Structural Changes in Housing Markets: The American, British, Australian and Canadian Experiences

by George Fallis

INTRODUCTION

While the theme of this paper is change and the response to change in the housing markets of four countries, I have tried to develop a framework which could be used to analyze any country. My starting point is to explore why these four countries form a logical group, then contrast this group with other groups and analyze how the place of a group in the world economy shapes its housing markets.

In the subsequent section, I consider the national housing markets of these four countries; but I argue for the greater importance of regional housing markets. As an economist, I naturally think of the demand side and the supply side of the housing market, and how they interact to determine the price of housing units (both owned and rented) and the quantity of housing units (both owned and rented) in the economy. The demand for housing finance is a demand derived from the demand to own housing units, on the part of homeowners, investors and government agencies.

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An understanding of the forces of change in the housing market will yield an understanding of the forces of change in housing finance. I emphasize two fundamental forces of change in housing markets: demography and household income. Mortgage markets both shape housing markets and are shaped by them. I also analyze the mortgage market itself. In all of these sections, I set out the major changes over the past decade, discuss likely future changes and draw out the implications for housing finance professionals.

There are many changes I will not deal with, in part because space is limited and in part because I have scant expertise in some of these areas. But this list is important—indeed it is a list of pressing issues of the late 20th century. Each item on the list will significantly influence housing markets in years ahead. I will not deal with: the changing role of women in the workforce and in the family; government housing policies; immigration and mixing of ethnic groups in cities; the environmental cost and sustainability of our current urban form; or the implications of the communications and computing revolutions for the location of home and work.

COUNTRY GROUPINGS AND THE WORLD ECONOMY

Let us turn to my four-country group—United States, Britain, Australia and Canada. All are liberal-democratic capitalist societies. But not all forms of liberal-democratic capitalism are the same. This group of countries follows what George Lodge, a Harvard Business School professor, has called the individualistic, British-American form of capitalism.[1] In contrast is communitarian capitalism, in particular the different variants in Germany and Japan.

Here I quote Lester Thurow,[2] Dean of the MIT Sloan School of Management:

> America and Britain trumpet individual values: the brilliant entrepreneur, Nobel Prize winners, large wage differentials, individual responsibility for skills, ease of firing and quitting, profit maximization and hostile mergers and takeovers. In contrast, Germany and Japan trumpet communitarian values: business groups, social responsibility for skills, teamwork, firm loyalty, industry strategies and active, growth-promoting industrial policies. Anglo-Saxon firms are profit maximizers; Japanese firms play a game that might better be known as "strategic conquest"; they are more focused on market share than on profit. These different visions of capitalism have profound effects on everything from labor relations to public education.

I would add to Thurow's list profound effects on housing markets and housing finance institutions. Countries that do not follow British-

American individualistic capitalism may have quite different housing finance institutions from my four-country group.

Thurow[3] argues that profound changes for democratic capitalist societies occurred in the late 1980s and early 1990s. The fall of the Berlin Wall in 1989 ended the old contest between capitalism and communism. The contest had been going on throughout the 20th century; by the end of the century democracy and capitalism had won. A second dramatic event was the economic integration of the Western European economies, symbolized by Europe 1992. For the first time in almost 100 years, the United States was the world's second largest economy. Together these two changes implied that the dominant economic contest had shifted. No longer was it a contest between communism and capitalism. Instead, economic competition became a contest between the United States, Europe, and Japan, and between individualistic and communitarian capitalism.

This changed environment in the world economy has implications for housing finance institutions in different parts of the world. At the World Congress (and in this issue of *Housing Finance International*) Dr. Bertrand Renaud analyzed housing finance in the East European transition economies. Dr. Otto Schafer examined housing finance and West European economic integration. How any country fits into this new world economy (including not only how the country is related to United States/Europe/Japan competition, but also whether the country has a developed or developing economy, and has a market economy or a transition economy) will shape its housing markets and housing finance.

The four countries in my group are not all affected in the same way. Housing finance in the United States and Canada is obviously shaped by the US/Europe/Japan competition. Britain is torn by a dilemma: whether to join the Western European economy of communitarian capitalism or to remain outside, relying more on the British-American connection and individualistic capitalism. Australian housing finance is shaped by the role of Japan and the United States in the region of the Pacific Rim.

