

Rethinking the Economics of Land and Housing

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Foreword by JOHN MUELLBAUER

RETHINKING THE ECONOMICS OF LAND AND HOUSING

Josh Ryan-Collins, Toby Lloyd
and Laurie Macfarlane

with the New Economics Foundation



WHY ARE HOUSE PRICES in many advanced economies rising faster than incomes? Why isn't land and location taught or seen as important in modern economics? What is the relationship between the financial system and land?

In this accessible but provocative guide to the economics of land and housing, the authors reveal how many of the key challenges facing modern economies – including housing crises, financial instability and growing inequalities – are intimately tied to the land economy. Looking at the ways in which discussions of land have been routinely excluded from both housing policy and economic theory, the authors show that in order to tackle these increasingly pressing issues a major rethink by both politicians and economists is required.

'This excellent book is both thorough and comprehensive. I am convinced that it will quickly become an important reference for the general public and for economists, and hopefully also for policymakers.'

—MICHAEL KUMHOF, senior research advisor, Bank of England

'A fresh and comprehensive look at the problems created by a failure to consider the role of land in the economy of the UK.'

—KATE BARKER, author of the Barker Review of Housing Supply

'This important book analyses land and housing with excellent clarity. Read it and you will understand the crucial underlying drivers of rising debt, increasing inequality and financial crises.'

—ADAIR TURNER, chairman of the Institute of New Economic Thinking

'A lucid and convincing explanation of why a free-market approach to the land problem makes little sense, why the state needs to intervene, and the wide range of policy options available.'

—DANNY DORLING, author of *All That is Solid: How the Great Housing Disaster Defines Our Times, and What We Can Do About It*

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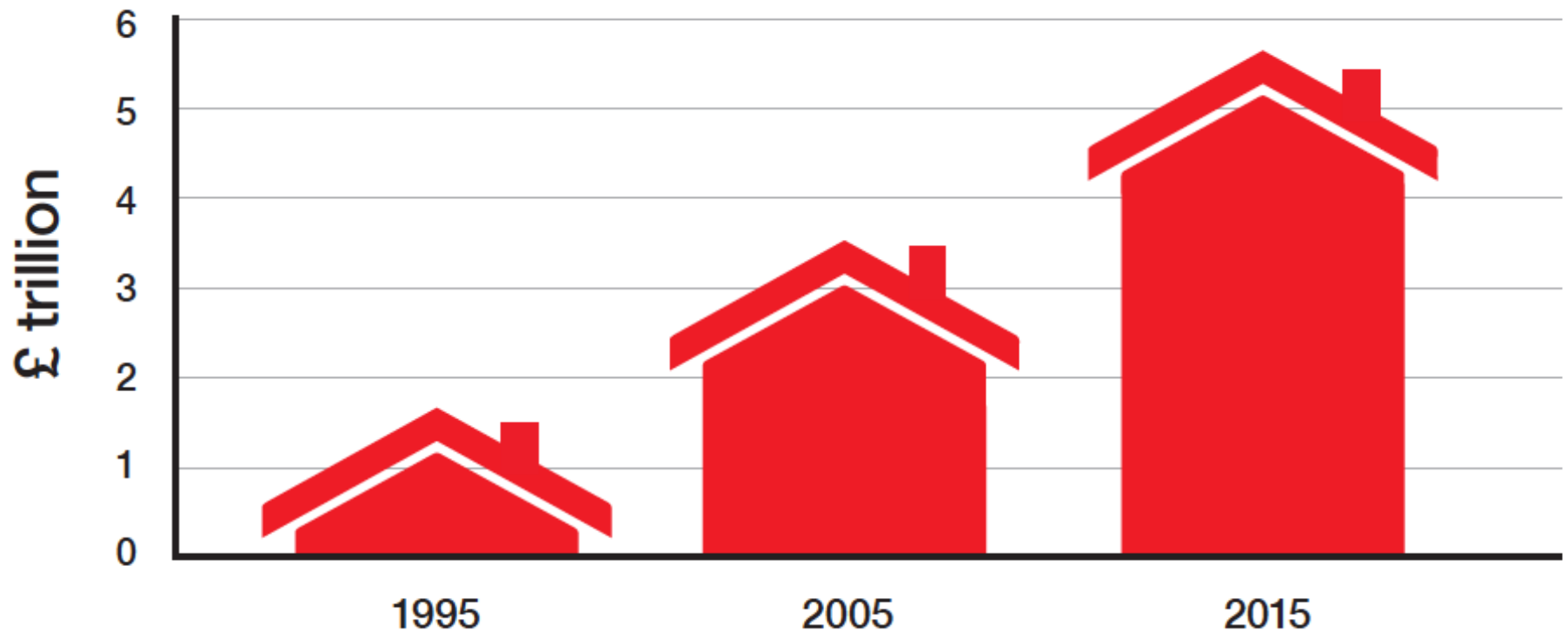


