

SA422: Housing Economics and Finance  
2008/09

Week 8: Reasons for Government Intervention

Objectives

- MAXIMISATION of WELFARE
- PRODUCTIVE and ALLOCATIVE EFFICIENCY  
– ensure scarce resources used as effectively as possible
- DISTRIBUTION/EQUITY  
Vertical  
Horizontal

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PARETO OPTIMALITY

- ONE DEFINITION of MAXIMUM SOCIAL WELFARE
- EXISTS where RESOURCES ARE ALLOCATED in such a way that it is IMPOSSIBLE TO MAKE ONE PERSON BETTER OFF WITHOUT MAKING SOMEONE ELSE WORSE OFF
- ASSUMES CANNOT MAKE INTERPERSONAL COMPARISONS

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- PARETO OPTIMALITY REQUIRES:  
PRODUCTIVE EFFICIENCY  
and  
ALLOCATIVE EFFICIENCY
- A PARETO OPTIMAL SOLUTION EXISTS for EACH AND EVERY DISTRIBUTION of INCOME – ADDRESS EQUITY SEPARATELY

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NECESSARY CONDITIONS to  
ACHIEVE PARETO OPTIMALITY

FOR EACH GOOD:

- PERFECT COMPETITION
- MAXIMISATION of UTILITY  
PROFIT
- FULL ASSIGNABILITY (no spillovers)
- FULL INFORMATION/ZERO TRANSACTIONS  
COSTS
- EQUILIBRIUM

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L/R EQUILIBRIUM

$MU_x$   
= MAX UTILITY  
 $P_x$   
= Perfect Competition  
 $MR_x$  PRICE TAKING  
= (both consumers/producers)  
 $MC_x$  MAX PROFIT  
= free entry  
 $\min AC_x$  exit  
 $D_x = S_x$  EQUILIBRIUM

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**SO FOR HOUSING  
Require**

A perfect market for housing would  
ensure

$$SMU = MU = P = MR = MC = \min AC = SMC = \min SAC$$

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### Why Housing Markets likely to be problematic

#### Special Attributes

- Heterogeneity/consumption good/asset
- Necessity/luxury good
- Indivisibility
- Longevity
- Spatial specificity
- Irregularity of decision
- Proportion of Income
- Importance in Government Policy
- Relation to macro-economy

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### What Type of Good is Housing?

- Private good:
  - Rival and excludable
  - Attributes provide very different utilities
  - Value of choice
- Social good:
  - Element of social wage?
  - Element of welfare state?
  - A merit good or just another good where there are market failures?

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Housing on a spectrum from private to public

Different government choices about extent and nature of intervention

USA/Japan...UK...Scandinavia...Communist states

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### MAJOR SOURCES OF MARKET FAILURE

- PUBLIC GOODS:  
NON-RIVAL  
NON-EXCLUDABLE/REJECTABLE
- SO  $MC_{\text{EXTRA USER}} = 0$   
so should not charge
- CAN'T EXCLUDE  
so cannot charge

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### EXTERNALITIES

- Spillover effects of Individual DECISIONS
- Social MU  $\neq$  Private MU
- Social MC  $\neq$  Private MC
- BOTH POSITIVE and NEGATIVE

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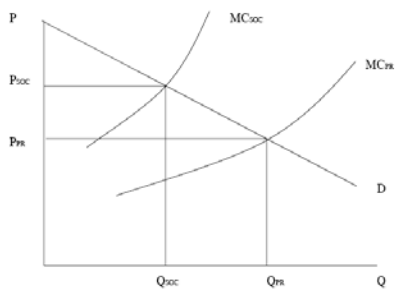
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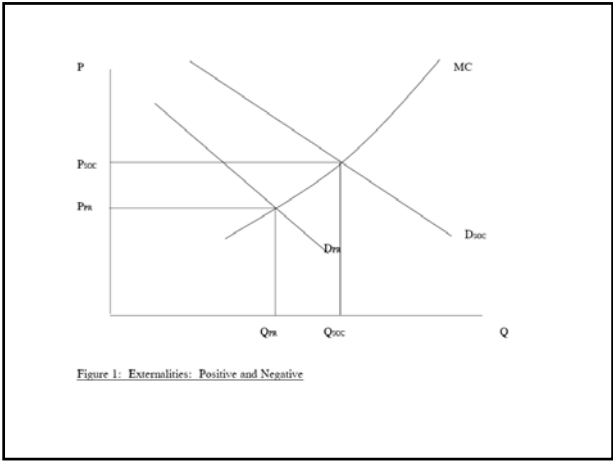
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### Evidence on Extent of Externalities

- Direct – overspill fire/spread of disease irrelevant in advanced economies? role of regulation → implications for affordability
- Externality/information/risk – overspill on occupiers health, education, employment possibilities, safety

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### Health

- Sources of concern:
  - Overcrowding
  - Cold, damp
  - Air quality
  - Mental health
- Issues:
  - Self reporting v. matched groups
  - Temporary accommodation/homelessness
  - Housing as cause v. poverty
  - