

Housing Economics and Public Policy

Edited by

Tony O'Sullivan

Head of Planning
Communities Scotland

and

Kenneth Gibb

Reader
Department of Urban Studies
University of Glasgow

Essays in honour of Duncan MacLennan

Blackwell
Science

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For Amanda, Amy, Gemma, and Angela

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Preface

This volume honours an urban economics scholar who has bridged long-standing gaps between a number of often quite dissimilar worlds – neoclassical and institutional economics, academia and government, Britain and its neighbouring continents, and the two sides of Hadrian's Wall. By creatively using the knowledge and perspectives of one world to advance discourse in another, Duncan MacLennan has made a singular contribution both to our understanding of urban phenomena and to the design of urban and housing policy. His *Housing Economics* (1982) changed the way in which we think about urban housing markets.

As important as MacLennan's own research and practice have been to the urban economics and housing policy arenas, his research leadership has perhaps been even more influential. In directing Britain's foremost housing research programmes, he developed and implemented a research agenda that has helped to reshape the way in which housing policy questions in Britain are being explored. In carrying out this agenda and through work for OECD, he has brought together housing analysts from different backgrounds and often conflicting ideologies to search for common themes and principles that could be broadly applied.

MacLennan's success in bridging intellectual chasms and crossing the boundaries of academic disciplines has been achieved in part through his wit and warmth but also through the contributions of urban analysts whom he either groomed or influenced. A few of the many persons who have enjoyed and benefited from the collegial settings he has created over the years have chosen to author this book of essays in his honour. These essays do not have a common theme except to the extent that together they reflect the range of MacLennan's interests. Their preparation is also a reflection of the affection and esteem in which the authors hold the person they have chosen to recognise in this fashion.

William Grigsby
University of Pennsylvania
Philadelphia,
May 2002

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Tony O'Sullivan
Kenneth Gibb
May 2002

1

Introduction

Tony O'Sullivan & Kenneth Gibb

From its very beginnings as a discipline for the study of society, economists have sought to apply economics to real world issues. While the roots of housing economics can be traced back to the work of the original classical and neoclassical pioneers of economic theory, it did not emerge as a separate and recognised area in its own right until very late in the day. After World War II economists, particularly in Europe, turned their attentions to a number of pressing issues of social policy, leading to the emergence of bodies of work on the economics of poverty, transport, education, and health. Applying the insights of welfare economics and emerging theoretical and practical developments, this work sought to address various efficiency and equity issues as they related to the everyday lives of millions of people as citizens and consumers. Not in the vanguard of this work, interest in housing as a proper area for study in the UK began to develop in a serious way from the 1970s onwards. Duncan Maclennan has from the first been prominent in contributing to and promoting this. The idea behind this book was a wish on the part of many contributors to the field to recognise his contributions.

Perspectives on theory

Housing is a difficult thing to theorise about. An inherently complex commodity, with spatial fixity a defining characteristic, and asset, investment and consumption dimensions to account for, the economics of housing remains a challenge to those who seek equity and efficiency improvements for society to this day. It is a field of inquiry where, in Joan Robinson's terms, thinking in 'theory time' is a poor substitute for recognising the role of real, non-abstract, historical time. Moreover, abstracting from the spatial aspects of housing leads, to quote Maclennan, to a curious form of 'pointless economics'. Good theory necessarily involves jettisoning many of the

assumptions usually made in neoclassical economics, rendering the work more difficult and 'messy'.

Early contributions from MacLennan drew on the insights of the Austrian school, and the work of such authors as Hayeck and Von Mises. The insights produced by the Austrians concerning information, knowledge, ignorance and time are central to his work on housing search and choice (MacLennan 1982). For MacLennan, information problems are central features of the housing market, as are spatial externalities, and transactions costs associated with mobility. In such a world, neo-institutional economics (Oliver Williamson 1975, 1985), evolutionary economics and disequilibrium analysis are often the natural modes of analysis to adopt in order better to understand housing phenomena.

Demand for 'housing' in the real world necessarily embodies demand for place, for access to public and private services, and reflects the fact that housing is in part at least a 'positional good' (Hirsch 1976). MacLennan built these factors into his work from the outset, and recognised the implications for the spatial structure of housing markets. Consequently, space and place feature prominently throughout MacLennan's work, both as a key friction for understanding the complexity of housing and its impact on household and market behaviour.