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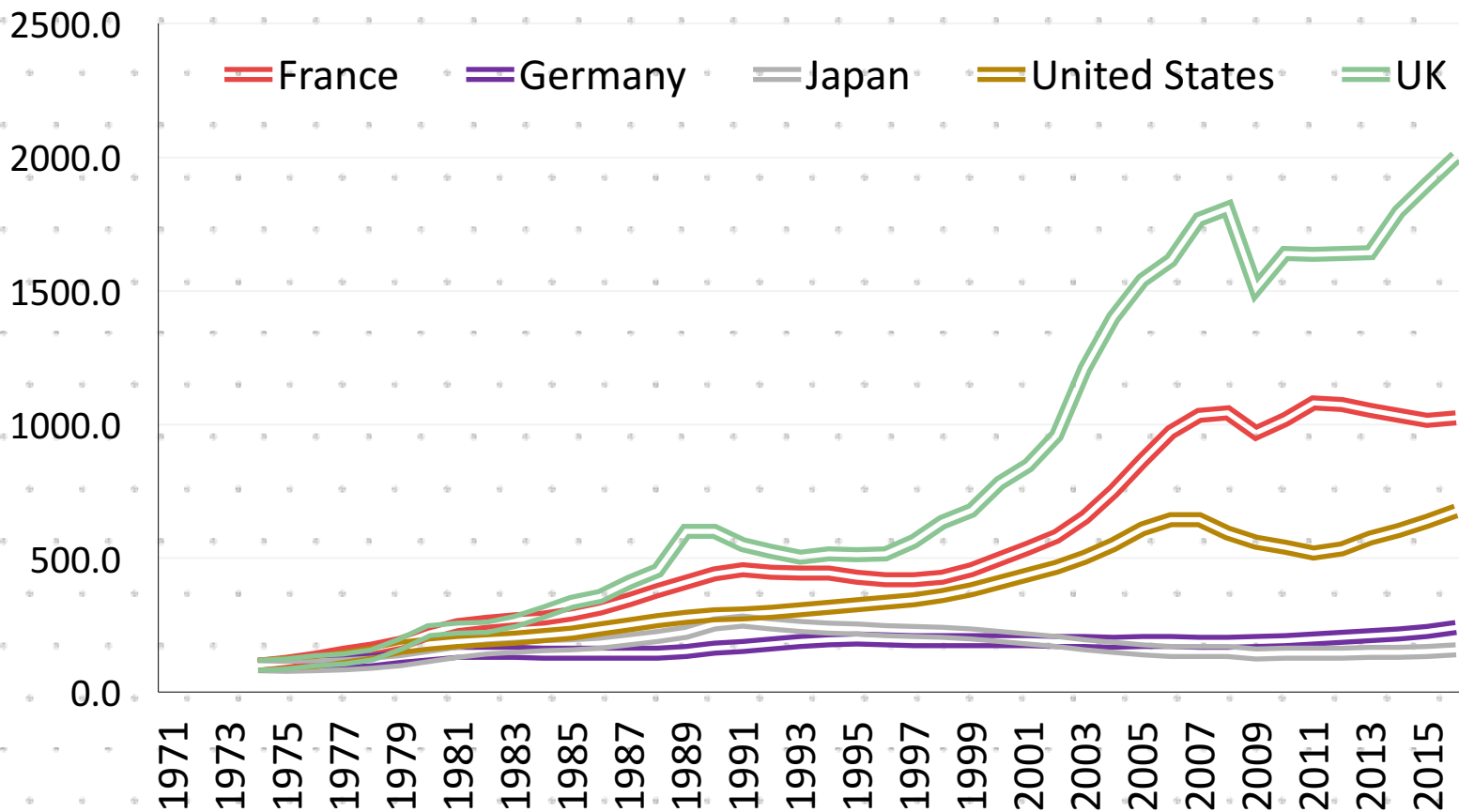


VALUE OF HOUSING STOCK IN THE UK

Source: Office for National Statistics

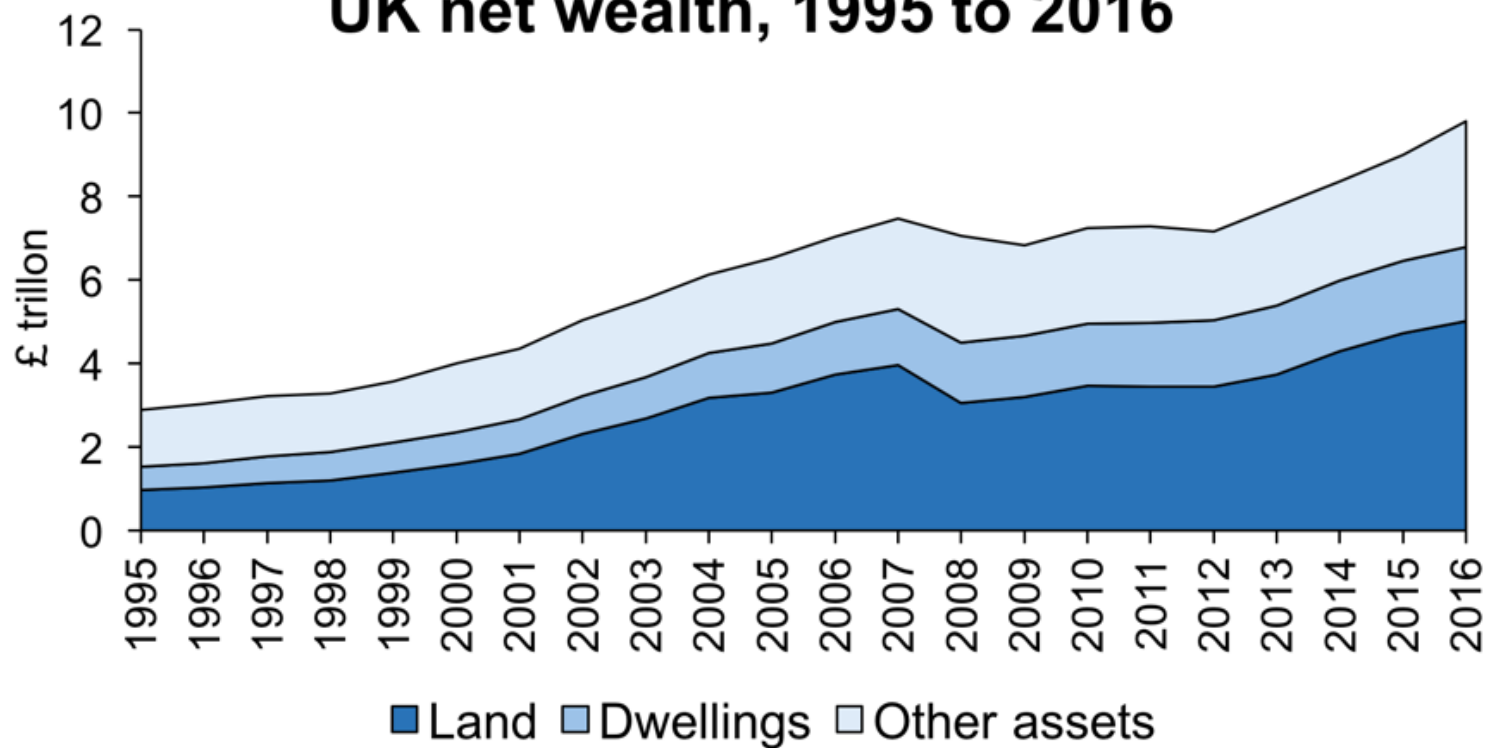


NOMINAL HOUSE PRICES (INDEX, 1974 = 100)



Source: OECD, Nationwide

UK net wealth, 1995 to 2016



Source: Office for National Statistics

“

Roads are made, streets
are made, services are
improved, electric light
turns night into day, water
is brought from reservoirs
a hundred miles off in the
mountains — and all the
while the landlord sits still.

