

[Reusing chewed-up ideas on the housing market](#) [1]

Written by [Vuk Vukovic](#) [2] | Wednesday 23 November 2011



On Monday, David Cameron announced a new policy on housing designed to partially underwrite mortgage loans for first time buyers in order to make it easier for them to buy and own a house. The idea is to make new buyers provide only a 5% deposit for buying a new home, instead of up to 20%, which the banks are demanding now. It is supposed to make the "homeownership dream" a reality for young people. The government and the construction firms will together underwrite a part of the loan creating an incentive to the banks to relax lending standards. This is aimed to help 100,000 new possible homebuyers who are excluded from the market due to high loan-to-value ratios.

The PM cleverly offered a caveat to potential critics by saying this policy won't result in another asset bubble like it did in the US, since it is only focused on people buying new houses. It is supposed to create jobs in the construction industry as well as making it easier to own a home.

This essentially means that no matter what the current supply of housing is in the UK, because the government is worried with low rates in housing construction, it is willing to distort the housing market by increasing the supply of new homes.

The policy such as this one comes closest to the Community Reinvestment Act (CRA) instituted in the US, more particularly its amendment in 1995. For those unfamiliar with the CRA, it forced the banks to offer more loans and weaker lending standards to underprivileged groups in the society (minorities for example). It was a popular political move that was guided under the idea that everyone is entitled to a home, and if they can't provide it by themselves, the government should do it instead.

As an effect, encouraging homeownership added to an artificial created demand for housing in the US which combined with a few other presumptions led to the boom and bust of the housing market. Houses became available to many of whom were unable to afford them, underwritten by the government controlled enterprises. Lending standards were decreasing due to short run interests of the politicians to remain in power. A populist policy such as "let's make more people own a home" sounds good to the median voter, and may even win some favours for the politician in power, but its effect can only be an artificial demand and suboptimal provision of an asset.

I do understand the difficult situation the PM and his Chancellor are finding themselves in as their growth strategy isn't delivering any results. I might understand the political need for a politically motivated act that will create a (temporary) artificial boost in housing and build some new homes for the people. However, it seems that every move they make to boost short-run growth further undermines their long-run growth path. Every new populist policy will simply detach them from their fiscal stabilization goal and make the UK more vulnerable to outside shocks of investor sentiment. I fail to see how increasing spending via credit easing programs or subsidizing homeownership can overturn a deficit. There will be no aggregate demand

created either, since household incomes are locked-in and it is unlikely for the people to start spending on houses all of a sudden. The effects cannot be immediate, they can only distort the economy in the long run. It all sounds more like an expensive political trick used to buy votes.

Haven't they learned anything from the eurozone sovereign debt crisis? A welfare state used to fund populist policies to finance political self-preservation leads to disaster.

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