HOUSE OF LORDS

Revised transcript of evidence taken before

The Select Committee on Economic Affairs

Inquiry on

THE ECONOMICS OF THE UK HOUSING MARKET

Evidence Session No. 5 *Heard in Public* *Questions 78 - 93*

TUESDAY 19 JANUARY 2016

3.35 pm

Witnesses: Lord Green of Deddington, Professor Robert Rowthorn, Professor John Muellbauer and Professor Tony Champion

Members present

Lord Hollick (Chairman)
Baroness Blackstone
Lord Forsyth of Drumlean
Lord Griffiths of Fforestfach
Lord Kerr of Kinlochard
Lord Lamont of Lerwick
Lord Layard
Lord Sharkey
Lord Teverson
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

Lord Green of Deddington, Chairman, Migration Watch UK, **Professor Robert Rowthorn**, Fellow, Cambridge University, **Professor John Muellbauer**, Oxford University, and **Professor Tony Champion**, Professor of Economic Geography, Newcastle University

Q78 The Chairman: Gentlemen—Lord Green, Professor Rowthorn, Professor Muellbauer and Professor Champion—welcome to the Economic Affairs Committee. As you know, we are conducting an inquiry into the housing market. Today brings us very much to the demand-side of the housing market, so we are interested to hear your contributions on that. Perhaps I might start.

We heard from Professor Dorling that one of the biggest factors behind the demand is increasing longevity. He said that this is often underestimated, but the fact that we are all living longer is proving to be one of the major factors—indeed, the largest factor—on the demand side, along with fertility and births, and immigration. Who would like to comment on that? Professor Rowthorn?

Professor Robert Rowthorn: I think you have to distinguish between the demand for housing and the size of population, because there is not the slightest doubt that longevity is much less important than migration for population growth. The ONS—the Office for National Statistics—produced a number of projections. It has one projection for which it assumes no change in mortality at all, so no increase in longevity. That knocks about 2.7 million off the population projection for the next 25 years. If on the other hand you assume that there is no migration, it knocks off 6.4 million. That means that in population terms, if we take the projections of the ONS as a starting point, longevity is only about 40% as important as migration. Migration is much more important than longevity for population size. Of course, that is not quite the same as demand for housing, because longevity may mean more people living on their own, for example, and more single-person households. Immigration might not mean that in the same way. You must distinguish between housing demand and population. But in terms of population there is not the slightest doubt that migration is much more important than longevity.

The Chairman: Obviously the focus of our inquiry is the demand for housing. Would you say that longevity is one of the principal factors behind the demands for housing?

Professor Robert Rowthorn: Well, it is certainly an important factor, but even then it is not as important as migration. If migration is almost two and a half times as important as longevity for population, it is unlikely that changing house sizes will offset that.

Lord Green of Deddington: Can I add to that, Chairman? First, thank you for your invitation. We were extremely surprised by that remark, which we thought was very misleading indeed. As Professor Rowthorn pointed out, the ONS projections are very clear. On the principal projection, 50% of the increase is the direct effect of immigration and another 17% or 18% is the effect of the future children of future migrants, so you are looking at 67% or 68% being the direct result of immigration. Obviously, as I think you touched on just now, that is critical to the household projections, which I am sure we will come to, particularly because household size has been fairly steady since the 1990s. That means, of course, that immigration has become the key driver of household growth, because it is now the key driver of population.

The last point on this is that you can demonstrate that, if you like, by looking backwards. If you look at the Labour Force Survey and the household data, you find that between 2000 and 2014 about two-thirds of the additional households had a foreign-born head of household, or HRP—household reference person—as it is called nowadays. In fact, in recent years that percentage has been even higher, so there is absolutely no question that international migration is the major factor in the demand for housing.

Professor John Muellbauer: I agree very much with those points, and Danny Dorling is clearly wrong, looking both backwards and forwards. One other thing to point out is that the long-term implications depend a lot on what counterfactuals you take, and what you assume is given. In the long run, the mortality rate and birth rate are not independent of each other, so doing these calculations can be quite misleading, particularly over a long perspective.

Professor Tony Champion: We have moved a little into the household projections side. In the breakdown of the anticipated growth in household numbers through to 2037, there are the 2012-based projections for those by age. This breakdown was produced about a month ago by DCLG. It shows that 77% of the net increase in total households is due to the increase in households headed by people aged 65 and over. So if you look at the household side of things by age, you get quite an emphasis on the ageing push. Obviously, some of these people will be former immigrants and will be contributing to this, but just by itself it looks like a strong growth.

The other thing about the LFS data on the increase in the number of households headed by foreign-born people is that what you are seeing there over a given period is to some extent a lag effect of previous arrivals of immigrants. When they arrive, they tend to live at quite high density in quite large households, but the longer they live here the more they tend to spread out and get more space. So the increase in the number of households headed by foreign-born people is not just a product of immigration in the same period but the knock-on effect of previous immigration, which I think contributes to the high growth that Lord Green talked about.

The Chairman: That brings us to another issue in the same bundle. When you talk about migration numbers and the impact on housing, are you talking about it in connection with the first generation or subsequent generations? The ONS takes a rather cautious view on this and looks at first generation only, but I think you were talking about the impact in subsequent generations. Could you help us navigate our way through that?

Professor Tony Champion: I am not sure I can personally. There will be a combination of both: the new households forming in old age groups from previous immigrants, as well as the impact of the second generation coming through.

Lord Green of Deddington: I think we are touching on the Boris problem. In talking about this, the ONS is careful to say, as I mentioned, that 50% are entirely new immigrants and the other 17% are the future children of future immigrants. But then you run into the problem of the children of immigrants who have already arrived and which of those you include. I am not sure it would be helpful to go too far into that. Arguably, Boris is an immigrant and his children would obviously be the children of somebody not born in the UK. I am not sure it helps to unwind backwards like that. We have to start from where we are and look at what the impact of currently expected rates of immigration will be.

Q79 Lord Forsyth of Drumlean: In your evidence to us, Lord Green, you drew attention to the difference in projections on numbers between DCLG and the ONS. Could you explain why that has occurred and what the remedy might be? It is not clear to me why the DCLG is doing this at all, actually.

