP in the space of just 4 years since 2012 (Bourke 2017), racing far ahead of
59
60
61 incomes. The two largest cities, Sydney and Melbourne, averaged 14% and

1
2
3 10% annual increases in house prices between 2013 and 2017 respectively.
4
5

6 And whilst average house prices did fall markedly in the UK and U.S., real
7
8 wages have also flat-lined meaning affordability has not increased as rapidly
9
10 as might have been expected.
11
12
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14
15

16
17 Despite taking some steps to regulate mortgage credit, governments and
18
19 central banks must both shoulder the blame for the emergence of this latest
20
21 house price boom. After an initial fiscal stimulus, governments cut back on
22
23 spending and hoped that easy monetary policy – low interest rates – would
24
25 encourage consumption and investment. Since 2009, the American, British,
26
27 Japanese and European central banks have together bought up more than
28
29 \$11trillion-worth of government bonds and other safe assets from investors,
30
31 replacing it with zero-interest newly created money via ‘Quantitative Easing’
32
33 (QE) programmes. The hope was that this would force investors to invest in
34
35 more risky, real economy debt such as debt and equity issued by companies.
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46 But the evidence suggests that rather than stimulating real economy growth,
47
48 QE has pumped up asset prices, in particular house prices (Moody's Analytics
49
50 2015). The ‘wall of liquidity’ created by QE catalysed a global search for
51
52 higher yielding but safe assets. Landed property, particularly in international
53
54 cities, proved to be one of the most attractive assets for investors with global
55
56 reach, not least because they could easily source borrowing, backed by
57
58
59
60

1
2
3 property assets, at ultra-low interest rates from a banking sector still hooked
4
5
6 on real estate. Land in 'global cities' such as Paris, New York, London, Hong
7
8 Kong and Toronto has become akin to gold – an essentially speculative but
9
10 still 'safe' store of value. Property prices in these cities have 'synchronized',
11
12 with price dynamics closer to each other than with domestic cities and regions
13
14 (Brooker 2018). Although speculative buyers from both home and abroad
15
16 usually target 'prime' (very expensive) properties, this naturally raises prices
17
18 across these cities and means they become unaffordable for those on middle
19
20 incomes.
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31 *2.5 The role of government policy*

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36 The financial deregulation, liberalisation and innovation that led to a huge
37
38 expansion in credit on the supply side was complemented by changes in
39
40 government policy that increased the demand for home ownership. In
41
42 particular changes in taxation and public subsidies made property more
43
44 attractive as a financial asset, as well providing a flow of housing services.
45
46 Anglo-Saxon liberal market economies led the way, beginning the process
47
48 even before the financial deregulation of the 1970s.
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58 *Tax changes favouring home ownership*

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6 In 1963 the UK abolished the 'Schedule A' income tax, a tax on imputed rental
7
8 income (the ground rent that a property owner would have had to pay if they
9
10 had not been an owner). Five years later, when capital gains tax was
11
12 introduced, an exemption was made for primary residencies. This
13
14 immediately made private property a more attractive financial asset than
15
16 shares and savings vehicles, both of which attracted hefty taxes. In the late
17
18 1980s, the Thatcher government abolished the local property tax scheme
19
20 ('Domestic rates'), at the height of the house price and credit boom, replacing
21
22 it with the Poll Tax and later 'council tax' which has not been revalued since
23
24 1991, making it highly regressive. All of these policies meant that property
25
26 owners were able to capture a larger and larger share of the capital gains from
27
28 rising house prices. Much of this could be realised through mortgage-equity
29
30 withdrawal which was also liberalised in the 1980s.
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44 In the U.S., the twentieth century saw the tax system become systemically
45
46 biased in favour of land and real estate ownership over other forms of
47
48 activity. Prior to the 1930s property taxes accounted for around 2/3rds of state
49
50 and local government tax receipts. But gradually taxes have been shifted off
51
52 property and on to incomes and consumers (via increasing sales taxes). Today
53
54 property taxes make up only 20% of state and local revenue (Hudson 2012 p.
55
56
57
58
59
60 227).