MacLennan has investigated the implications of space at several different housing market scales. An enduring concern has been examining the process of neighbourhood change, within which neighbourhoods are defined as relatively open residential production and consumption spaces. MacLennan has sought throughout his career to apply useful economic models to the problem of interest. One such example at the neighbourhood scale has been his attempt to capture house price change in unimproved properties after nearby properties have received grant aid to improve their fabric, thus measuring the neighbourhood externality (MacLennan 1993b). More generally, in collaboration with American colleagues (Grigsby *et al.* 1987), he helped develop a comprehensive framework for deciphering neighbourhood change.

At the urban or metropolitan scale, MacLennan has both examined spatial aspects explicitly through the early exploration of the concept of housing sub-markets (and the associated concept of 'product groups') and used the urban level of analysis as the implicit or explicit focus for microeconomic models of tenure choice, search and housing choice (often in collaboration with Gavin Wood) (Wood & MacLennan 1982; MacLennan & Wood 1982a). In his 1982 text, MacLennan went a long way to establish a richer conception of housing choice, rooted in real time decision-making, search and bidding

behaviour, the active role of institutions and a more appropriate notion of equilibrium initially developed by Frank Hahn, where market equilibrium is based on learning of information by economic actors.

Information, time and space matter as much for supply and its appropriate conceptualisation as they do for demand. Again, MacLennan made it clear from the outset that the reductionist approach of neoclassical theory was particularly inappropriate to many of the tasks at hand. He showed that noise in the market, and uncertainty about the nature and meaning of market 'signals' result in endemic inefficiency and market failure (MacLennan 1982). These insights remain to be built upon.

Defining the product 'housing' is a basic issue in the conceptualisation of housing demand, supply, and the housing 'market'. Equally fundamental is getting an adequate handle on the concept of the 'price' of housing. Over time hedonic analysis has become the approach of choice for most economists, but it has some quite fundamental limitations. These certainly do not invalidate the use of this technique, but they do indicate the need to be careful in its application. MacLennan, who has used the technique frequently in his work, provided an early and cogent summary of these limitations (MacLennan 1977b).

A specific issue relating to the price of housing is that of housing subsidies – their definition, measurement and impacts (not to mention their rationale). Often these take the form of tax concessions. Considerable work in this area has occurred in the last 20 years, following early critique of the efficiency and equity effects of such subsidies (in the UK context see for example Robinson 1981; MacLennan & Wood 1982b; MacLennan & O'Sullivan 1987; O'Sullivan 1984, 1987). Much subsidisation of housing, however, particularly in a European context, has been tied into direct provision through public or social housing. This has raised issues not just about the welfare implications of the pricing of housing, but the comparative efficiency of public versus private provision. On pricing *per se* a considerable literature has developed, to which MacLennan has contributed (Atkinson & King 1980; Grey *et al.* 1981; Ermisch 1984; Hills 1991, 2000; MacLennan 1986b). On the question of public versus private provision, traditionally non-market providers of housing have operated through bureaucratic hierarchies, providing a rich opportunity to apply Coasian transactions costs concepts and insights from the wider work of Oliver Williamson to the specifics of organisational efficiency in public housing. MacLennan contributed to such analysis in the late 1980s in considering the comparative efficiency of different housing providers in the UK (Centre for Housing Research 1989).

While the microeconomics of housing has developed apace over the last two decades, attention has also been given to modelling at the regional and macro scale. At the national scale of analysis, housing in the UK (as elsewhere) was transformed in the 1980s by a process of financial deregulation. Collaborative work by MacLennan with Geoff Meen, John Muellbauer, Mark Stephens and others identified many of the connections between housing and the macro-economy and helped forge a bridge between housing specialists and those macroeconomists coming to the housing sector for the first time. This also helped policy makers who needed to understand the micro-foundations of mortgage market change, housing equity withdrawal, house price volatility and their transmission mechanisms into consumption, indebtedness and the labour market (MacLennan *et al.* 1997).

Policy and practice

Much of the interest in housing economics that has developed over the last two decades has emerged on the back of considerable intervention in housing by central and municipal government. Policy makers of all political hues, especially but not exclusively in Europe, have seen it as desirable if not essential to intervene in, regulate, suspend, replace or compete with various aspects of the housing market. MacLennan has been particularly active in seeking to influence policy, especially, but not exclusively, in a UK context. In doing this, being based at the University of Glasgow for most of his professional working life is not the only link between MacLennan and the classical economists. In his conception of policy there is much to link MacLennan's approach to the classical school.