But housing finance in the four countries of my group is influenced in the same way by other aspects of the world economy in the late 20th century. This is in part because all have well-developed market economies. All are influenced by what is often summed up in the term "globalization." All are influenced by the move to freer trade, whether globally or within trading blocks. All are shaped by the internationalization of capital markets and the integration of mortgage finance into global capital markets. So too, are all influenced by the ability of transnational corporations to split up the production process and locate different bits in different countries around the world.

The countries of my group are among the richest and most industrialized in the world. They all face special concerns about the falling wages of their low-skilled workers and about how to create high-skill, high-wage jobs. Government macroeconomic policy has shifted from fiscal and monetary fine tuning and toward trade policy, structural policies and policies to encourage innovation. The implications for housing finance are many, and will be drawn out later in this article. One is especially noteworthy. The new orientation of economic policy emphasizes mobility and flexibility. This will increasingly conflict with traditional housing policy which has emphasized and sought to encourage the stability of people and neighborhoods.

NATIONAL VERSUS REGIONAL HOUSING MARKETS

Ostensibly, this paper is about the housing markets of four countries, about four national housing markets. I must begin, however, by stating what we all know although often forget: there really are no national housing markets; rather, there are regional (or local) housing markets. The housing market of London, England, is very different from the housing market of Sheffield, England. The forces of demand and supply in London and the resulting housing price and construction movements are quite different from those in Sheffield. Just as the housing market of Toronto has quite different price movements and construction changes from the housing market in Montreal; and the Atlanta housing market differs from Detroit; and so on.

There are, of course, some similarities across a nation: in the world economic context, in national mortgage market institutions, in demographic and income trends and government policies. But local demand and supply factors overwhelm these national similarities, causing radically different price movements in different housing markets across a nation.

During the latter part of the 1980s, each of the countries saw dramatic increases in house prices in certain of their regional housing markets: for example, London in Britain, Boston in the United States, Sydney in Australia and Toronto in Canada. During the early 1990s there were dramatic declines in real house prices. These regional housing markets have been subject to booms and busts. Demand surged because of employment growth, in-migration and income growth within the region; in the short run, supply couldn't expand quickly, causing sharp price increases.

Because house prices rose, existing homeowners felt wealthier and increased their consumption levels, which increased regional prices and in turn regional wages. Speculation of future house price increases further fueled demand, and owners and investors took out high-ratio mortgages. Eventually the bubble burst, and the cycle reversed itself. The turnaround was especially dramatic from the late 1980s to the early 1990s because these economies shifted from high inflationary ex-

pectations to low inflationary expectations.[4] Professor Maclennan's paper, in this issue of *HFI*, analyses some of these issues in greater detail.

Housing units, whether detached dwellings, terrace housing or high-rise apartments, and the land on which they stand, are durable assets with a low rate of depreciation. This makes them good security for a mortgage loan. However, there are significant risks. Although the boom/bust of certain regional markets of the last 10 years is unlikely to repeat itself during the next 10 years, the basic reality remains. Regional/local housing markets will exhibit considerable volatility in the prices of houses and rental buildings. Mortgages, especially mortgages with higher loan-to-value ratios, will be risky. Housing finance institutions should diversify across regional housing markets. Bundles of mortgages used to back other securities should be low-ratio mortgages and diversified across housing markets.

DEMOGRAPHY

A fundamental determinant of the medium-term demand for housing, and the derived demand for mortgage finance, is demography: population growth, the age structure of the population and the formation of households. The main changes of the later 20th century are quite well recognized: a relatively low rate of population growth, the maturing baby boom, the aging of the population and declining average household size. The interaction of these changes causes an evolution of the demographic structure of the population which will shape housing markets over the next decade.

Compared to the 1950s and 1960s, population growth has slowed in these countries, and therefore so has population-based demand for new housing and related finance. When the backlog of new housing construction that had to be cleared during the 1950s and 1960s is recognized—a backlog caused by low construction levels during the Depression and the Second World War—it becomes clear that new residential construction and its attendant mortgage financing must be classified as a "mature" industry. The share of residential construction in GDP will decline slightly. (See Table 1.) There will be ups and downs in construction levels, year-over-year, but a secular decline as a share of the economy.

In three of these countries (less so in Britain), there was a baby boom in the early postwar period, the largest absolute number of children being born in the late 1950s. The boom was caused by many factors: an increasing rate of marriage, an earlier date of marriage, an earlier age of first child and an increase in the number of children per family. One can chart the age distribution of the population and actually see the baby boom moving through its lifecycle. (Table 2 presents some raw data.) Schools were affected first, then rental housing and recently ownership housing. The largest group of the baby boom is now aged 35 to 38, a few years past the average age of buying a first home.