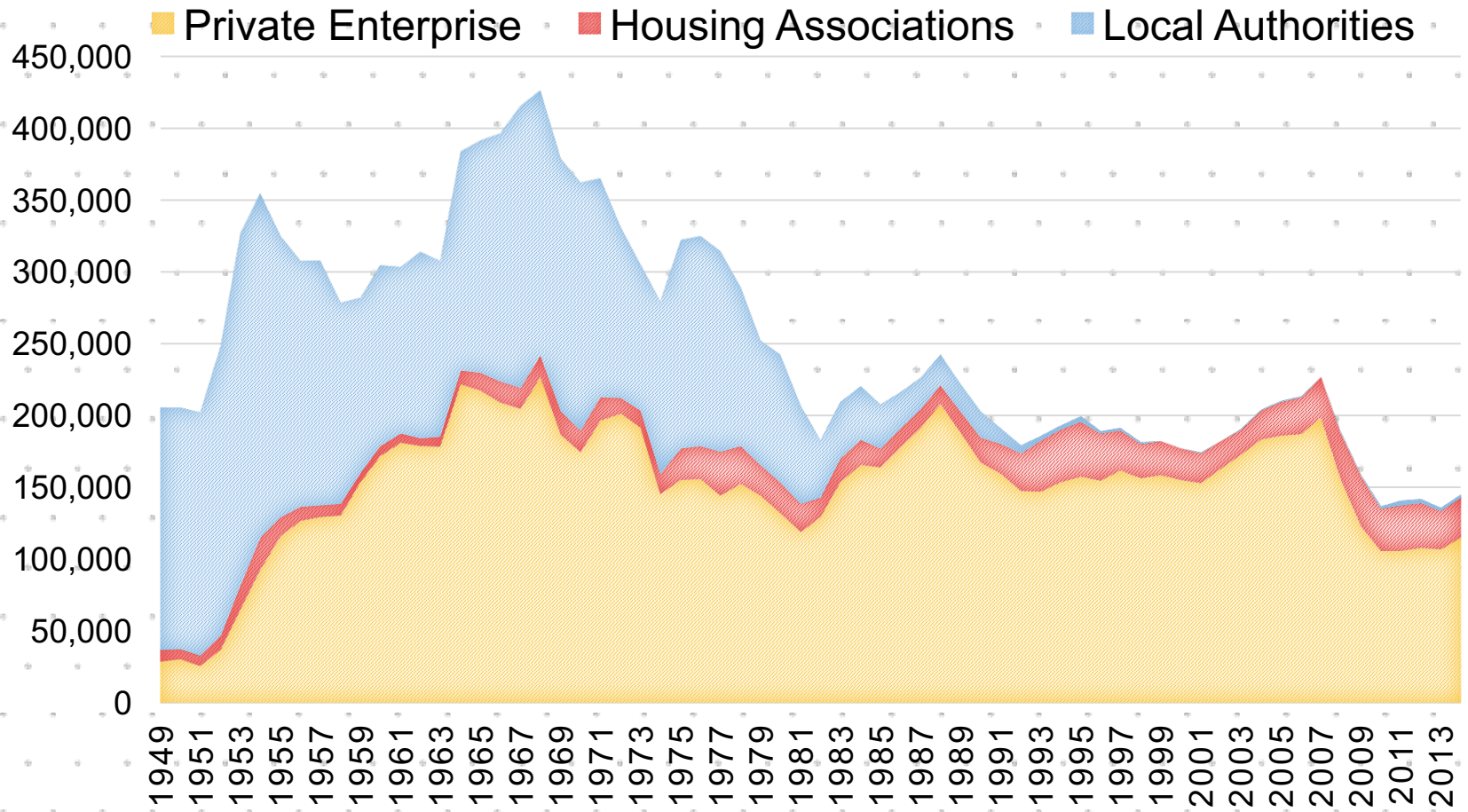
Winston Churchill

”



<https://flic.kr/p/rthwtX>

New houses built by tenure (United Kingdom)



Money creation in the modern economy

By Michael McLeay, Amar Radia and Ryland Thomas of the Bank's Monetary Analysis Directorate.⁽¹⁾

- This article explains how the majority of money in the modern economy is created by commercial banks making loans.
- Money creation in practice differs from some popular misconceptions — banks do not act simply as intermediaries, lending out deposits that savers place with them, and nor do they 'multiply up' central bank money to create new loans and deposits.
- The amount of money created in the economy ultimately depends on the monetary policy of the central bank. In normal times, this is carried out by setting interest rates. The central bank can also affect the amount of money directly through purchasing assets or 'quantitative easing'.

Overview

In the modern economy, most money takes the form of bank deposits. But how those bank deposits are created is often misunderstood: the principal way is through commercial banks making loans. Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money.

The reality of how money is created today differs from the description found in some economics textbooks:

- Rather than banks receiving deposits when households save and then lending them out, bank lending creates deposits.
- In normal times, the central bank does not fix the amount of money in circulation, nor is central bank money 'multiplied up' into more loans and deposits.

Although commercial banks create money through lending, they cannot do so freely without limit. Banks are limited in how much they can lend if they are to remain profitable in a competitive banking system. Prudential regulation also acts as a constraint on banks' activities in order to maintain the resilience of the financial system. And the households and companies who receive the money created by new lending may take actions that affect the stock of money — they could quickly 'destroy' money by using it to repay their existing debt, for instance.