Lord Green of Deddington: For a start, they were using obsolete population projections from three or so years ago—three or so years behind what the ONS looks at. That explains part of it. They also used different assumptions, which were lower. Professor Rowthorn is the expert on this. His paper takes account of all that and explains the differences, but those are the basic reasons.

Lord Forsyth of Drumlean: Do you think they should be doing it?

Lord Green of Deddington: That is a wider question and quite an important one for this Committee, because, to be frank, we have not been much impressed with the DCLG's approach to this whole issue. It seems to us that like quite a lot of people in the public service, they are nervous about any issue that touches on immigration. They do not like talking about it. They certainly give it no prominence in their work. I think they may have their own reasons for that. Our view is that you might like to consider as a Committee whether this kind of work is better brigaded with ONS work. They are considerably interrelated, and I am not sure that the DCLG has quite the resources or the will, if you like, to bring it together properly and give us the best view of the impact on housing. Of course, if you cannot have a sensible and reasonably accurate projection of housing demand, you are never going to tackle the housing crisis. We are constantly behind the game, because nobody has focused on the impact of immigration on housing.

The Chairman: You are saying, are you not, that the ONS has sufficient depth and accuracy of data to be able to do not just first generation but subsequent generation impact assessments on housing.

Lord Green of Deddington: They would do it much better, I think. They have the depth of knowledge and the range of other related activity. I think, frankly, that the DCLG struggles with this, and it would make sense to move it.

Lord Lamont of Lerwick: One of the points that the ONS makes is that the impact of immigration is only one element of the impact of migration in a broader context. It refers particularly to births to and deaths of people who had migrated to the UK before 2014, how to account for births to and deaths of UK-born people who had emigrated and subsequently returned to the UK, and how to account for births to and deaths of UK-born people who had parents or grandparents who were themselves immigrants, and the corresponding figures for foreign-born people descended from UK emigrants. Have you looked at all that and taken it all into account as well?

Lord Green of Deddington: To be frank, they are pretty minor points. They were produced by the group of academics who advise on what the immigration assumptions should be. We have looked at it briefly. One of my colleagues is, as you know, the professor of demography at Oxford, and while from a strictly academic point of view it is right to point to these issues, we do not believe that they are of any huge importance.

The Chairman: Do you want to ask the second question, Lord Lamont?

Lord Lamont of Lerwick: In view of what has been said, I do not think there is much point in asking how important net migration is.

Q80 Lord Forsyth of Drumlean: One of the things that has been suggested to the Committee is that in looking at the effect of migration on demand it is important to consider the length of time a migrant stays in order to assess the effect on the housing market. Could we have your thoughts on that?

Lord Green of Deddington: It has some effect in the sense that most migrants start with rented accommodation and move on to owning their own property. The really important factor is population. The net migration figures of course include those who come and take away those who have gone, so at the broad level of trying to assess what housing demand will be 10 or 20 years ahead, I would not have thought it was a major factor, but my colleagues might do better on this.

Professor Robert Rowthorn: It is not just the people who come and go, it is the fact that those who come have children, and if they are typically young when they arrive, considerably later on they die, so they have a net impact on population. If you look forwards beyond 25 years and make, say, 50 or 60-year projections, you find that for each net migrant there is a 40% or so greater net effect on births minus deaths. Even on a 25-year perspective, it is about a third as important in births and deaths as the people who flow in. A report on this for the House of Commons neglected that issue. I tried to reverse-engineer the DCLG projections for households to see what assumptions they had made, but they say very little about their migration assumptions. They tell you the number, but they give virtually no information on what they assume about births and deaths or about household size. I circulated a paper that I wrote, which you might have seen, that has projections in it that take births and deaths into account, which the ONS does. The ONS has an actual document that points out that they take this into account. When you talk about the effect of migration, you have to talk about the induced effect on the natural population growth rate.

Lord Forsyth of Drumlean: Absolutely. We are not supposed to form opinions on the evidence here, but I was quite startled by something Professor Cheshire said: “Short-term … migrants tend to live at incredibly high densities, in multi-occupation, so they do not take up much space”, and that housing demands differ by country of birth. That does not seem to me to be a long-term factor, but perhaps that is wrong.

Lord Green of Deddington: Certainly not. One would hope that if people are coming to join our community they will in due course live as we live. It does not go into the statistics, because if 10 people are living in one house they are still one household. It is not until they split up that you get that effect.

Professor Rowthorn touched on one point: the DCLG does not give a very full account of its methodology, which means that it is very difficult to unwind it and see whether it makes sense or not. If you are dealing with the ONS, it is much more open about how it does things.

Professor John Muellbauer: One of the problems of demographic projections is that they ignore the economic impact on migration itself. Imagine you were in the Irish ONS in 2007 and you were going to project net migration for Ireland for the next 10 years. Just think how grossly wrong you would have been, because Ireland has seen a huge outflow of net migration as jobs have dried up in the building industry and elsewhere in the Irish economy. Recently, some of those migrants have come back, but economic conditions matter a great deal for international migration, so that is very important to bear in mind.

The other thing is that these demographic projections are often linked with the numbers: house numbers, units and people. Of course, it is much more complicated than that. Demand for housing has much to do with income—people with a higher income demand more space—so we have to think more broadly about housing as a composite good that is not just a unit. Composition of the population matters a great deal. I agree entirely with Paul Cheshire that if short-term migrants live at very high densities they have a much smaller impact. If the outflow is retired British people, most of them owner occupiers retiring to

Spain, let us say, if they actually sell up rather than retain their property and leave it empty, and the housing comes back into use, the impact on total housing demand could be relatively small. So you could have positive in-migration of people with a low impact on housing, a smaller out-migration of people with a large impact on releasing supply, and a zero effect on demand. Of course, if you have large levels of in-migration, that point is overwhelmed by the size of in-migration.

Lord Green of Deddington: Yes, the argument only works if you assume that migrant families live in much larger numbers than native families. However, over the years British immigration has been pretty steady at between 60,000 and 100,000. It is pretty unlikely that there will be huge changes to that. The changes have, of course, been in net foreign migration.

Professor Tony Champion: Just a couple of points. The first is the general impact of the components of population change on housing. Immigration is focused on people principally aged 20 to 40, so they have an immediate impact on the housing needs of the population, whereas natural change—births, shall we say—has a 15 to 20-year lag at least. That is an important point.