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6 The maximum capital gains tax rate payable by individuals in the U.S.
7
8
9 between 1942 and 1995 averaged 27% in contrast to 70% on income. Likewise
10
11 for corporations, the maximum capital gains tax was 28% compared to 45%
12
13 on corporate profits (Hudson 2010 p. 236). In addition, the tax code permits
14
15 investors to avoid paying tax on real estate at the point of sale if they reinvest
16
17 their sales proceeds to buy new property of equal or greater cost. Real estate
18
19 is further favoured because land appreciation is not recognized in US
20
21 accounting protocols. It is treated for tax purposes in the same way as
22
23 depreciable capital – taxed income is considered to be cash flow less
24
25 depreciation. But real estate does not provide a physical cash flow, but rather
26
27 an imputed flow of income (or imputed rent). Land *appreciates* since increases
28
29 in land values typically outpace the costs associated with depreciation of the
30
31 physical structures of land. Yet real estate owners typically are able to offset
32
33 their tax against depreciation whilst capital gains are ignored.
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46 These changes to taxation in the UK and US made home ownership
47
48 increasingly attractive as a financial asset. In particular in the cities where
49
50 rapid growth was occurring, home owners were now able to enjoy large
51
52 capital gains – i.e. economic rents - from the simple virtue of owning property
53
54 in an area of rising economic growth and investment. But there was no
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1
2
3 political constituency at the time to push back against these developments as
4
5
6 the desire for home ownership increased and incomes continued to rise.
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10
11 *Subsidies shift from supply to demand*
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16
17 By the early 1980s, neo-liberal policies had become more entrenched in the
18
19 Anglo-Saxon economies and governments began to withdraw from the direct
20
21 provision of affordable housing and housing finance, instead enabling the
22
23 market to take on a greater role. Rather than subsidizing or investing in the
24
25 *supply of housing* or land – or indeed building or buying land themselves –
26
27 these states began to shift towards subsidizing the *demand for home ownership*.
28
29
30
31 Selling publicly owned houses to tenants – often at a discount - became a
32
33 popular strategy: it increased home ownership and won votes whilst at the
34
35 same time reducing public expenditure, in particular the costs of
36
37 maintenance. The most spectacular example was the British Conservatives’
38
39 “Right-to-Buy” legislation which saw 1.5 million publicly owned houses sold
40
41
42
43
44 off in one of the largest ever privatisations of public housing in history, worth
45
46
47
48
49 £40 billion in its first 25 years (Meek 2014).
50
51
52
53

54
55 In other countries, policies have been more subtle but the direction of travel –
56
57 towards the commodification of housing and privatisation of land rents – has
58
59
60 been the same (Aalbers 2017). In many countries, tenant protection and rent

1
2
3 regulation laws were rescinded leading to an increase in rents and evictions
4
5
6 (Rolnik 2013). Municipalities were given increased responsibility for
7
8
9 affordable housing provision but seen their funding to provide it cut
10
11 (Hulchanski 2009). As funding for maintenance was cut, the quality of
12
13
14 remaining public housing stock deteriorated and housing estates were
15
16
17 increasingly stigmatized in the public and political imagination.
18
19
20

21
22 In most countries today, there is no capital gains due on primary private
23
24 residences and a whole range of other subsidies privileging home ownership
25
26 both as a form of tenure and as a financial asset (OECD 2016, Figure PH 2.2.1).
27
28 Most advanced economies offer mortgage interest relief (MIR) on taxable
29
30 income. In the Netherlands the foregone tax revenue from MIR was estimated
31
32 to be around 2.14% of GDP in 2015 and 0.5% in the U.S. (ibid). Because the
33
34 ownership of housing is skewed towards older and higher income
35
36 households, this is a highly regressive. Evidence from both the U.S. (Hilber &
37
38 Turner 2014) and Europe (Matsaganis & Flevotomou 2007) demonstrate that it
39
40 has mainly benefited higher income groups, many of whom will already be
41
42 home owners.
43
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53
54 For neo-liberal governments concerned about rising budget deficits,
55
56
57 encouraging the personal accumulation of assets such as housing equity as a
58
59 means of meeting the cost of social care and retirement needs in an aging
60

1
2
3 population also made political sense. 'Asset-based welfare' began to emerge
4
5
6 as a new policy framework with home ownership leading to less support for
7
8
9 higher taxes to fund universal welfare provision and pensions (Doling &
10
11
12 Ronald 2010).

13 14 15 16 17 18 **3. Policies to break the feedback cycle: financial reform**

19
20
21
22
23 How might it be possible to wean the advanced economy banking sector off
24
25
26 landed property? In the next two sections, I outline reforms to the financial
27
28
29 sector and to land and housing policy that might be effective in breaking the
30
31
32 housing-finance feedback cycle.

33 34 35 36 37 **3.1 Central banks and financial policy**

38
39
40
41
42
43 As discussed, central banks have begun to implement new policies to restrict
44
45
46 mortgage credit in the post-crisis period – so called 'macroprudential policy'
47
48
49 (Cerutti *et al.* 2017). So far, this does not appear to have been effective in
50
51
52 preventing new house price bubbles in a number of advanced economies.