Monetary policy acts as the ultimate limit on money creation. The Bank of England aims to make sure the amount of money creation in the economy is consistent with

low and stable inflation. In normal times, the Bank of England implements monetary policy by setting the interest rate on central bank reserves. This then influences a range of interest rates in the economy, including those on bank loans.

In exceptional circumstances, when interest rates are at their effective lower bound, money creation and spending in the economy may still be too low to be consistent with the central bank's monetary policy objectives. One possible response is to undertake a series of asset purchases, or 'quantitative easing' (QE). QE is intended to boost the amount of money in the economy directly by purchasing assets, mainly from non-bank financial companies.

QE initially increases the amount of bank deposits those companies hold (in place of the assets they sell). Those companies will then wish to rebalance their portfolios of assets by buying higher-yielding assets, raising the price of those assets and stimulating spending in the economy.

As a by-product of QE, new central bank reserves are created. But these are not an important part of the transmission mechanism. This article explains how, just as in normal times, these reserves cannot be multiplied into more loans and deposits and how these reserves do not represent 'free money' for banks.

[Click here for a short video filmed in the Bank's gold vaults that discusses some of the key topics from this article.](#)

⁽¹⁾ The authors would like to thank Lewis Kirkham for his help in producing this article.

“Banks do not act simply as intermediaries, lending out deposits that savers place with them.

“Commercial banks create money, in the form of bank deposits, by making new loans.”



“We assumed that we could ignore much of the details of the financial system”

Olivier Blanchard

Chief Economist of the IMF, October 2012

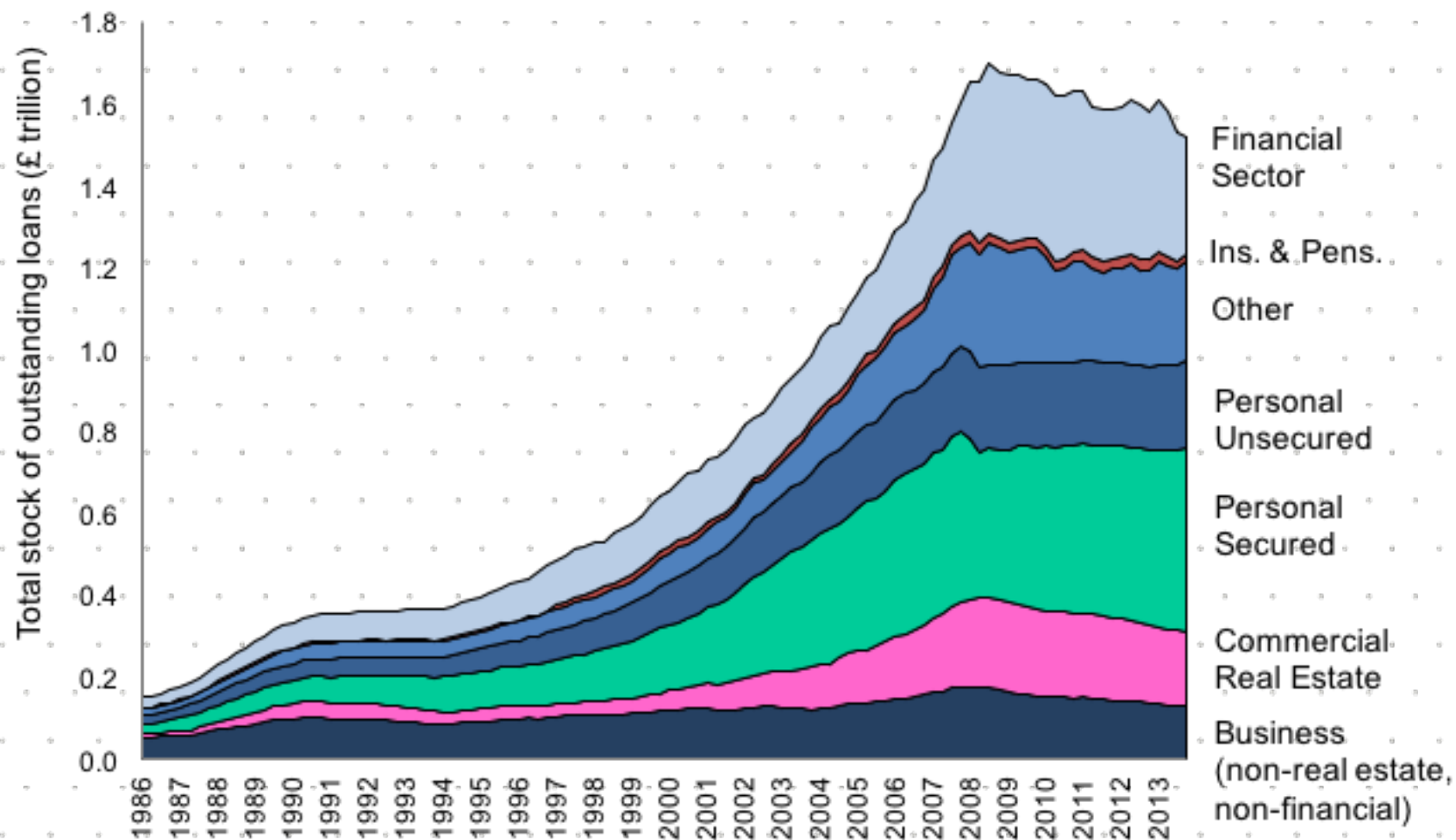


“The dominant new Keynesian model of monetary economics lacks an account of financial intermediation, so that money, credit and banks play no meaningful role”