I want to pick up on a point that Lord Forsyth made in correctly distinguishing between different types of migrants. He talked about short-term migrants, and we have had experience over the last decade of a very high number of short-term migrants from the accession countries of the European Union. Many of those were indeed short-term migrants, although some have stayed, and their impact on the housing situation was pretty limited because they wanted to make as much money as possible to send or take home, so they did not spend that much money on housing. The broad distinction that is normally made is immigration from rich countries as opposed to immigration from poor countries. The immigrants from rich countries normally have a very similar impact on housing numbers to the growth of the native population, because they have the economic wherewithal to buy in at the same level to owner occupation and so on. A few right at the top of the ladder, of course, have immense buying power in central London, whereas the arrivals from poorer countries, and the asylum seekers and refugees whom we hear so much about now, have the capacity and the need to group together in large households, at least for the first few years. As we mentioned before, the hope is that if they stay they will become more like the home-born population in their housing needs.

Q81 Lord Griffiths of Fforestfach: I want to move on to the issue of an ageing population and the housing market. The projection from the DCLG, as I think Professor Champion hinted earlier, is that the number of households headed by someone over the age of 65 is going to increase considerably over the next 20 years. There are two questions. First, what is the implication of this for the housing crisis—or for the housing market, to be less pejorative? Secondly, are we doing enough in policy to shape the more effective housing arrangements that we could have? America, for example, seems to have more of those than we do here.

Professor John Muellbauer: One point to make in support of Danny Dorling, who spoke at length about this issue, is that the UK tax system discourages the efficient use of space. Stamp duty impedes mobility and the planning system greatly slows down the market's ability to respond. We have a highly dysfunctional system of tax—and, indeed, of supply, because the planning system is so poor at responding to market issues. Clearly we need a shift in the housing mix towards apartments, sheltered accommodation, granny flats and so on to deal with this issue, but at the moment the institutional framework is very much set against responding efficiently in that way.

Lord Sharkey: So you would have a change in tax policy to deal with it.

Professor John Muellbauer: A change in tax policy and in the supply side. We will talk more about the supply side later, I think.

The Chairman: It seems to me, on the basis of the longevity figures that we have seen, that there is clearly a demand there. It is surprising, is it not, that the market has not responded to that. Do you put it all down to the dysfunctionality of the tax system?

Professor John Muellbauer: Many people have said how dysfunctional the British arrangements in the housing market are, both on the tax side and on the supply side, and commented on the inability of the market to respond quickly—it can take four or five years to get a planning agreement through to actual development—because of the way the industry is organised, which has a lot to do with the history of the industry and the way it is structured.

Professor Tony Champion: The extra point to make is in relation to the investment potential of the housing that older people are occupying. If they hang on to their larger house, they are going to reap greater benefits over the next few years—or they would have done in the last boom period—than if they downsized immediately. If they have thoughts about passing on a large inheritance estate to their children, it is in their children's interest for them to stay as long as possible in a large house that is gaining money. I read last week that people living in the Home Counties are seeing their house prices rise in a year by more than the cost of their seasonal rail card, or some comparison along those lines. While there is still a shortage of supply, which, along with reasonable demand, guarantees that their house price is going to increase, there is a great disincentive to move, along with the tax issue.

Q82 Lord Lamont of Lerwick: Slightly at a tangent, you mentioned the planning system and how it does not really work. The Government have made big efforts to liberalise planning. Do you think those efforts fall short of what is required? What further specific changes in the overall regime do you think could be put into practice?

Professor John Muellbauer: I think the most important change would be to allow a national authority, a land bank, to buy land on the open market with existing uses and existing use values, and in the end to be able to change the permissions to develop. This would capture the planning gain. Previous witnesses have talked about a hundredfold planning gain for agricultural land near Oxford. If a farmer gets planning permission, there is a hundredfold increase in the land value. If most of that were captured by the nation, you could build infrastructure and schools and supply affordable housing to low-income people. It would all make complete sense. Not only that but, at the same time, you could change the definition of national debt to make it a net debt. If you were able to net off the saleable value of assets like land, which obviously a land bank would have acquired, from gross debt in the fiscal target that the Treasury pursued, an increase in land purchases would actually reduce the debt rather than add to it. The subsequent revaluation would be highly beneficial to the national accounts.

The Chairman: This is alchemy.

Lord Lamont of Lerwick: Magic.

The Chairman: But it seems to me that there is an element of insider dealing if you have a national land bank that buys land and is then able to procure the planning consent on that. Are you not depriving the people who own that land of some of the benefit of the planning consent?

Professor John Muellbauer: Well, the Oxfordshire farmers who previously sat on the hundredfold gain would be deprived, there is no question about that. The Oxford colleges that own some of that land would lose out as well. Someone has to lose.

Lord Forsyth of Drumlean: When you talked about the tax changes necessary to address the problem, you mentioned stamp duty. Were you thinking particularly of stamp duty, or of the inheritance tax allowances tied to property, or what?

Professor John Muellbauer: The recent changes in inheritance tax are dysfunctional because they increase the demand for land as an investment. Uniquely in the world, we have a property tax—we call it council tax—which has zero marginal tax rates for the wealthy. No other country in the world has this. Not only do we have zero marginal tax rates but we have a highly regressive structure lower down all the way to the bottom, so the poorest in the poorest housing pay the highest tax rates as a fraction of value. Furthermore, we have the 25% discount for single people and we do not link the tax rates to market values. We use 1991 valuations to try to figure out what the rate should be. This is the craziest system imaginable. When foreigners hear about this, or when foreign economists come to the UK and are told about it, they think we are completely mad.

Lord Griffiths of Fforestfach: You may be right in saying that it is a crazy system, but if we are to take away the incentives that already exist for people to stay in their houses because of capital appreciation, and if we are to have what is in effect a revolution in fiscal policy for housing, it seems that that will take decades to implement.

Professor John Muellbauer: One would have to introduce it gradually. You could not bring it in from one day to the next, that is for certain.

Lord Griffiths of Fforestfach: My question is whether it is really a solution or an ideal, academic proposition.

Professor John Muellbauer: Well, Jim Mirrlees is a Nobel Prize winner and certainly a star academic. His and his committee's views on the reform of the British tax system are pretty thoroughly thought through. We can look at other countries. In the US, if I were living in Princeton, New Jersey, I would be paying property tax of probably $40,000 a year, which is more than four times what an Oxford person would pay in the UK. Property tax rates in the US are much higher than in the UK, and this is an advanced capitalist society. Why are we so different?