As the baby boom reached the age of marriage and children, there was an echo but not a loud echo. The original causes of the baby boom reversed themselves; there was a decreasing rate of marriage, a later age of marriage, later age of first child and fewer children per family.

This further suggests that new residential construction, both for ownership and for rental,

Table 1. Residential Construction as Percentage of GDP

	1960–67	1968–73	1974–79	1980–89
Australia	4.6	5.6	5.7	n.a.
Canada	5.4	5.8	5.9	5.1
United Kingdom	3.5	4.0	4.1	3.5
United States	4.8	4.8	4.9	4.5

Source: *OECD Economic Outlook, Historical Statistics 1960–89,* Paris: Organisation for Economic Cooperation and Development.

Table 2. Age Distribution of the Population (Estimated)

		1950	*1960*	*1970*	*1980*	*1990*	*2005*
Australia	15–24	14.6	14.0	17.5	17.5	16.2	13.6
	60+	12.5	12.2	12.3	13.7	15.5	16.2
Canada	15–24	15.9	14.6	18.4	19.4	14.5	13.2
	60+	11.3	10.7	11.4	13.4	15.8	17.2
United Kingdom	15–24	13.6	13.3	14.7	15.5	14.8	12.6
	60+	15.5	16.9	18.7	20.1	20.7	20.5
United States	15–24	14.7	13.6	17.8	18.8	14.4	13.5
	60+	12.1	13.2	14.0	15.7	16.8	16.7

Source: *United Nations World Population Prospects—The 1992 Revision.* Paris: Organisation for Economic Cooperation and Development.

will be a mature, slow growth industry. (One controversial academic paper in the United States suggested that these demographic forces would lead to a 25 to 45% decline in the real price of houses.)[5] The construction needed in these countries will be less the building of new units and more the reconfiguration of existing units to match current needs and tastes. Renovation rather than new construction will predominate in residential investment. This shift is already well along. For housing finance institutions this requires new approaches to marketing mortgage loans for construction and new appraisal techniques to assess the quality of the loan.

Although it will be almost 25 years until the biggest portion of the baby boom is over 60, the share of the population over 60 will rise in these countries (except the U.K.), during the next 15 years, mainly because of longer life expectancy and slow population growth at younger ages. (See Table 2.) This aging of the population will have severe implications for pensions and health care. For housing markets and finance, it will imply increasing use of reverse mortgage instruments, allowing a monthly payment to the owner accompanied by a rising principal outstanding.

Together all these demographic changes have implied a declining average household size over the postwar period, from well over three to now well below three persons per household. The number of households grew faster than the population, and so the demand for dwelling units grew faster than population. Average household size will likely decline still further, but not so rapidly. One-person households will continue to be the fastest growing household size. Such households will likely want and need rental housing, perhaps in existing owner-occupied housing. Homeowners may want to renovate their homes to create small apartments, using a mortgage loan to finance the construction. Housing finance institutions will have to assess whether the rents from these units are sufficiently secure and predictable to carry a mortgage loan.

HOUSEHOLD INCOMES

An important determinant of the demand for housing, and indirectly therefore the demand for housing finance, is the level of national income, its growth and its distribution to households. All four countries are high-income countries and have been so for many years, with the obvious result that their people are, on average, very well housed. During the 1950s and 1960s, and into the early 1970s, real incomes grew very rapidly. Growth and productivity increased at rates above almost all historical records. (It is noteworthy that the "four tigers" of the Pacific have exceeded even these rates.) Angus Maddison in his study of advanced capitalist economies since 1820, *Phases of Capitalist Development*,[6] called the period from 1950–1973 the "Golden Age." Not surprisingly, this was also a period of relatively low rates of unemployment.

Around 1973, things changed. Rates of income growth fell and unemployment rates increased. (See Tables 3 and 4.) Productivity growth slowed, even stagnated. For some types of workers real wages have not risen since the late 1970s. This change to slow real income growth has been with us for a long time, but I sometimes wonder whether we have fully recognized it even yet. We keep expecting, perhaps now simply hoping, for a return of the Golden Age, where education or willingness to work hard in the mine or the plant meant a job, rising real incomes and, for most families, a house of their own. To my mind the most important cause of the public's current dyspeptic mood is the slow growth of real income jarring against our memories and expectations of the Golden Age.