Mervyn King

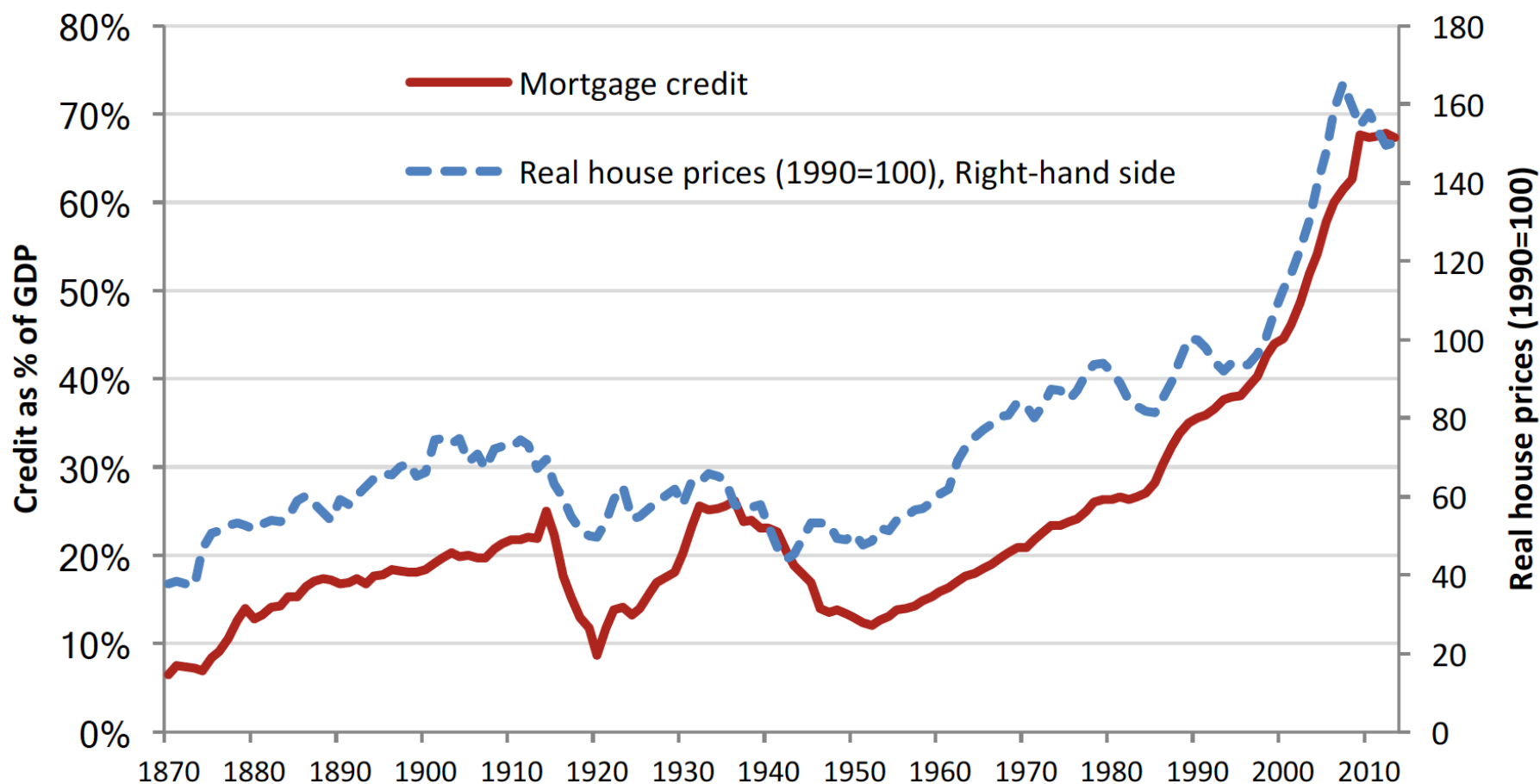
Governor of the Bank of England, 2012

UK bank lending by sector 1986–2014



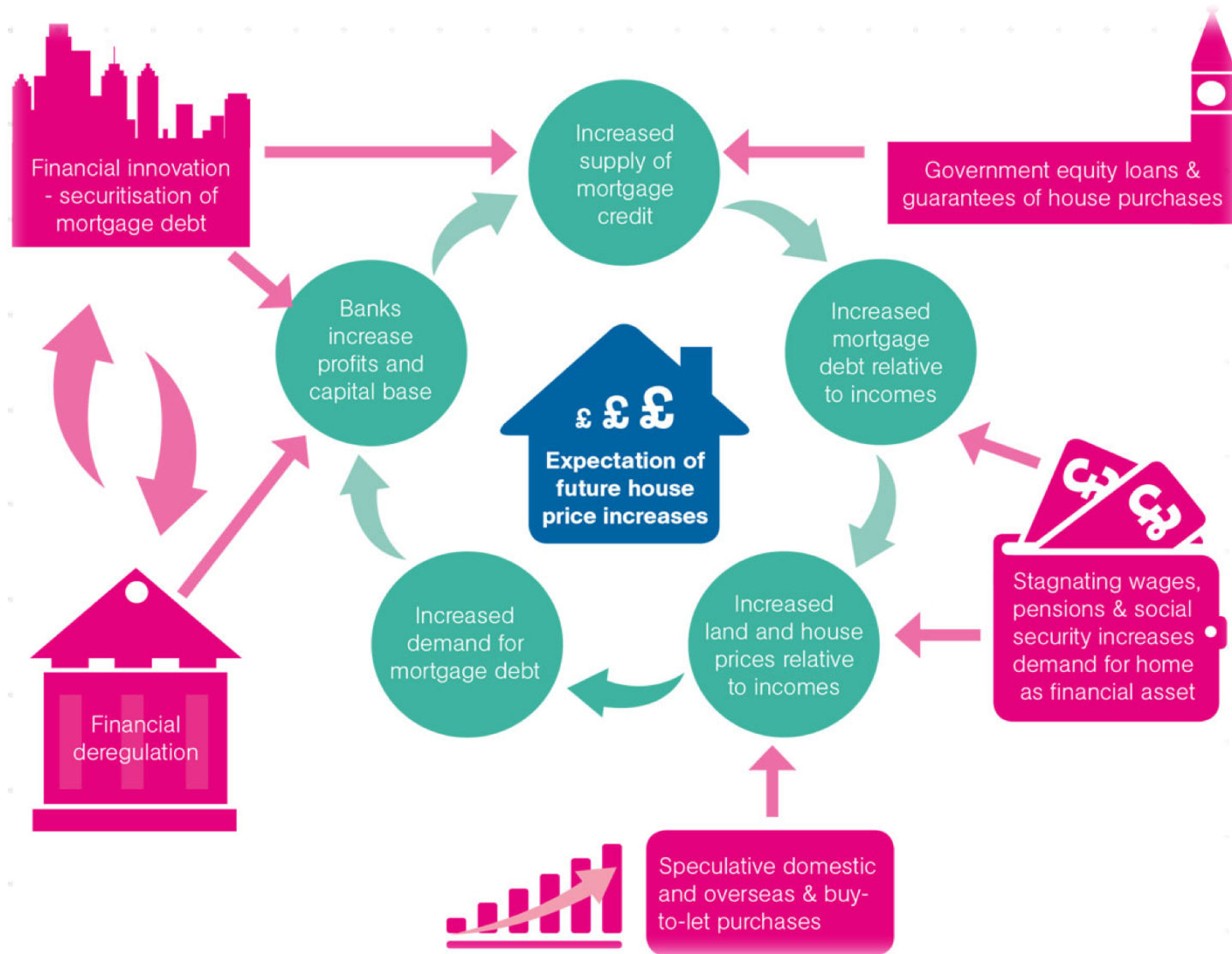