Q83 Lord Sharkey: Professor Muellbauer mentioned Paul Cheshire earlier. Professor Cheshire pointed out to us that, "The population of London since 1951 has increased by less than 5%. Real house prices … have increased sixfold". He therefore asserted that, "it is not population that drives house prices. It is the fact that people, as they get richer … choose to consume more housing space" and gardens. Do you agree?

Professor John Muellbauer: Very much so. What matters is what we might call income per house: population multiplied by average income divided by the housing stock, measured in some way. I do not like measuring housing stock in units. The national accounts definition of housing stock, the capital stock figures and constant prices, is a more sensible way of measuring the housing stock for the population. Income per house is what really matters. Of course, the income component of that—the average income per head—has risen much more than population in the period under discussion. That has been a major factor in the increased house prices. About two-thirds of the rise in house prices in the UK since 1980 is attributable to rising income per house.

Baroness Blackstone: Is it not also the case that in France and Germany income per household has gone up very substantially as well? Similarly, both these countries have had quite high levels of migration over a 30-year period, and they both have increasing longevity, so why have their house prices gone up by so much less than those in the UK? It must be supply factors.

Professor John Muellbauer: That is a very good question. You are absolutely right: income per household has gone up similarly in Germany and France, but the housing stock has risen far more in Germany than in the UK. Paul Cheshire estimated that Germany released nearly three times as much housing land since 1980 compared to the UK for a broadly similar population.

Lord Lamont of Lerwick: Could I ask Lord Green and Professor Rowthorn to comment particularly on the Cheshire quote about London?

Lord Green of Deddington: I do not quite understand this argument. The population of London has gone up very substantially since 1981 when it was 6 million. It was 8.5 million in 2013. We have an extra 2.5 million people.

Lord Lamont of Lerwick: He said that the population since 1951 increased by less than 5%. Is that incorrect?

Lord Green of Deddington: He took 1951, but it declined because, as you may remember, there was a policy of moving people out of London, a lot of slum clearance and so on, which will have affected the situation substantially. If you start in 1981—you can start where you like—it was 6 million and it is now 8.5 million. That is 2.5 million extra people, and that must have something to do with the increase in house prices. There is another factor which I am not quite sure how to interpret. The population has gone up because we have a foreign inflow of 100,000 a year and a UK-born outflow of 60,000 a year. You have a change in the composition, if you like, of the population of London. Some of those may be very rich and bidding up the prices. Some may be very poor and living in huddles. I do not know, but that is the reason for the change in population. The sheer increase in numbers must have something to do with the prices.

Lord Sharkey: Could I press this point a little and ask the panel in general? We are now quoting two different starting points. Clearly, the figures will reflect the starting points that have been taken: 1981 or 1951. Do you know of a long-run study that can help us resolve the question of the true driver of house prices and whether it is mostly income per household? I think Professor Muellbauer said that was about two-thirds of it.

Professor John Muellbauer: Income by house not per household.

Lord Sharkey: I see. Or, as I think Lord Green asserted, does the rise in population play a much greater part?

Professor John Muellbauer: Other factors need to be mentioned as well. Financial liberalisation is an important one. When Mrs Thatcher came to power in 1979, there began a really radical change in the whole credit architecture of the UK. Mortgages are now available at far lower loan-to-value and far higher loan-to-income ratios than would have been true in, let us say, 1977. That was a radical change in the credit market architecture, and it had a big effect. Interest rates obviously play a role as well. In addition, the demand from wealthy foreigners has been a factor in the London market. There are other things apart from income per house that drive the market.

Lord Green of Deddington: You can also look at rents, because they are not so much affected by the financial changes in interest rates and so on and so forth. They are of course going up. They have gone up very substantially.

Lord Forsyth of Drumlean: Why would rent not be affected? Surely rent reflects the capital value of the property to some degree.

Lord Green of Deddington: Oh yes, but not as directly as far as the individual householder is concerned. It is not your mortgage payment going up in a steady way; it is your rent.

Professor John Muellbauer: International comparisons are really crucial here. Baroness Blackstone mentioned France and Germany. I have been working with economists at the

Bundesbank and the Bank of France on modelling the German and French housing markets along with the rest of the household portfolios. It is very clear that Germany has had essentially no financial liberalisation, so the credit market architecture in Germany is pretty much as it was at the time of unification. Real house prices in Germany have been flat, although in just the last few years there has been a bit of boom. The main reason for that flatness, and the difference between Germany and the UK, is the vast release of housing land and the lack of credit liberalisation. Those two factors are really dominant in explaining the British/German difference. In France, what is interesting is that there has simply been a fairly high degree of mortgage liberalisation. Credit conditions in the mortgage market have liberalised to a considerable degree, so French house prices have risen much more than German house prices, even though in income terms income per head has evolved fairly similarly. Again, like the UK, France has not built as many houses as Germany. Comparing these three countries and the differences on the credit side and supply side of housing is crucial in explaining what happened in Europe.

Lord Green of Deddington: There is another crucial difference, which is that the population of Germany is flat and unless it continues to get high immigration it will decline by 25% in the next 25 years. In France, the population is growing quite fast, rather like ours. Italy and Poland expect their populations to fall. I cannot remember what Spain's is. So the significant difference in population growth is presumably a factor in all this.

Professor Tony Champion: I just wondered whether there is any similar analysis going back to the 1950s and 1960s comparing the British and German housing markets. I imagine that they would be very much more similar at that time. When we had the planning system set up in 1947 and the household and population projections of that time, it was on the basis that there was going to be no long-term population growth and there was going to be decanting of population from large cities through slum clearance out to new towns and expanded towns. Sufficient land was made available in the development plans of the late 1940s and early 1950s for 20 years' building supply under those assumptions. Professor Sir Peter Hall produced a landmark study in 1973 suggesting that things were already beginning to bite at that time, because population growth had turned out to be faster during the 1950s and 1960s than anticipated but the land supply situation had not changed. What we have had since the 1970s is a further ratcheting up of that supply issue.

Q84 Baroness Wheatcroft: Clearly, rising household incomes have been one factor in driving up prices, but is there any research that you can point to that shows how the proportion of household income that is taken up by housing costs has changed over a period in this country and how that compares with other European markets?

