

Housing, productivity and economic development

INTERNATIONAL EVIDENCE SUGGESTS HOUSING AFFECTS PRODUCTIVITY THROUGH INTERMEDIATE FACTORS SUCH AS HUMAN CAPITAL DEVELOPMENT AND BUSINESS INVESTMENT. AN AUSTRALIAN EVIDENCE BASE IS REQUIRED TO DRAW HOUSING INTO WIDER ECONOMIC POLICY DEBATES.

KEY POINTS

- Microeconomic and city/regional level research indicates that housing processes (e.g. construction) and outcomes (e.g. prices, quality and location) can affect economic growth. High land and house prices, for example, may push businesses to locate in lower productivity places lacking agglomeration economies, and increase the cost of installing new infrastructure. While poor quality homes can affect health and learning and therefore labour market productivity.
- There is a lack of systematic empirical evidence in Australia and overseas testing the long-term relationship between residential investment and productivity. This study identified a range of databases and statistical techniques that could be used to explore this relationship further, arguing in particular for studies at the local and metropolitan levels.
- Interviews with local economic development practitioners in housing and planning in Victoria and Western Australia revealed differences in approach, but little or no focus on the effects of housing outcomes on productivity and growth. Rather, economic development specialists focused on improving human capital and business investment; housing officials concentrated on meeting

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social needs with declining resources; and planning strategies neglected economic drivers and rarely evaluated outcomes of plans on the local economy.

- Although businesses increasingly recognised the importance of housing affordability, rising land values and house prices in raising costs and displacing economic activity, these effects were rarely addressed in local economic strategies.
- Housing policy and local planning and economic strategies therefore need to be much better integrated with each other and include productivity and place competitiveness as explicit objectives.
- Developing a research expertise within the public service that has the capacity to analyse the interrelationships between housing and local and metropolitan economies will be important to this task.

CONTEXT

Policy-makers have long understood the relationship between housing and the economy through the multiplier effects of housing investment on national income and employment. There has, in contrast, been little regard to the longer term productivity and growth impacts of housing. Housing advocates and policy-makers usually focus on the social dimensions of housing.

RESEARCH METHOD

This scoping study reviewed evidence of links between housing and productivity in order to understand how housing processes and outcomes impact economic growth in Australia. The researchers sought out national and international evidence on how housing shapes growth from the fields of economics, housing, planning and local economic development. They also examined metropolitan and local area plans and strategies in Western Australia and Victoria to see whether practitioners had developed ways of connecting housing and economic development. More than 100 planning documents were assessed, and interviews carried out with 18 policy-makers in 12 illustrative areas.

KEY FINDINGS

Housing has not featured in macroeconomic models of productivity

Macro economists generally assume that economic growth is driven by changes in the supply of factors of production (in particular labour and capital), while productivity (caused by things like technical progress and innovation) is usually treated as a statistical 'residual'. The influence of land use and housing on growth is, by default, considered part of the statistical residual.

Analysing the growth effects of housing is complicated by the multidimensional attributes of housing, its spatially fixed and durable characteristics as well as its dual role as a form of consumption and investment. Consequently there is no conventional macroeconomic measure of housing effects on productivity/growth.

However, the failure of macroeconomic models to incorporate housing for the purpose of estimating growth parameters should not lead us to conclude that housing outcomes do not affect productivity. Rather, housing and its productivity effects require scrutiny using other localised data and methods.

Housing impacts on productivity

The links between housing and productivity in a regional or metropolitan economy can be shaped by:

- housing processes (design, sales, production)
- quality characteristics (size, type, location, neighbourhood attributes)
- market outcomes (prices, rents, turnover, vacancies).

As well as having location and shelter properties that directly affect householders' wellbeing, housing also provides the opportunity for social connection, including the ability to exploit economic opportunities. The key to identifying how different housing outcomes and processes impact productivity is through *intermediate* factors like human capital, business investment and innovation.

Existing research highlighted the many potential housing productivity connections in Australia, but also highlighted the absence of systematic, literature-based knowledge on most of the key issues. Even so, published international research suggests a range of potential links between housing and economic growth. For example:

- rising real house prices without increased housing quality will reduce the supply of capital to other sectors, encouraging rentier rather than entrepreneurial activity and constraining productivity growth
- the high transactions costs associated with home purchase, regional house price differentials or housing shortages in destination regions, might reduce workers' willingness or capacity to move to jobs
- increasing housing density might promote agglomeration economies and thus labour productivity
- locating housing close to jobs can reduce commuting times, increase time for work, and facilitate job seeking which all lead to higher incomes and productivity. The deeper labour pools fostered by increased housing density also help employers fill vacancies
- housing market processes can segregate lower income people into certain areas, reinforcing areas of low productivity
- price inelastic housing supply can make it more difficult to house in-migrants, and is therefore a drag on productivity growth
- housing might affect health and children's learning, which influence human capital formation and long-run productivity.

Housing and local economic planning

Among housing policy officials, productivity is not usually considered when undertaking planning processes because they are mainly focused on housing those in need. Planners take a more holistic approach and are aware of the spatial significance of decision-making, but pay relatively

little attention to the market driven economic impacts of their decisions. This is especially evident in relation to housing plans and their implications for house prices and rents.

However, scrutiny of economic development plans and interviews with key decision-makers revealed a number of ways in which decisions about land use and housing are being made with the promotion of economic development and productivity in mind:

- Increasing mixed land use—by mixing housing with commercial work places, planners can increase work opportunities locally, ease work commutes and traffic congestion, with consequent time savings and productivity gains. It might also facilitate agglomeration economies, especially in knowledge intensive industries.
- Increasing housing diversity—middle and outer city local governments are seeking to create precincts with diverse housing styles (e.g. adding in townhouses and apartments to precincts with otherwise detached housing and villas) as a way to stem the flow of professional workers into inner metropolitan areas.
- Encouraging home-based economic activity—flexible work arrangements facilitated by high speed internet connections and video telecommunication, allow telecommuting among workers in certain types of jobs.
- Retaining land for commercial and infrastructure purposes—the strong demand for residential property in most Australian cities has driven up rents (or prices) for business premises. Governments can retain some land as exclusively commercial, or reserve land for expansion of transport and other land-using infrastructure.

POLICY IMPLICATIONS

This study shows that while there is a lack of systematic literature-based knowledge, there is evidence that housing processes and outcomes influence the productivity of capital and human capital. This evidence needs to be developed to ensure important opportunities are not lost and policy is effective.

A range of strategies will be critical in bringing housing into the wider economic policy debate, including:

- policy review—for example, the Federal Government might undertake a review or refer this question to the Productivity Commission
- skilling of the public service in housing and urban expertise, especially from an applied economics perspective
- change in the governance arrangements around housing, planning and economic development at local scales so as to facilitate more information sharing and greater understanding of the economic implications of housing
- ongoing research including use of new statistical sources and techniques to establish robust relationships between housing and economic outcomes.

FURTHER INFORMATION

This bulletin is based on AHURI Project 53035, *Making connections: housing, productivity and economic development*.

Reports from this project can be found on the AHURI website: www.ahuri.edu.au or by contacting AHURI Limited on +61 3 9660 2300.

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