53
54 One additional policy reform would be for central banks to incorporate asset
55
56
57 prices in their inflation target (currently house prices are excluded in most
58
59
60 measures of consumer price inflation). More generally, financial policy

1
2
3 makers – in both central banks and ministries of finance - should now have
4
5
6 the confidence to more explicitly regulate the quantity and allocation of credit
7
8
9 for different purposes. During their history, almost all advanced economies
10
11
12 and many emerging economies – including East Asia - employed forms of
13
14
15 formal and informal quantity-based credit regulation under various terms,
16
17 including ‘credit guidance’, ‘window guidance’, ‘moral suasion’ (see Bezemer
18
19 et al. 2018 for a review).

20
21
22
23 Credit for the purchase of land and property was suppressed under these
24
25
26 regimes as it was seen to produce excessive asset price inflation and
27
28
29 subsequent banking crises. Most bank credit was allocated to productive
30
31 useⁱⁱⁱ, either investment in plant and equipment to produce more goods,
32
33
34 investment to offer more services, or other forms of investment that enhanced
35
36
37 productivity (such as the implementation of new technologies, processes, and
38
39
40 know-how) – and often a combination of these (Wade 1990; Wang & Vittas
41
42 1991; Werner 2003). A recent study found that the removal of credit controls
43
44
45 and credit guidance policies (including the privatisation of state investment
46
47
48 banks) is strongly correlated with an increase in the share of asset-based
49
50
51 lending (mainly mortgage debt) in advanced economies (Bezemer *et al.* 2018).

52
53 Domestic regulations of this type would be considerably more effective if they
54
55
56 were complemented by supportive international regulation. International
57
58
59 regulators, including the BIS and the IMF, need to reverse the strong
60

1
2
3 favouritism shown towards property lending in terms of capital and liquidity
4
5 requirements to support domestic regulations. Regulations should support
6
7 banks that are able to de-risk their loans via methods other than land-based
8
9 collateral, most obviously via the building up of long-term relationships with
10
11 non-financial businesses, as discussed in the next section.
12
13
14
15
16
17
18
19

20 *3.2 Structural reforms*

21
22
23
24
25
26 There may be limits to what regulation can achieve on its own given how
27
28 entrenched mortgage assets have become on modern banks' balance sheets
29
30 and their strong attachment to collateral. In addition, the highly competitive
31
32 and globalised nature of banking and capital flows today makes regulation
33
34 easier to 'game'. Countries might have to re-impose foreign exchange controls
35
36 to prevent foreign banks and shadow banking structures from getting around
37
38 domestic rules. Given these challenges, institutional and structural reforms to
39
40 banking systems may be appropriate.
41
42
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49

50 *Stakeholder banks vs. Shareholder banks*

51
52
53 A range of studies suggest that bank lending behaviour is strongly influenced
54
55 by ownership type, size and other institutional factors (Altunbas *et al.* 2001;
56
57 Ferri *et al.* 2014; Prieg & Greenham 2012). Since the 1990s, advanced economy
58
59
60