Professor John Muellbauer: Well, okay, how does one measure housing costs? There is the rental market and the owner-occupier market. The retail prices index committee struggled for many years with the question of how one measures the cost of owner occupation. Obviously, you can think about cash flow costs: what is the cost of financing a mortgage? In the UK, with floating rate mortgages, we have to think not only about this year's cost. At the moment, housing looks, on the face of it, to be reasonably affordable. If you can get a 100% mortgage with very low interest rates, housing does not look that expensive. But of course if we move from a floating rate regime to more normal interest rates, even if they are lower than they have been for the last 20 years, that would change those calculations a great deal. So it is a very difficult question to answer. In Germany, with fixed-rate mortgages, it is more straightforward because you know for the next 10 years what your outgoings are going to be. In Germany, mortgage interest rates are even lower than they are in the UK. In Germany, the current outgoings in terms of cash flow would be quite low; even lower than here.

Baroness Wheatcroft: Obviously, mortgage rates make a huge difference to the potential outgoings. Would it be any easier to try to get a pattern for the value of owner-occupied homes in relation to household incomes?

Professor John Muellbauer: Sorry, can you rephrase that question?

Baroness Wheatcroft: If what one is trying to get is a picture of the proportion of household income that goes on housing, and I take your point that it is difficult to measure the cost of a mortgage over time because it will fluctuate, can we get any handle on what proportion of household income goes on housing now, both owner-occupied and rental, and how that compares with, say, 20 years ago and with overseas?

Professor John Muellbauer: I am sure it must be the case that for renters in the UK, rents now, as a fraction of income, are probably the highest they have ever been. Rent levels are far, far higher than in Germany. The international comparison would certainly point to rented housing being far cheaper in Germany that it currently is in the UK.

Professor Tony Champion: There also may be the question of what is actually being paid and what the potential to be paid on housing is. I get the feeling that, over the last few years, through the recession and its aftermath of austerity, people have been much less willing to consider paying out a certain proportion of their income on housing compared to the situation earlier in the 2000s, when growth prospects seemed to be unlimited, the future looked buoyant and people were prepared to take bigger risks. The recession in 2008-09 was, I think, a real shock. There was an impact on employment and an increase in the number of people in less secure work now. People have to be really brave, in many cases, to take out mortgages, particularly if people start talking about interest rates going up in the near future.

Baroness Blackstone: I do not really understand why that should be. Since interest rates are still very low, historically lower than they have been for a very long time, even though there is some talk about very small increases in interest rates, the value of the houses they will buy is going up in most parts of the country, certainly in London and the south-east. So what is the disincentive to them trying, if they can get a mortgage, to buy a place, other than that prices may be so high they cannot get into the market? I do not understand the point you are making about what would demotivate them in relation to interest rates.

Professor Tony Champion: I am not an economist, as you can see, but I just had the feeling that people were becoming more uncertain in this situation. A lot of people are buying and the rates of buying have been going up, including those being supported by the Government to do it. But at the margin, I think there may be quite a large number of cases of people who may not be prepared to make that step and who are therefore putting extra pressure on the private rented sector.

Baroness Wheatcroft: How effective, particularly in London, do you think the investment market is in pushing up property prices?

Professor John Muellbauer: Certainly, at the top end of the market, it is dominant. Buy to let is also quite a big fraction of the market. As you know, London has the highest fraction of renters of any location in the UK, so the investment market is clearly much more important in London than it would be in most other cities, apart from maybe Oxford and Cambridge.

Q85 Lord Turnbull: I want to come back to Professor Rowthorn's estimates of the impact of migration. You are telling us that it almost certainly boosts GDP. GDP per head probably does not change very much, but possibly in the early years it is slightly beneficial. There are various other benefits, such as a better dependency ratio and economies of scale—it costs the same to defend 70 million people as it does 60 million people—and the debt ratio improves. So you have a choice: are you telling us that these are the number of houses that you have to build, or are you saying that what you really have to do is do something about migration, as Andrew Green would say? There is a missing variable in all this, and I want to know whether or not it is in the figures. If you have an extra 10 million or 20 million people, you have to invest in a great deal of infrastructure, some of which is housing and some of which is roads, rail, hospitals, et cetera. That initially is a cost to society. Have you built that into the figures, and how would that change this choice as to whether working on migration or building houses is the right solution?

Professor Robert Rowthorn: As you know from previous conversations, I have not done that. It is quite important, because if you have as a starting point an underpopulated country with a lot of infrastructure, such as roads and railways, that is underutilised, population growth from whatever source, whether it is immigration or birth rate, is beneficial, because you can tax a large number of people to cover the costs of that infrastructure, or, if you charge them through with rail fares, for example, they pay it in that way. But of course you come to a certain point where infrastructure gets overloaded, and if you get more population growth you sometimes have to have very big investments; they are not marginal. I have to say I did not take that into account at all when I considered the fiscal aspects of the problem. I am not sure why I did not; I should have done. Maybe it was too difficult, but I will have another go at it.

Lord Green of Deddington: Chairman, I cannot resist reminding you that it was this very Committee that produced a landmark report in 2008 on the impact of immigration on GDP per head. It found that there was no significant benefit for the resident population. Nobody has laid a glove on that since, and we have quoted it continuously.

Q86 Lord Teverson: Perhaps we could get back to internal migration. As a resident of rural Cornwall, I sometimes wonder whether, if what was going on in London and the south-east, as has just been referred to, was not happening, we would find this an issue at all—although, believe me, there are all sorts of issues down my way. What proportion of the problem relates to internal migration in the UK? As has been said, in the 1950s and 1960s there was a movement out. Even towards the 1980s, people moved into rural areas. Now, there seems to have been a moving back in. In certain parts of the country we hear that rows of houses are being knocked down because there is no market for them. Is this issue in part a question of solving the northern powerhouse or of better distribution of the economy? Could we solve it through all that?

Coming back in particular to London and house prices, is it those internal migration flows or is it foreign investors that have really caused the big change in house prices here?