We have all attended economic forecasting conferences, and all have our views about

Table 3. Real GDP Per Capita Year-to-Year Percentage Changes (Average)

	1960–68	1968–73	1973–79	1979–89
Australia	3.0	3.5	1.5	1.7
Canada	3.6	4.1	2.9	2.1
United Kingdom	2.4	3.0	1.5	2.1
United States	3.1	2.0	1.4	1.8

Source: *OECD Economic Outlook, Historical Statistics 1960–89,* Paris: Organisation for Economic Cooperation and Development.

Table 4. Standardized Unemployment Rates

	1964–67	1968–73	1974–79	1980–89
Australia	1.6	2.0	8.0	7.5
Canada	3.9	5.4	7.2	9.3
United Kingdom	2.5	3.3	5.0	10.0
United States	4.2	4.6	6.7	7.2

Source: *OECD Economic Outlook, Historical Statistics 1960–89,* Paris: Organisation for Economic Cooperation and Development.

future economic growth. We are aware of how tenuous is anyone's forecast. My own view is that income growth in these four countries is likely to be at the modest rates of the last 15 years, not the historically high rates of the Golden Age. Indeed, we should regard the 1950s and 1960s as a period of abnormally high rates of growth, and we should not expect the restoration of these rates.

What is more difficult to forecast is whether we will continue to have high levels of unemployment, and whether governments will work vigorously to reduce these or become more accepting. In the short to medium run, it is inevitable that unemployment will remain high.

The first major break in the pattern of income growth and distribution in the postwar period occurred in 1973. The second occurred around 1979, when there began a sharp growth in the inequality of earnings, particularly among men. In contrast, during the 1970s, earnings inequality declined or remained stable. There were increases in earnings inequality in all four countries, but the United States and Britain experienced especially large increases. More specifically, there was a sharp deterioration in the relative earnings of young, less-educated men. This combination of high unemployment and increased earnings inequality will, I believe, be a prominent social problem, of influence in a wide variety of areas including housing demand and housing finance, and government social housing policy.

The extent of earnings inequality and its causes have recently been widely studied.[7] There can be little doubt of the stylized picture of increased earnings inequality; although different measures of dispersion alter the detail of the picture slightly. One common measure of inequality is the ratio of the upper and lower deciles to the median of the earnings distribution. Increasing earnings inequality is shown by an increase in the ratio of the upper decile to the median and a decrease in the ratio of the lower decile to the median. This has occurred in all four countries during the 1980s for male earnings. (See Table 5.) There is some evidence that the increase in inequality has been slower in the communitarian economies than in the individualistic economies.

Many explanations have been offered for these changes in the wage structure. Three have received most attention. Two deal with changes in demand for labor and focus on the fact that the increase in earnings inequality can be seen especially in an increase in the wage of educated workers relative to less-educated workers and also in an increase in the wage of experienced workers relative to the less-experienced workers.

Two reasons are offered to explain the increased demand for educated and experienced workers. The first is a shift of manufacturing jobs, requiring less-educated workers but traditionally offering relatively high pay, out of these four countries into low-wage countries. This is sometimes referred to as de-industrialization. Changes in technology and communications have enabled firms to separate the production process into different bits and shift these jobs to low-wage countries without having to shift the high-skill jobs.

A second demand-side explanation is that technological change, especially the spread of computers and computer-based technology, has raised the productivity of highly skilled workers and reduced demand for less-skilled workers. Both fall under the umbrella explanation of globalization.

The third explanation emphasizes the role of wage-setting institutions in countries, in particular the declining influence of unions, the falling real level of the minimum wage and changes in pay-setting norms.

We have all heard rhetoric championing each of the explanations. Thus far econometric analysis has been unable to distinguish among them. My own view is that all three have some truth.

For our purposes, the main question is: what will be the effect of this increase in earnings inequality on housing markets? If lower deciles of the income distribution have suffered declines in real incomes, there will be a decrease in their demand for housing and some households will no longer be able to afford to buy a house. The improved relative position of the upper deciles implies that the demand for housing will grow most for high-quality houses and the demand for mortgage finance will be

Table 5. Trends in Male Earnings Dispersion, 1979–1991 (Decile Ratios)

		1979	*1981*	*1989*	*1990*	*1991*
Australia	D9/D5	1.48			1.56	1.59
	D1/D5	0.74			0.70	0.70
Canada	D9/D5		1.67		1.75	
	D1/D5		0.48		0.44	
United Kingdom	D9/D5	1.67			1.96	1.99
	D1/D5	0.69			0.61	0.59
United States	D9/D5	1.93		2.14		
	D1/D5	0.41		0.38		

Source: *OECD Employment Outlook,* July 1993, Table 5.2, Paris: Organisation for Economic Cooperation and Development.