Source: Bank of England

HOUSE PRICES AND MORTGAGE CREDIT ACROSS ADVANCED ECONOMIES

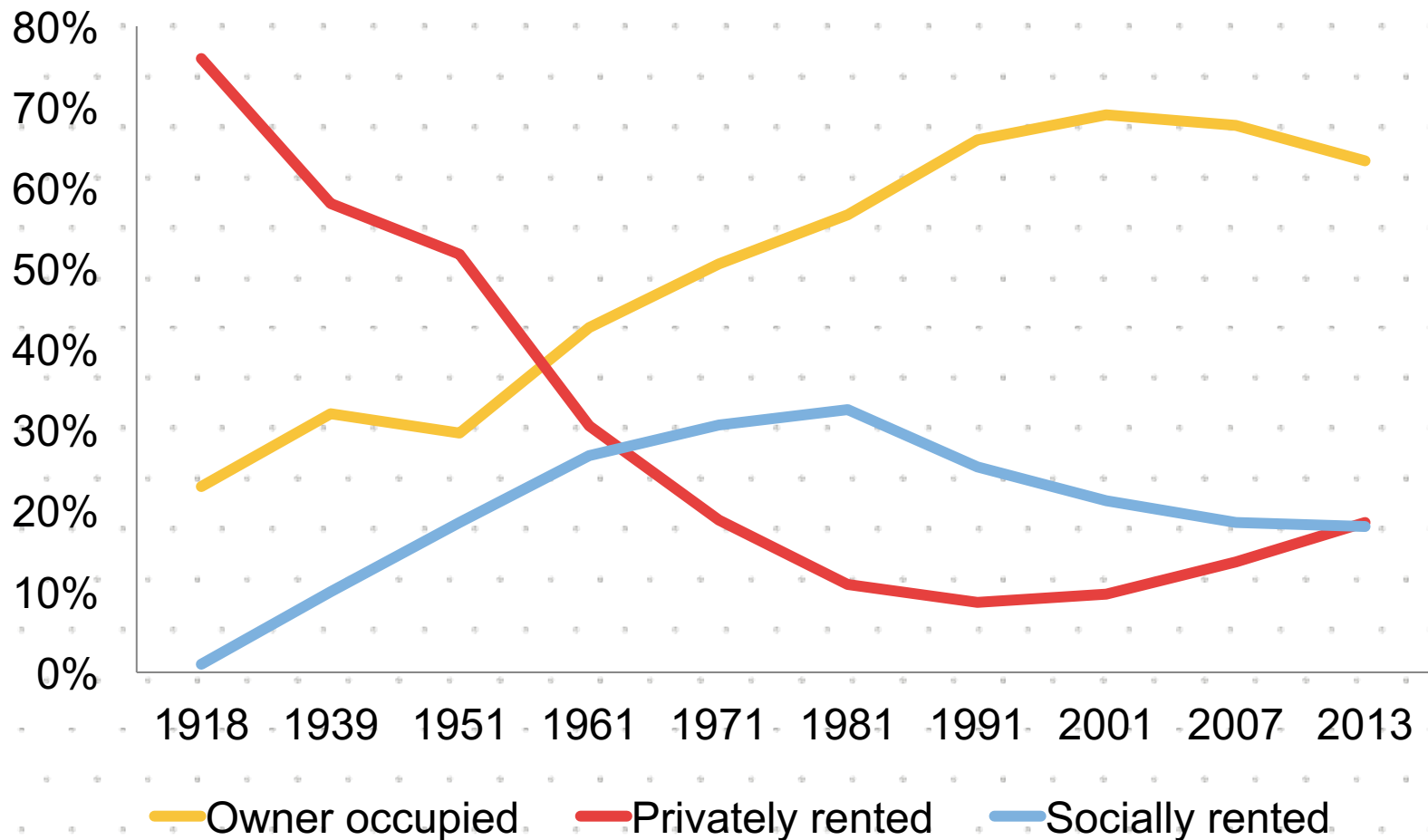


Source: Jorda, Schularick and Taylor 2017

