

High house prices: a blunder of our governments

AUT Briefing Papers series

Published 11 August 2015

There has been a strong sense this year that “something must be done” about high house prices, especially those in Auckland. To date, however, the policy responses display little awareness of how previous policy choices have made New Zealand housing increasingly unaffordable over the last couple of decades. Blaming “investors”, or the tax system, is largely a distraction. And while non-resident Chinese purchasers may be bidding up house prices in Auckland (and Sydney, Vancouver and other cities) right now, these pressures are recent and housing affordability problems are not. Increased demand for houses, whatever the source, doesn’t create problems if it is easy to bring new houses to market

In 2013 Anthony King and Ivor Crewe published *The Blunders of our Governments*, which traced Britain’s experiences with various policy disasters over the previous thirty years. Unaffordable New Zealand house prices, especially in Auckland, are the predictable outcome of a similar blunder: the collision of two sets of perhaps well-intentioned policy choices.

In New Zealand urban areas cover only around 0.7 per cent of our land. And land used for agriculture is just not that expensive. Prime dairy land at the peak of the boom in around 2008/09 was selling for around \$50000 a hectare. Residential sections in Auckland, of less than a tenth of a hectare, are selling for ten times that much. The comparison isn’t precise - subdivisions need streets and footpaths etc, so one hectare of farmland doesn’t generate one hectare of residential land. But in research done some years ago now, Arthur Grimes and Andrew Aitken found that land just inside the Auckland Metropolitan Urban Limit was selling for 10 times the prices of land just inside the limit. Even if we had a construction industry that was as efficient and productive as any in the world, our house (house plus land) prices would still be very high just because central and local government together have created this artificial scarcity. Auckland’s geography is certainly difficult, but that is all the more reason for having as few restrictions as possible on the ability of owners to use and develop land for housing. Land use restrictions appear to have become a much more serious constraint in the last 25 years. By contrast, in the 1950s and 60s, with a much stronger policy emphasis on home-ownership and house-building, planning restrictions (and especially land use restrictions) had a much less serious impact.

Of course, there are land use restrictions in place in local authority areas all over the country. Councils - staff and councillors - seem to feel a need to “plan” and central government legislation allows them to do so. But house prices in Auckland are four times those in Invercargill. That difference is really down population growth differences.

In places where there is no population growth, land use restrictions still impose costs, but they don’t have much impact on house and urban land prices. And where land use restrictions aren’t very important, rapid population growth also won’t do much to boost house and urban land prices. An example is the big US city of Houston, where there are few land use restrictions. Over the last 35

years, Houston's population has more than doubled, and real house prices have actually fallen a little.

New Zealand's land use restrictions are similar, in effect, to those in a range of other Anglo countries. House and land prices are extraordinarily high in places as diverse as Auckland, Sydney, Melbourne, London, Vancouver, and San Francisco. In each of these places, the inability to easily bring new land to market and use it intensively for housing runs into the pressures of rising demand from a growing population. When those two pressures collide, house prices rise. High house prices in these cities are not the result of aggressive and unwise lending by banks. They aren't the result of "speculation". They are just what happens when land use restrictions run head-on into population pressures. And housing demand is, in the jargon, quite inelastic. Existing residents of high-priced cities mostly don't move somewhere else, partly because the big cities are where the jobs are. Sometimes the resulting high house prices are discussed as some sort of "market failure", instead it is a sustained failure of governments to allow markets to operate.

Where does the population pressure arise from? In the post-war decades most advanced countries experienced a high birth rate. Demand for housing rose strongly on account of this natural increase in population. Government policy choices didn't have much to do with that source of demand, and governments in free societies generally don't attempt to influence the rate of natural increase.

But natural population increase is now quite small in most advanced countries. Even in New Zealand, which has a relatively high birth rate by advanced country standards, the birth rate is only around replacement rate. . And for the last 40 years or so, New Zealand has had a large net outflow of New Zealanders, pursuing a better life abroad for themselves and their families. This outflow swings around a lot from year to year, but in total around 870000 New Zealanders (net) have left in the last 40 years.

With little or no natural increase, and a substantial average annual outflow of New Zealanders, New Zealand's population would now be falling slightly even with the modest rate of inward migration of non New Zealanders we had in the 1980s. There would be no population pressure on the housing stock in the country as a whole, and probably only modest pressures even in Auckland.

But around 25 years ago, New Zealand immigration policy was reformed to encourage a much larger annual net inflow of non-citizens. The current annual target, reconfirmed by Cabinet only last year, is around 45000 to 50000 permanent residence approvals each and every year. That is one of the largest rates of non-citizen immigration (as a share of population) of any advanced economy. As one would expect, a disproportionate share of the migrants settle in our largest and most diverse city.

No one envisaged the impact on house prices when the land use restrictions became progressively more binding, or when the more expansive immigration policy was adopted. But, with hindsight, the contribution of these two, directly contradictory, sets of policies is pretty clear. Land use restrictions might do little harm in a country with little or no population growth (the situation in many OECD countries today). And rapid rates of non-citizen immigration would have no adverse impact on housing affordability if land could be as freely used for housing as in Houston. As it is, the young and the poor, disproportionately of Maori and Pacific origins, find it almost impossible to purchase a house in our largest city simply because of the choices—blunders - of our governments. It is time for our government to confront that responsibility, and to bring about change. If sufficient reform of

land use restrictions is not possible - and the overseas precedents are not encouraging – the case for a significant reduction in the target rate of non-citizen immigration is pretty clear.

Bio

Michael Reddell is a Wellington-based independent economist and commentator on economic and financial affairs, blogging at www.croakingcassandra.com. He recently left the Reserve Bank where he had held various economics and management positions over many years, including Head of Financial Markets and manager responsible for economic forecasting. He spent time on secondment to the New Zealand Treasury, and as resident economic adviser to the central banks of Papua New Guinea and Zambia. From 2003 to 2005 he represented New Zealand, and various other countries, as Alternate Executive Director on the board of the International Monetary Fund.