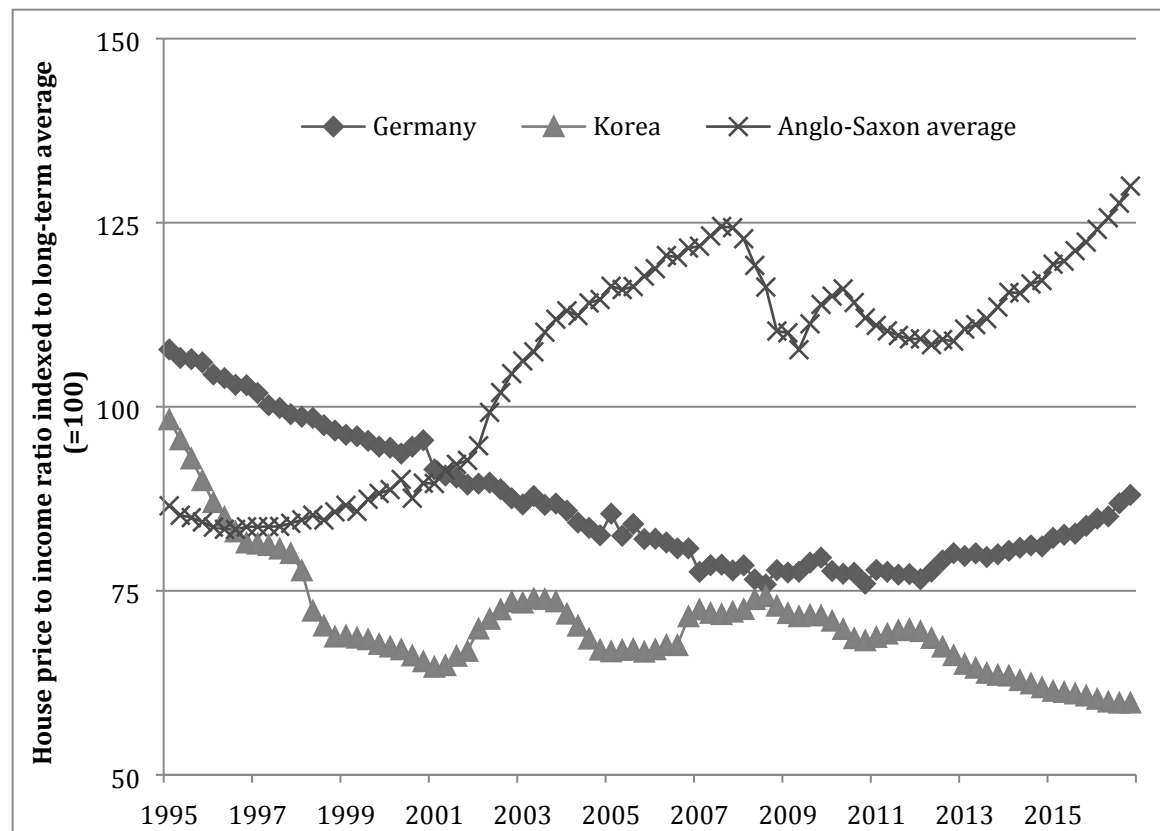
1
2
3 banking systems have become less diverse as financial deregulation led to
4
5
6 waves of mergers and acquisitions, often following financial crises. Large,
7
8
9 universal shareholder banks that combine investment- and retail-banking
10
11 functions have become the dominant model in Anglo-Saxon economies.
12
13
14 Specialist mortgage banks – the Savings and Loans and Building societies
15
16 discussed in the previous section – having demutualised or been absorbed
17
18
19 into larger universal banks.
20
21
22
23
24

25 The dominant ownership model for these banks is the publicly listed
26
27 shareholder model. Shareholder banks typically operate a ‘transaction’
28
29
30 banking model (Collins 2012) characterised by a preference for centralised
31
32
33 and automated credit-scoring techniques to make loan decisions, a need for
34
35
36 high quarterly returns on equity, and a strong preference for collateral and
37
38 thus property. Increasingly, the model favours the generation of profits
39
40
41 through securitisation. The imperatives of short-term shareholder value mean
42
43
44 that lending to SMEs – involving high transaction costs for relatively small
45
46
47 loans – does not make business sense for larger banks (Berger & Udell 2002).
48
49
50

51 By contrast, in other countries, for example Germany, Switzerland and
52
53
54 Austria, there is a much stronger culture of ‘relationship banking’. In
55
56
57 Germany, two-thirds of bank deposits are controlled by either cooperative or
58
59
60 public savings banks, most of which are owned by regional or local people

1
2
3 and/or businesses. These 'stakeholder banks' are more focused on business
4
5
6 lending, do not have such stringent collateral requirements and devolve
7
8
9 decision making to branches (Prieg & Greenham 2012). They de-risk their
10
11
12 loans not by requiring property as collateral but by building up strong and
13
14
15 long-lasting relationships and an understanding of the businesses they lend
16
17
18 to. Although the general pattern in advanced economies has been a shift
19
20
21 towards mortgage lending, in Germany lending to non-financial businesses is
22
23
24 significantly higher than mortgage lending at 40% of GDP, whilst mortgage
25
26
27 lending has only increased to around 30% of GDP. This stands in marked
28
29
30 contrast to the advanced economy average of 70% mortgage credit and 50%
31
32
33 non-mortgage (Ryan-Collins 2018: 103) and likely plays a significant role in
34
35
36 German households enjoying a falling house-price to income ratio for most of
37
38
39 the last 4 decades (Figure 2).
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Figure 2: House price-to-income ratio in Germany, Japan, Korea and Anglo-Saxon economies indexed to long term average (=100).



Source: OECD analytical house price database

Empirical studies find that 'stakeholder' banks, including public savings banks and cooperative banks, maintain their lending – both mortgage and non-mortgage - in the face of financial shocks (e.g. changes in interest rates) in contrast to shareholder banks which are much more pro-cyclical (Ferri *et al.* 2014; Beck *et al.* 2018). This is unsurprising if their models of lending are based on relationships rather than collateral values – a bank with a long and strong relationship with a firm is much more likely to have the confidence to

1
2
3 continue lending during a downturn and may also have a better grasp of the
4
5
6 local and regional economy.
7
8
9