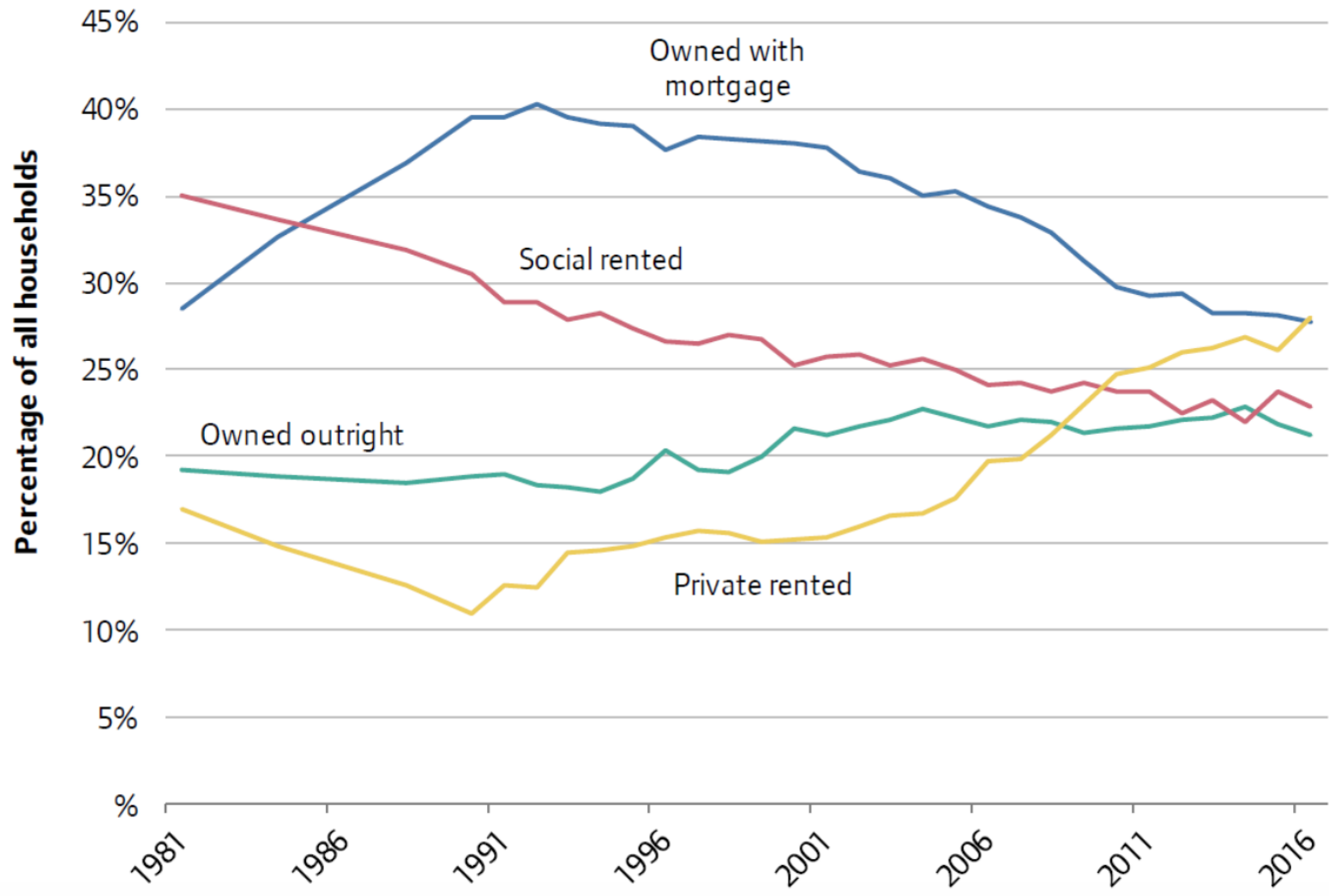
The land-credit feedback cycle



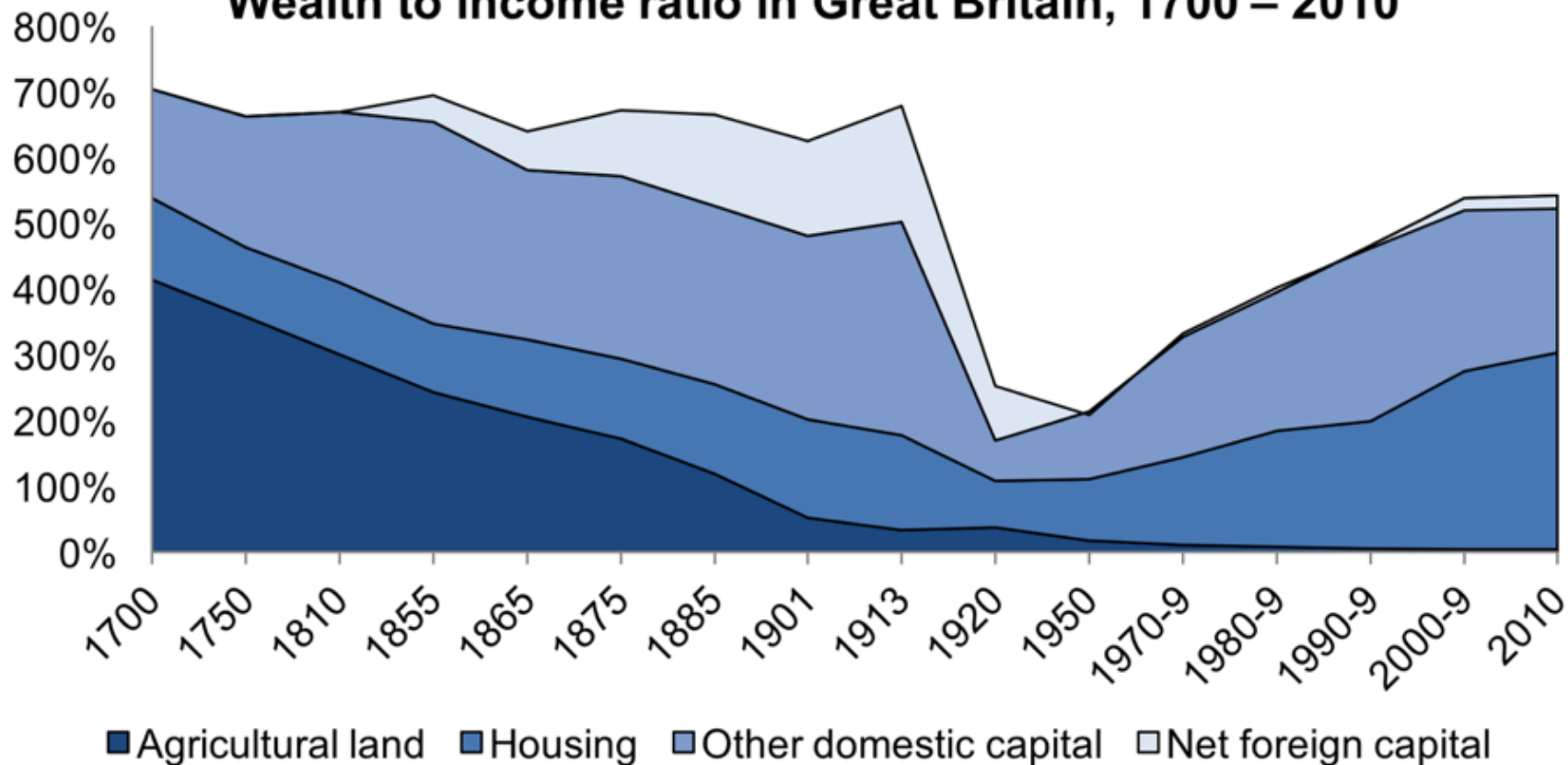
Trends in tenure type from 1918 to 2013 (Great Britain)