Professor Tony Champion: I think I am meant to know something about internal migration, so I will start. That is a lot of questions. In answer to the pre-circulated question on what has changed in internal migration recently, one of the things that has changed, surprisingly perhaps, is there is no longer any net migration from north to south. Migration was running at something like 40,000 a year in the 1970s and 1980s, then it went down to 20,000 in the 1990s, and in the whole period since 2000 it is net to the north on balance. North-south migration fluctuates during the economic cycles, but basically it is not contributing to the pressures on growth in the south-east. It is international migration and population natural change that is doing that, particularly for London. That is one change.

The urban-rural shift, as it is sometimes called to contrast the north-south drift, has notably slowed since 2008. It was slowing a bit before then, but it has slowed very much since then. The prime driver for that is lower outflows to some extent from other cities but principally from London. That has obviously led to more people staying in London, which has fuelled London housing prices and issues. Migration out of London is accelerating again now. It has got up to the sort of long-term average that Lord Green mentioned of 60,000 to 70,000, but it was at 100,000 in the early 2000s and it looks as though it is heading that way again. If this continues, there will be an impact on the housing situation across the country, particularly across the south, over the next few years, because the population of London will not increase quite as fast as the population projections have suggested, because the internal migration assumption for internal migration is based on the last five years' average of migration, which in the 2012 projections that underpin the household projections was for 2007 to 2012, when this process was running at a much slower level than average. The corollary of that, of course, is that more people are going to arrive in Cornwall and points in between, and to some extent in the north, which could provide some sort of basis for helping to power up the northern powerhouse, but the main pressures are going to be felt in the rest of the south, and the south-east in particular.

Lord Teverson: Do we understand the reason for that change in the London population, which presumably is a major part of those changes? Is it cultural? Is it because of commuter rail fares? Is it fashion? Why do people decide to live in or outside London?

Professor Tony Champion: The normal pattern is that the population has a sort of life course. People move into London in particular at the early stages of their career, usually after leaving university, because there is an outflow of UK students from London to universities in the rest of the country. They come back, and others come with them from other universities and the rest of the country. After a few years, if they want to try to buy a family-sized house and start the family off, that is the trigger to get out into a place that is cheaper but still within commuting distance, near to good schools and so on.

Lord Teverson: A life cycle.

Professor Tony Champion: Yes.

Lord Green of Deddington: In some areas, people are not very happy with the schools, which adds to the factors that have just been mentioned.

Lord Lamont of Lerwick: Presumably a lot of this is due to the rapid acceleration in London house prices. Houses are simply unaffordable.

Lord Forsyth of Drumlean: I was just going to make that point. You say that it is surprising. Is not surprising to me at all that more people are not moving from the north to London because they cannot afford to buy in London. Nor is it surprising to me that more people are cashing in and leaving London to move to where they can get a decent house, provided they can find employment outside.

Professor John Muellbauer: The economics of this is really interesting. As you say, it is the ability to be employed. Earnings are very important for regional migration, but they are offset by housing-market constraints. Regions such as London that have had the biggest earnings growth and the lowest unemployment rates—for skilled workers, that is—are the places where house prices have always risen the most. So the rise in house prices has choked off in-migration and is encouraging out-migration, but what is interesting, I suggest, is that our research suggests that it is not just the level that is important but the expected rate of change. People keep moving to London, even though London has become expensive, as long as they expect appreciation in London to continue, so provided they can get a mortgage and have some capital they will still be willing to buy in London. If London were to reach a plateau, having got to this extreme—the highest ever ratio of London prices relative to the rest of the UK—and expectations were to shift, you might see quite a large regional outflow from London. It is the incoming foreign migrants whose first destination is typically London who are the major part of the story. They are the ones who put pressure on rental accommodation and house prices in London. That then encourages other people to go for the capital gain and move out. In our research, London was the place where they seemed to be some direct connection between supply constraint—in other words, the amount of housing per working-age population that was available—and regional migration. The regional outflow from London is partly due to the fact that when you have a lot of in-migration from abroad, that pushes the amount of housing relative to the working-age population to extremely low levels, and that pressure is partly what explains the regional migration.

Lord Forsyth of Drumlean: Does this explain the paradox of employers complaining that they cannot get skills, and therefore we need more migration to provide those skills, because the indigenous skills are being forced out due to the increasing cost of housing?

Professor John Muellbauer: That is absolutely right.

Q87 The Chairman: One of the areas of skills shortage to which our attention has been drawn by witnesses is that of the house construction market. Some witnesses suggested that if the Government are to achieve their target of 1 million new homes between now and the end of this Parliament, almost 1 million new, skilled construction workers will need to come into the country. Have any of you a comment on that?

Professor John Muellbauer: In Spain, they definitely managed to do that. During the great housing boom in Spain, dysfunctional as it was in relation to the Spanish economy in the long run, they certainly managed to attract vast numbers of migrants, many of whom worked in the construction industry in Spain and fuelled that great boom.

Lord Green of Deddington: Significant numbers of them went home again.

Professor John Muellbauer: Yes.

Lord Green of Deddington: That is not always our experience. There is no question about this. To go back a bit, the number of skilled people in our economy has declined significantly over the last eight years. That is because we have not trained them and because, when it comes to serious training, employers have very substantially reduced what they are prepared to do. There is a whole report on that by Baroness Wolf, which gives a very clear graph of what has been done. If at short notice, and within the period of training a bricklayer or whatever, you want this huge expansion, then yes, that would suck in bricklayers, probably from eastern Europe.

Q88 Lord Turnbull: We have discussed a whole series of measures at various points. Have each of you one measure—with Lord Green I suspect I can guess which one—to put top of the list?

Lord Green of Deddington: I think you guessed. There is no question that a significant and effective reduction in net foreign migration would make a huge difference to the housing market.

Professor Robert Rowthorn: It would have a very large effect, but I am not convinced that we have the instruments to produce that.

Lord Green of Deddington: Ah, well, that is a different question.

Lord Turnbull: Then, of the instruments we do have.

Professor Robert Rowthorn: If you put aside the migration one, I would say a very big public investment in social housing.

Professor John Muellbauer: I have already shot my bolt: the national land bank combined with a change in the Treasury's measurement of the debt to GDP ratio.

Lord Turnbull: You would put those above reforming council tax?

Professor John Muellbauer: Yes, they are even more important than reforming council tax, which I have been a long proponent of, as you know.