10 11 *State investment banks* 12 13 14 15

16
17 Another way of supporting non-collateralised lending to support productive
18
19 activity and priority-infrastructure (including affordable housing) would be
20
21 the creation of - or greater support for - State Investment Banks (SIBs) (also
22
23 known as 'development banks' or 'public banks'). These institutions are
24
25 government-owned or sponsored financial institutions concerned primarily
26
27 with the provision of strategic and usually longterm finance to industry (De
28
29
30
31
32
33 Aghion 1999).
34
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36
37

38
39 Development banks are recognized as having played a crucial role in the
40
41 rapid industrialization process of continental Europe in the 19th century,
42
43 providing the patient capital necessary to build railroads and canals across
44
45 the continent and in the process revolutionizing capitalist production. One of
46
47 the largest examples from the 19th century was the French *Crédit Mobilier*^{iv}
48
49
50
51 bank, founded in 1852 by followers of the French socialist thinker and
52
53 reformer Henri de Saint-Simon. Its name is revealing. In contrast to the
54
55 common mortgage bank (*Sociétés du Crédit Foncier*) or 'land banks', which lent
56
57 money on the security of *immovable* property, the *Crédit Mobilier* aimed to loan
58
59
60

1
2
3 to the owners of *movable* property and so to promote industrial enterprise
4
5
6 (Hudson & Bezemer 2012 p. 7). The bank funded transport infrastructure in
7
8 France via low-interest long-term equity investment and bond finance, rather
9
10 than the short-term higher interest lending provided by French family banks
11
12 such as the Rothschilds (Hudson 2011 pp. 13–14). The *Crédit Mobilier* also
13
14 enabled the development of railroads across the rest of Europe by supporting
15
16 other continental development banks, via share ownership and the provision
17
18 of engineers and expert knowledge.
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27

28 State sponsored banks were also key to rebuilding western and East Asian
29
30 economies in the aftermath of the Great Depression and World War II when
31
32 mortgage finance dried up and or property was destroyed on a major scale.
33
34 The U.S. Reconstruction Finance Corporation (RFC) was a central component
35
36 of the Roosevelt's New Deal, financing a huge expansion in infrastructure in
37
38 the 1930s (Todd 1992). State investment banks played a key role in the rapid
39
40 growth of East Asian countries in the 1970s and 1980s – the so called 'East
41
42 Asian miracle' (Stiglitz & Uy 1996). Globally, by the 1970s, governments
43
44 owned 50 percent of assets of the largest banks in industrial countries and 70
45
46 percent of assets of the largest banks in developing countries (Levy-Yeyati *et*
47
48 *al.* 2004 p. 2). The emergence of neo-liberal policies in the 1980s and 1990s, as
49
50 described in section 3, saw a wave of privatisations of public banks. From
51
52 1987 to 2003, more than 250 banks were privatized (Megginson 2005).
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6 Development banks can play an important role stimulating innovation
7
8 because of their capacity to provide patient long-term capital to potential
9
10 growth sectors (such as green energy for example) that private sector venture
11
12 capitalists find too risky or too low-yielding (Mazzucato & Penna 2015). For
13
14 example, a recent study found that a large proportion of patient capital
15
16 supporting green energy projects came from public institutions, including
17
18 SIBs, rather than the private sector sources more usually associated with
19
20 financing innovation (Mazzucato & Semieniuk 2017). Historically and in the
21
22 present, SIBs have also supported SMEs that otherwise struggle to attain
23
24 finance from the commercial banking sector and who in many cases lack
25
26 property-based collateral. Both the German and Canadian SIBs, both set up in
27
28 the post-war period, have played a key role in supporting SME sectors
29
30 throughout their 60 year history. Germany and South Korea, which have
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32 both enjoyed falling house price-to-income ratios in the last two decades
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34 (Figure 2) both have large SIBs.
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4. Policies to break the feedback cycle: Land policy reforms

4.1 Reforming fiscal policy: a land-value tax

Reforms to the banking system would suppress perhaps the most important source of finance flowing in to property – newly created credit and money.

But in the post crisis world of low interest rates, land and housing will remain a highly attractive financial asset for speculative investment. Reversing the fiscal favouritism for home ownership and treating landed property in the same way as any other financial asset would appear a logical step if we are to bring house prices back to levels closer to incomes.

One proposal, supported by economists from across the political spectrum, would be a tax on the increasing value of land, or land value tax (LVT), most famously proposed by Henry George (1879). This would involve an annual tax on the incremental increase in the unimproved market value of land that would fall upon the landowner. The advantage of the tax is that it would accurately capture the economic gains deriving from public and private investment in a location – such as a new school or better transport infrastructure - not due to the land-owner's own efforts; in other words the tax would capture for the public purse economic rent.