Table 6. Size and Composition of Part-time Employment, 1973–1993; Part-time Employment as Share of Total Employment

	1973	*1979*	*1983*	*1991*	*1993*
Australia	11.9	15.9	17.5	22.6	23.9
Canada	9.7	12.5	15.4	16.4	17.3
United Kingdom	16.0	16.4	19.4	22.2	
United States	15.6	16.4	18.4	17.4	17.5

Source: *OECD Economic Outlook,* July 1994, Paris: Organisation for Economic Cooperation and Development.

more associated with high-income households. But housing finance institutions could overreact and all chase the high-income family. There is still lots of business elsewhere.

A third major trend in the income/employment experience of households is the increasing share of part-time employment in total employment. (See Table 6.) This means that housing finance institutions increasingly will have to consider atypical earnings patterns when assessing the creditworthiness of borrowers.

HOUSING FINANCE

Housing finance was once a stable, growing industry. The economy was growing, incomes were growing, the postwar suburbs were being built, specialized housing finance institutions existed, making mortgage loans using a well-tried and unchanging financial instrument.

Today and into the future, housing finance is changing and turbulent. Previous sections of this paper dealt with housing finance changes caused by changes in the housing market. But there are major changes within the mortgage market. Especially important are high real interest rates and the integration of national housing finance institutions into global capital markets through the deregulation of financial institutions and the breakdown of differences between commercial lenders, mortgage lenders, insurance companies and underwriters.

For much of the 1970s, real mortgage interest rates were very low, even negative for short periods, which greatly spurred housing demand. Over the 1980s and 1990s, real rates have been high and are likely to remain high. In the short run, the large borrowing requirements of many governments, the capital demands of East European and other transition economies, and the decline in private saving rates will combine likely to keep real rates high. In the medium run, continued public sector dissaving coupled with an aging population's needs for health care and pensions could further increase real rates. Housing investment is very interest sensitive and will be discouraged. Also, housing investment is relatively less attractive in a low inflation or disinflationary environment.

Housing finance was once relatively sheltered from global financial forces but no longer. The combined effect of financial market deregulation and globalization has meant savers shift their deposits to where returns are highest, just as financial institutions make the type of loans where returns are highest.

The deregulation and shifts in world inflation rates led to the near collapse of the housing finance system in several countries, most particularly in the United States with the savings and loan debacle, and the failure of many individual financial institutions. Overall, however, the financial system proved quite robust.

Finally, the mortgage as a financial instrument has evolved into many options, from index-linked mortgages to deal with inflation to reverse annuity mortgages to meet the demands of aging homeowners.

The integration of mortgage markets into global financial markets and other mortgage market changes has meant housing finance is more volatile, more complex and requires new skills and sophistication of institutional managers. The growth and stability of the Golden Age has been replaced by the global turbulence of the 1990s.

NOTES

[1] G. C. Lodge, *Perestroika for America*, Boston: Harvard Business Press, 1991.

[2] Lester Thurow, "Who Owns the Twenty-First Century," *Sloan Management Review*, Spring, 1992.

[3] Lester Thurow, *Head to Head: The Coming Economic Battle Among Japan, Europe and America*, New York: William Morrow and Company, Inc., 1992.

[4] This pattern of regional housing markets is analyzed by John Muellbauer and Anthony Murphy in *Explaining Regional House Prices in the UK,* York, UK: Joseph Rowntree Foundation, 1994.

[5] Gregory Mankiw and David Weil, "The Baby Boom, the Baby Bust and the Housing Market," *Regional Science and Urban Economics*, May 1989.

[6] Angus Maddison, *Phases of Capitalist Development*, Oxford: Oxford University Press, 1982.

[7] A recent study with an international overview is Marvin Kosters' "An Overview of Changing Wage Patterns in the Labor Market" in Jagdish Bhagwati and Marvin Kosters, eds., *Trade and Wages: Leveling Wages Down*, Washington, D.C.: The American Enterprise Institute, 1994.