Professor Tony Champion: I think I am more general. I would like to see any mechanisms for reducing the disincentives of people moving house when they feel it is about time to. That would include one or two of the things here. I do not know whether you could actually move that in the other direction and increase incentives for people to move to a more appropriate house. The supply side would obviously be key to that, with houses for them to move to. I have heard comment in the media that there are people prepared to downsize housing at older age if the opportunities were available, despite the investment potential of hanging on to their houses. I do not know of any studies that tried to measure how effective such a programme of building more bungalows or apartments for old people would be.

Lord Turnbull: We seem to have a vicious circle. While we have inflationary conditions, people will hoard housing. The inflationary conditions need to be brought under control. Then two things could happen: one is the migration of families, and the other is that the elderly could decide that it is a good time to sell and move on.

Baroness Wheatcroft: Professor Champion, to what extent you think stamp duty might be one of the contributors to making people disinclined to move house?

Professor Tony Champion: I do not have any expertise in this. I saw that Paul Cheshire identified this as the key to the big slow-down in the rate at which people move or change address over short distances. Interregional migration gross flows have maintained themselves over decades, but the proportion of people moving each year over short distances has really reduced since the 1970s. I have been doing research back to then. He mentioned it in his contribution here before Christmas. He mentioned it in the context of stamp duty, but I am not an expert.

Professor John Muellbauer: Housing turnover is definitely affected by the level of stamp duty. There is quite a big impact there. You are quite right in arguing that.

Q89 Lord Forsyth of Drumlean: I am anxious about the changes that the Chancellor announced on inheritance tax, which are tied to a family home under £1 million. At the moment, if people pass on wealth to their children and survive for seven years they do not have to pay inheritance tax. Professor Champion, have you thought about what might happen if that were reversed and, almost the opposite of what the Chancellor is doing, there were a scheme that enabled people who downsized to have some kind of shelter from inheritance tax?

Professor Tony Champion: I have not really thought that far from my migration expertise. What you say sounds very sensible to me, but I defer.

Lord Forsyth of Drumlean: I do not think Professor Muellbauer would like it.

Professor John Muellbauer: Well, your proposal would keep privileges with the privileged.

Lord Forsyth of Drumlean: Yes, but I am just worried about housing.

Professor John Muellbauer: Yes.

Professor Robert Rowthorn: I think one should be rather careful of encouraging turnover of accommodation, moving from one place to another over short distances. It depends on how short those distances are. If people frequently move a mile from where they live in the course of their lives, it disrupts communities and social networks. Social networks arise because people live in the same place and interact with the same people all the time. I know this because in my street, for example, virtually everybody has moved within the last 20 years, at a big social cost. It is one thing to say that we want to use the housing stock more efficiently so that people move to smaller dwellings, but that should be in the context of being able to move to smaller dwellings very close to where they already live, instead of having to go a long distance. Particularly as you get older, you get isolated if you move several miles. I think that is why a lot of people do not downsize. It is not simply that they want to cling on to a large house. They have friends living locally but cannot find anywhere to live locally.

Baroness Blackstone: Professor Rowthorn, could you say just a bit more about how you think a big increase in the building of social housing should take place? Who will do it, and how will it happen?

Professor Robert Rowthorn: Well, the present policy is the opposite: it is to encourage the sale of properties from housing associations and the like. It seems to me that a big expansion could be publicly financed, but I am not a housing expert. It was the sort of question that I prefer not to be asked and I was asked to answer it, but I think that would be an important step. It is all very well saying that people will get on the housing ladder, but a lot of people at the moment are close to the minimum wage. Even if they get the "living wage", that is not what I would regard as a living wage, and it is certainly not enough to buy a house anywhere in the south of the country. They will be in rented accommodation of some kind. In general, they would be better off in social housing.

Lord Teverson: From an economist's point of view, has the increase in the rented sector encouraged greater economic mobility in the country over that period? Has it had the benefit that people can move around more easily and avoid all the disruption that they had as owner-occupiers perhaps earlier in their life?

Professor John Muellbauer: The work on mobility by tenure does suggest that mobility rates are substantially higher for people in the rental sector. So presumably, all things being equal, you are right that the increase in the rental sector in the tenure structure has increased mobility. But of course there are many other factors that impact on mobility.

Baroness Blackstone: But do you agree that mobility in the private rented sector is driven by very poor quality in the housing that people are occupying? They move to try to get away from it and get something better.

Professor John Muellbauer: And of course short-term tenure—typically two-year or less tenures in the UK structure—is very disruptive. In Germany, with longer contracts and much more stable relationships between landlords and tenants, you have a much more stable environment in which, if people move, it is more to do with jobs and families rather than because the apartment is not satisfactory.

Q90 Lord Lamont of Lerwick: Can I ask your opinion about the buy-to-let phenomenon, which we have seen a tremendous increase in? We referred to it earlier as investment buying, but it is investment buying with a view to it being let, not investment through it just being held. Has not the buy-to-let phenomenon actually, to some extent, increased the supply of rented accommodation?

Professor John Muellbauer: I am sure it has had an effect on both the demand side and the supply side. One of the big changes in the late 1970s was when the banks decided to lend on much more generous terms to buy-to-let investors. I am sure that that change in credit conditions added to the demand side. Of course, it has also to some degree expanded supply. As we know from the work of Geoff Meen, among others, the response of the UK building industry to higher house prices has been anaemic, to say the least. Much of the housing that has been bought by those investors is not new build but existing housing.

Lord Lamont of Lerwick: But there has been some. In Manchester particularly, and in Liverpool and Leeds, there has been quite a lot of new build.

Professor John Muellbauer: That is perfectly true.

Lord Forsyth of Drumlean: So when you say more generous terms, what do you mean? On the whole, buy-to-let interest rates have been higher because the risks are higher.

Professor John Muellbauer: I am talking about loan to value ratios.

Lord Forsyth of Drumlean: So did you mean on more risky rather than more generous terms?

Professor John Muellbauer: You could put it that way.

Professor Tony Champion: The private rented sector is, of course, crucial for labour mobility. I have seen figures that show that the private rented sector has doubled in importance in the housing market since 1991 when it was 7%; it is now 14%[1]. That is a big step forward in terms of increasing labour mobility. If that sort of change had not happened, I think the London skills shortage would be much greater today than it is. It is London that really depends on the private rented sector. The other cities do to some extent. One of the key things for getting the northern powerhouse under way is to provide more incentives for people who are prepared to or can only live in rented housing to go to those places and have

[1] Note by witness: the share did double, but the correct numbers are 9% and 19%.

the rented housing to accommodate them. Obviously, the pressure on rented housing in London from other sources besides migration from other parts of the UK is possibly one reason why it is difficult to get more people, particularly less skilled people, to come to London: because of the cost. It is crucial and it needs to be manoeuvred so that it can increase labour mobility further.