By attaching a cost to owning land, LVT diminishes the incentive to buy land for speculative purposes – i.e. to realize capital gains – rather than productive purposes or simply to provide shelter. Knowing that any increase in the value

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3 of a property would be taxed should lead to a shift towards households
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6 purchasing a house purely on the basis of its value as a place to live – i.e a
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9 consumption good - rather than a financial asset. There would also be less
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12 incentive for developers to hoard undeveloped land. Such a tax would likely
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14
15 end the practice of 'land banking' or 'slow release' that is a problem in
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18 countries like the UK and Australia where developers have no incentives to
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21 build and sell property efficiently because the capital gains on their assets are
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24 rising, despite the shortage of housing the country faces (Ryan-Collins *et al.*
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2017 pp. 200–201).

A tax on land should naturally reduce mortgage lending. Under current
arrangements, as land values increase, land owners/home owners benefit
from most of this increase as the value of their properties increase. The larger
the increase in land values and thus property equity, the larger the loan the
bank will be prepared to make, all else being equal. Of course, the larger the
loan relative to equity, the more of the economic rent will flow to the bank in
the form of interest payments. With a sizeable land value tax, most of the
increase in land values flows to the public purse leaving just a small
proportion for the household to use as collateral. This would inevitably
reduce the size of mortgage loans and the rentier interest profits flowing to
banks.

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3 There are major political challenges with implementing property taxes in
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6 western democracies where home ownership and the idea of wealth
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9 generation from the home has become culturally entrenched. Today
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11 'immovable property taxes' make up just 1% of GDP and 2.5 per cent of total
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13
14 tax revenues on average across the OECD economies (Blöchliger 2015 p. 6).
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17 There are genuine fairness issues in some cases – in particular where a
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20 household or individual is asset rich but cash poor, meaning a tax would
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23 significantly reduce their income.
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28 To overcome these concerns, any land tax should be introduced as part of a
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30
31 wider tax reform that would reduce other unpopular and regressive taxes
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34 such as income or sales taxes (research shows land taxes are more
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37 economically efficient than other taxes (Arnold *et al.* 2011; Blöchliger 2015)).
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40 Exemptions for low-income home-owners, or allowing homeowners to defer
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43 payment until sale, may reduce the political difficulties of land taxes. Or
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46 home-owners could give up a percentage of their equity in the property each
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49 year that wasn't paid to the state, enabling the community to gain from any
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52 capital appreciation (Mayhew & Smith 2014).
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55 Another option would be to hypothecate the proceeds of a large-scale land tax
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58 evenly across the population as some kind of universal basic income, or
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61 perhaps hypothecate it to support a widely popular public service such as

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3 national healthcare. Reframing a property tax as a shared citizens' 'land
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6 dividend' could make it more appealing in the public imagination. Finally,
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8
9 reducing the saliency of the tax by withholding it at source from employment
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11 or pension income could make politically more acceptable.
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16 Ultimately, the biggest challenge facing the implementation of taxes on land
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18 and property are the vested interests facing significant wealth losses from
19
20 such a policy. Nevertheless, the stagnation of incomes and ageing
21
22 demographics that have been a feature of advanced economies over recent
23
24 decades suggest the policy may become more politically attractive. Recently
25
26 there have been calls by major international bodies including the OECD
27
28 (Blöchliger 2015) and the IMF (Norregaard 2013) for an increase in property
29
30 taxation as the tax best placed to boost growth in the post-crisis period. As
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32 incomes decline and wealth increases, and financial wealth becomes ever
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34 harder to locate and tax, it may become increasingly tempting for politicians
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36 to turn to land and property taxation to maintain tax bases.
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50 *4.2 Land ownership reforms*