Trends in tenure type from 1981 to 2016 (London)

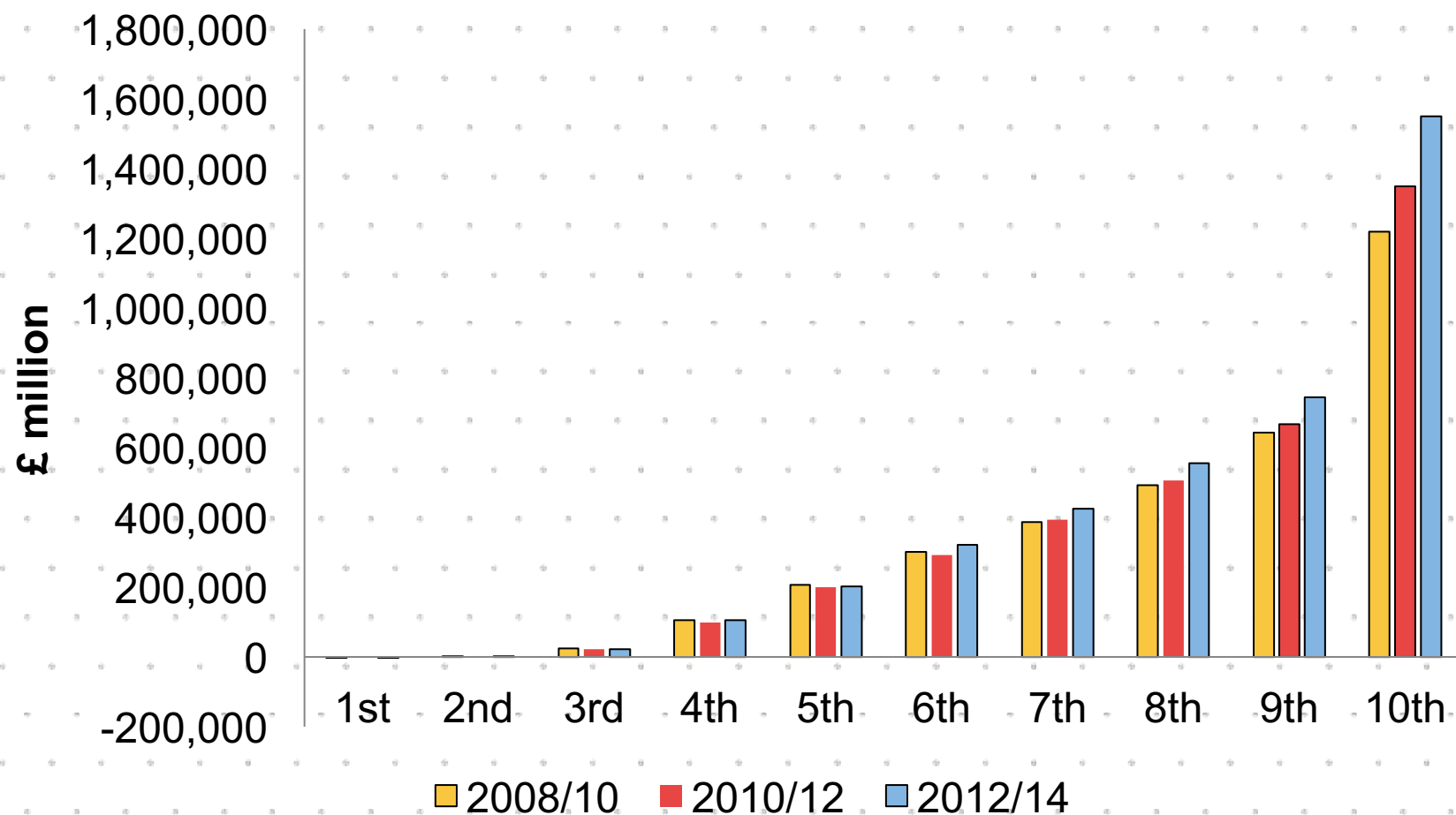


Wealth to income ratio in Great Britain, 1700 – 2010



Source: Piketty, *Capital in the Twenty-First Century*

Breakdown of net property wealth, by deciles (Great Britain)



RIISING LAND VALUES



PROPERTY OWNERS

- Increased net wealth
 - Greater economic security
 - Ability to borrow more
-

EVERYONE ELSE

- Higher rents
- More to save for a deposit
- Less disposable income

Man whose house has gone up in value thinks he's a brilliant businessman

27-03-17



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A MAN who has benefited from constantly rising property prices somehow believes it is due to his excellent business skills.

Cafe owner Norman Steele, 56, feels the ridiculously high £525,000 value of his three-bedroom home can only be the result of his shrewd eye for an investment.

“

If some of us grow rich in our sleep, where do we think this wealth is coming from? It doesn't materialize out of thin air. It doesn't come without costing someone, another human being. It comes from the fruits of others' labours, which they don't receive.

”



Objective #1:

Reaffirm the role of land,
economic rent, money and
credit in the teaching of
economics and in national
accounting frameworks.

Objective #2:

Capture uplifts in the value of
land for public benefit

Objective #3:

**Make housing supply less
dependent on the volatile private
market in land and homes**

Objective #4:

Level the playing field between tenures so that people are not incentivised to overinvest in homeownership

Objective #5:

Break the positive feedback cycle between the financial system, land values and the wider economy.

Objective #6:

Reduce reliance on housing market as a means for accumulating wealth, paying for retirement, or funding care in old age.

Thank you!

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