Lord Turnbull: Is 14% a national figure?

Professor Tony Champion: Yes.[2]

Lord Turnbull: What is the London equivalent?

Professor Tony Champion: If you take the GLA area, I would say it is something like 50%, but I would look to the experts on that[3].

Q91 Lord Layard: A number of you have mentioned the importance of the supply of land for housing, in which case obviously a crucial issue is how we can get more and faster planning permission granted. One obvious way of doing that is to give the people who give the planning permission some of the share in the price uplift that comes when the planning permission is granted, meaning the local authorities. That is rather different from the sort of nationalised approach that Professor Muellbauer suggested. I do not know what the comments of any of you are on this proposal that local authorities should, by some mechanism or other, be given a substantially greater share—the lion's share—in the price uplift.

Professor John Muellbauer: You are talking about Section 106, which has been in existence for quite some time and has not, I think, been tremendously effective in giving local authorities that share. Because the negotiations over Section 106 take such a long time, it has slowed the whole process of the delivery of housing and made the system much less responsive to market forces. There are much better ways than Section 106.

Lord Layard: I am talking about a proposal that has some features in common with yours: that local authorities should have the power, just as they have the monopoly over giving planning permission, to be a monopoly buyer of the land for development but then immediately to sell it on for development and get the difference in price. But it would be the local authority that was involved in all that, not a national land bank. I do not think that you would want to think of it as a bank either. You would want to think of it as a process.

[2] Note by witness: the correct, current number is 19%

[3] Note by witness: The 2011 census figure for London was closer to a quarter, not a half: GLA put it at 26.4% of households then, compared with the national figure of 18% in 2011.

Professor John Muellbauer: It is a localised version of the national land bank. It still seems to me pretty important that local authority investment in land is accounted for by it being treated as an asset from the point of view of the national balance sheet. Otherwise, it looks as though the country is going heavily into debt, when in fact it is doing something sensible in buying up land and providing and reissuing land for the long term.

Lord Layard: Well, the version of the proposal that you must know from Dr Leunig is that the local authority takes out an option on the land and buys it on the same day as it sold it, so it would never have the necessity to raise finance to buy the land.

Professor John Muellbauer: You would need some complicated finance to finance the option.

Q92 Lord Griffiths of Fforestfach: One issue that has come up in various answers to various questions is the difference between house prices in Germany compared to those in the UK. If you look at a period of globalisation from say the late 1970s, it seems that the difference is genuinely dramatic. The house prices in the UK have increased by, I think, a factor of up to 10 compared to Germany. The argument has been that the Germans increased the amount of land available for housebuilding—I think you said by a factor of three, but it is a huge amount. Secondly, you said that the credit market in Germany has not really been as competitive or, to put it differently, has been more regulated than in the UK, which has been much freer. Thirdly, there were hints that the nature of, for example, rental in Germany is different from that here, so there has been a sort of cultural element. So there are these three factors. Clearly, the remarks were very supportive of what happened in Germany in contrast to what happened here. The question is: what do you deduce from that as to what we could do here to improve our situation?

Professor John Muellbauer: The German system is radically different from that of the UK. One other difference apart from those three is that in Germany, essentially, home equity loans are not legally impossible, but hardly any are available. In the UK, if the value of your house rises you can borrow more on the basis of that increased collateral. You can spend it, do up your house, send your children to private school or whatever. In Germany, that is essentially close to impossible. It is at least very hard to find a bank that will give you an extension of a loan on an existing home. The structure of the German economy and the way in which the housing market interacts with the rest of the economy is very different from the UK. The housing booms that we have here are part of a system-wide response, in which credit conditions ease and house prices rise. That feeds into more borrowing and spending, which fuels the economy and boosts the business cycle. We have a much more unstable boom and bust type of economy compared to Germany because of that difference in the way the economy operates.

Now, moving from the UK system to the German system is not something that I would recommend just like that. For one thing, the German system does not function quite as well as it might. It seems to me that the German system is probably too restrictive in the way it deals with household finance. In my view, the UK system in the past has been too liberal. The combination of the tax treatment of housing in the UK and the way the supply-side has been mishandled has fuelled the way the rest of the economy operates by making these booms and busts in house prices worse than they would have been otherwise.

In reply to your question, one starting point would be: first, to change the supply side; secondly, to change the tax system; and, thirdly—much as the Bank of England's Prudential Regulation Committee is doing—to be careful about loan conditions in the mortgage market.

Lord Green of Deddington: Just to add to that, there are two other substantive differences. One is that England is almost twice as populated as Germany—1.8 times, I think. Secondly, I think I am right in saying that in Germany there are more regional cities and not quite the same concentration as in London and the south-east. Both those points might play into that.

Q93 Lord Lamont of Lerwick: I wonder if I could ask about the impact of foreign buying on London. I notice today that Zac Goldsmith has announced that he will not allow houses built on public land to be sold to people who have been resident here for less than three years. I have been in touch with developers who are developing quite near to here, and quite a high proportion of houses seem to be reserved for foreign buyers. It may be a very central London effect, but is this not part of what is driving the move out of the centre of London to outer London, and out of outer London to other areas of the country?

Professor John Muellbauer: Absolutely. That is very much the case. The top end of the London market typically leads the rest of the London market. There is a trickle-down effect from the top end. If you have foreign buyers who essentially buy a bank account and park their money in a rising asset in London, and the housing is withdrawn from general use so you do not have workers in London living in that supply, you are contracting the supply side and pushing up rents in central London. Of course, in the longer term, a lot of the new build coming on-stream in London is to satisfy that part of the market. Much of that new build is not as functional as it might be and is drawing resources away from other building that would have supplied the middle of the market.

Lord Lamont of Lerwick: Some builders argue that building these very high-end properties provides the finance and development for what they may do subsequently in lower-cost units.

Professor John Muellbauer: They would say that, wouldn't they?

The Chairman: Thank you very much indeed. It has been a very illuminating session. Thank you for participating today.