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55 The risk with LVT, as with any tax, is that it could be easily reversed by a new
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57 government. By keeping land – and the economic value of land – outside the
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3 market economy and the financial system completely, the banking sector
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6 would be forced to find alternative ways of de-risking its lending. Few banks
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8
9 will be prepared to lend purely against the deteriorating value of the
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11 structures on top of a location.
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17 In mainstream economic theory, private property and home ownership has
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19 generally been thought of as beneficial. However a number of empirical
20
21 studies find a positive relationship between the growth of home ownership
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23 and increasing unemployment in a given area or country (Blanchflower &
24
25 Oswald 2013; Laamanen 2013). Countries with high levels of home ownership
26
27 will likely have less mobile populations, reducing the efficiency of the
28
29 distribution of labour and increasing the likelihood of NIMBY-ISM (Not In
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31 My Backyard-ISM) that may impede economic development. Whilst the rise
32
33 in home ownership in the 1945-1970s period certainly coincided with
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35 widespread increases in prosperity, since the 1970s, growth rates have fallen,
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37 inequality of wealth and income has risen and financial instability increased
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39 despite a continued growth in home ownership.
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51 One alternative is public ownership of land. At its simplest, public ownership
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53 serves to remove land from the market in perpetuity and socialise rents in the
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55 process. Public land ownership today is widespread, and takes many forms:
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57 from public parks and public highways, to social housing and heritage
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3 buildings. Holding land under permanent public ownership can ensure that
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5 such socially desirable uses are preserved in particular locations when market
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7 forces would dictate that they make way for more profitable uses, squeezing
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9 affordability.
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17 In Singapore, a densely populated city-state island of 3.9m residents, 90% of
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19 the land is owned by the state which leases it out for development, enabling it
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21 to capture land value increases as leases come up for renewal. 82% of the
22
23 resident population lives in high quality public housing provided by the
24
25 state-owned Housing Development Board. The Central Provident Fund
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27 (CPF), a compulsory savings scheme for both employers and employees,
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29 invests its balances in government debt and the government issues a variety
30
31 of affordable housing loans to the HDB. This creates a virtuous circle of
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33 socialised non-bank mortgage finance that has proven effective at providing
34
35 affordable housing (Phang 2001 p. 449). The average house price to income
36
37 ratio in Singapore is one of the lowest in Asia and has been falling since a
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39 housing bubble in the mid-1990s. Meanwhile, the system provides the
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41 Singapore Government with a handsome source of public revenues. In 2012
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43 alone government receipts from land sales totalled the equivalent of £9.1
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45 billion (Purves 2015).
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3 In South Korea, around half of all residential land development and almost all
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6 industrial land development is carried out by the Korean Land Corporation
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8 (KLC)^v. Since being formed in 1975, the KLC has played a key role in
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10 transforming the economy of South Korea by efficiently managing land and
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12 promoting economic development. The KLC's functions include developing
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14 and selling land for residential use, acquiring idle and vacant land for resale
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16 at current usage prices and developing new towns (Kaganova 2011). This has
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18 helped ensure that land and housing has remained affordable in South Korea,
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20 as shown in Figure 2.
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30 Of course, majority state ownership of land may not be politically feasible in
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32 many western countries. However, similar principles can apply at a smaller
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34 scale. If public sector entities are willing and able to purchase sufficient land
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36 for entire new settlements, it becomes fairly easy for the public body to
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38 capture all of the land value created by the development of the new town,
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40 enabling the cost of the original land purchase to be made up and exceeded,
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42 with profits put in to further upgrades to infrastructure. This is the model that
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44 was used successfully in the development of New Towns in the UK in the
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46 1960s (DCLG 2006).
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57 A similar approach can be used to capture the land value uplift created by the
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59 provision of infrastructure. if a public body acquires land at pre-development
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3 prices, it can then sell or lease the land at development prices upon
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6 completion of the new infrastructure – thereby capturing the rent itself. This
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8 form of land value capture has been perhaps most effectively used to finance
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11 Hong Kong's Mass Transit Railway (Purves 2015).
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17 These kinds of benefits could be achieved on a national basis by establishing
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19 national land banks or development authorities responsible for purchasing,
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21 developing and selling land for residential and commercial use following the
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23 Korea model. These land banks could use public money to buy land without
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25 planning permission and then lease or sell land to private developers at
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27 development prices following the grant of planning permission. As well as
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29 being a source of land release for housing and other development, the
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31 increase in land values could provide significant sources of revenue for the
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33 government.
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42 *4.3 Alternative tenure patterns*