From the first, any failure to distinguish technical from ideological positions in policy analysis has been rejected as at best sloppy intellectualism and at worst sharp practice. This does not imply however that he has promoted a narrow 'technical' interpretation of the economist's role in policy formulation; on the contrary he has been a constant advocate of a broader 'political economy' interpretation of the role. Moreover, the use of assumptions regarding the operation of housing (and wider economic) systems to progress an argument, where the basis should be the results of applied research, has usually been given short shrift. In this regard, MacLennan has been very aware of the relatively poor base provided for applied research by official statistics and has indeed been a stern critic of government.

In 2001 MacLennan was involved in redesigning the Right to Buy (RTB) in Scotland as an element of what was to become the Housing Act (Scotland)

2001. Starting from an examination of the available evidence he commented:

'The RTB has been a source of enduring controversy over the two decades since its introduction. Views on policy proposals can diverge for at least three different reasons. First, individuals or organisations may have different ethical or political views about an issue and facts or evidence may have little relevance in resolving such differences. Secondly, many policy decisions involve changes with complex, long-term effects on the economy and society. Individuals with the same values may reach different conclusions because their model or analysis of impacts differs from each other. Again this requires judgement in choices, but it also requires the participants in a debate to be clear and consistent in their analyses. Finally, even with the same ethical values and analytical approaches, individuals may reach different conclusions if they have different facts or evidence at hand.'

(MacLennan *et al.* 2000, p. 1)

These views echo those expressed in his 1982 text (which, coincidentally, used the then very new RTB issue to illustrate the point).

MacLennan has consistently rebuked both economists and critics from other disciplines who have sought to interpret or represent the role of the economist in policy discourse as being focused on competitive housing markets, the use of deductive partial or general equilibrium models, or to be unthinkingly centred on Pareto-based social welfare functions. For him,

'... it is not enough to restrict the role of the political economist to accurately describing market behaviour for policy makers – although such action may be an improvement on proffering advice largely based on deductive reasoning and assumption. Instead, applied economic analysis of policy (or political economy) requires the analysis of a more detailed set of questions. For instance the analyst must enquire as to what are the objectives of government, what role housing policy plays in attaining such objectives, who actually makes housing policy, what economic and political constraints restrict action, what advice and information exists and what model of the housing system is used by policy makers? These questions are not to be viewed as minor concerns for applied economists. Economists may deduce conditions for optimality or second best conditions for the design of housing policies *ad infinitum* but unless they understand how economic analysis and research is absorbed and transformed by the policy

process they run the risk of having their work, at best, ignored or, at worst, misused.'

(MacLennan 1982, p. 142)

Policy influence, then, must start from an understanding of the institutional, administrative and legal contexts from which policies emerge. Ethical positions on policy issues are acceptable (indeed unavoidable) but should be explicit and honest. Value judgement should not be dressed up as technical issue, and ignorance on empirical matters of importance must be acknowledged and must constitute the soil to be tilled by the applied researcher. This view of the policy role is demanding above all else of honesty, and for this reason is brutally demanding in application.

While MacLennan has been clear from the start of his career that governments can quite legitimately hold to non-Paretian objectives, he has also been steadfast that these objectives must be capable of clear operational interpretation. This in MacLennan's eyes is perhaps the key part of the bargain policy makers have to deliver, for the policy-making process to have any hope of working to the benefit of the citizen – the impact on whom always remains the focus of MacLennan's work. In his writings but even more so in direct dealings with senior government administrators, ministers and politicians, he has delivered this message in an uncompromising way. Given this, other issues can be largely worked around – recognising there is plenty to be so worked.

For a start, the structure of government and the distribution of policy responsibility across different tiers and geographies of government make the achievement of coherent policy intrinsically difficult. Joined-up government is a popular current slogan, but also a desideratum recommended by MacLennan over 20 years ago – with due recognition of the inertia built into the existing system, and the consequent need for an institutional economics perspective on the problem. Writing in the UK policy context he noted:

'[The] complex organisational model for housing policy in Britain would not necessarily be inadequate if some centrally determined operational principles for policy existed such as market pricing or income/wealth related subsidy systems. But where policy, as in Britain, lacks a central organising principle then the distribution of subsidy reflects neither house type nor household characteristics but is an outcome of chance, history and in particular of tenure selected. Thus, whilst it has been argued that housing market intervention may be rational and required, it is difficult to believe that the present system could not be improved or it may even