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44 Tenure patterns play an important role in mediating the impact of
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46 deregulation and innovation in the financial sector. The higher the levels of
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48 home ownership in an economy, the greater the impacts of such
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50 developments are likely to be. This is because renters are not in a position to
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52 leverage against their property. The general pattern of home ownership in
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54 advanced economies has been an increase from around 40% home ownership
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3 in the 1940s to closer to 60% by the 2000s (Jordà *et al.* 2016 p. 121)(Jordà *et al.*
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5
6 2016 p. 121). But there are some interesting exceptions. Not all countries
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8 implemented changes in policies to boost private home ownership and
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10 mortgages. Germany, Austria and Switzerland, where home ownership rates
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12 are below 50%, provide good counter-examples.
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19 In Germany, loan-to-value ratios at savings and mortgage banks (the main
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21 providers of home loans) were often capped at 60%. At the same time, the
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23 comparatively high levels of rent protection that were put in place in the
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25 immediate post-war years were upheld in the following decades. In addition,
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27 the German tax code provided only limited incentives to take on debt. As a
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29 consequence, the home ownership rate in Germany stood at 43% in 2013 and
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31 was hence only marginally higher than the 39% ratio reached in 1950.
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38 Switzerland is one of the few remaining advanced economies that still levies
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40 taxes on the imputed rents of house owners. It also has rent caps in many
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42 cities and many Cantons ban foreigners from buying up property. Home
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44 ownership in Switzerland levelled out at around 35% in the past half century.
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47 And, also like Germany, Switzerland has a more devolved fiscal, planning
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49 and banking system with the Cantons having considerable autonomy over
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51 these issues.
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3 There is little evidence that economies where private home ownership
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5 dominates as a form of tenure are more productive or efficient. Easy access to
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7 housing credit may provide a short-term boost to consumption but ultimately
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9 results in greater financial fragility and growing wealth inequality. Housing
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11 policies should be tenure neutral in terms of subsidies or taxes offered or
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13 taken by the state. The private rented sector should be made as secure as
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15 possible, with long guaranteed tenancies, limitations on rent rises and strong
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17 tenants' rights. Government should take steps to boost the stock of non-
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19 market housing including homes with social rents, community-led schemes
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21 and co-operatives to ensure that different housing types and sizes are
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23 available in all tenures, and to make housing supply less dependent on the
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25 volatile private market in land and homes. Finally, decent investment
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27 alternatives and secure pensions should be provided so that households are
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29 less prone to invest in the housing market to pay for their retirement, or to
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31 rely on it to fund their care in old age.
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50 51 **5. Conclusion**

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56 Housing affordability presents a major challenge in modern capitalist
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58 economies. This is because the major cause of the affordability crisis is the
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3 interaction of two of its central pillars: private landed property and a
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5 deregulated financial system. Their interaction creates a feedback cycle that
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8 came to dominate Anglo-Saxon economies since the 1980s and, via the
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10 harmonization of cross-border financial flows, banking regulation and
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12 financial innovation, also European economies since the 1990s (with some
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14 important exceptions). At its heart, the cycle involves an elastic supply of
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16 credit and finance flowing in to an inherently scarce, fixed and irreproducible
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18 asset, land (or desirable location), with inevitable inflationary consequences.
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27 The deregulation and liberalisation of the financial system, initiated by the
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29 U.S. and U.K. in the late 1970s and early 1980s led to an enormous expansion
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31 in mortgage credit supply, flowing mainly in to existing property. This has
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33 been complemented by fiscal favouritism for home ownership over other
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35 tenures, through both taxation and subsidies, leading households to
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37 increasingly view property as a financial asset as well as a consumption good
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39 and attracting investment funds. The affordability crisis can thus be seen as
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41 primarily a demand-side problem, yet policy makers have largely focused
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43 attention on supply-side issues such as insufficient new building of homes,
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45 excessive immigration and restrictive planning rules.
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57 The housing finance-feedback cycle is economically inefficient, incentivising
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59 investment in unproductive property, but has strong self-perpetuating
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3 dynamics because a majority of the middle-class population in advanced
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6 economies own homes and have enjoyed significant capital gains – there is no
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8
9 longer a simple dichotomy between rentier landowners and workers. Home
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11 equity withdrawal has enabled these households to monetize a proportion of
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14 these gains and propped up consumer demand. But this debt-driven growth
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17 model involves a high level of rent extraction and generates increasing wealth
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20 inequalities as the young and those outside cities are shut out of the process.
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22 Ultimately, such a model also generates financial instability and crisis as
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25 rising debt levels eventually eat in to demand.
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30 The housing-finance feedback cycle is more than just a minor ‘market failure’.
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33 Unregulated banks will naturally incline towards asset-backed lending given
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35
36 the attractiveness of land as a form of collateral. As a result, demand-side
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39 reforms are needed. These include regulatory and structural changes to the
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41
42 ownership of banks to support business-lending over property lending; and
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44
45 major changes to taxation, subsidies and tenure policies. Important lessons
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48 can be learned from economically successful countries such as Germany,
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51 Singapore and South Korea which have shown that the financialisation of
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54 housing is not an inevitability.
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ⁱ Based on the average across 14 advanced economies.

ⁱⁱ Regulation had previously only focused on the stability of individual financial institutions: 'micro-prudential' policy.

ⁱⁱⁱ This is not to say that all forms of real estate lending are unproductive – for example mortgage finance that supports the building of new homes is likely to contribute positively to economic growth. However the majority of mortgage lending in advanced economies enables households to buy existing property.

^{iv} Although formally privately owned, the *Credit Mobilier* had close working relations with the state and was the only private bank to invest heavily in state-subsidized projects.

^v In 2009 the KLC merged with the Korean National Housing Corporation to the Korean Land and Housing Corporation.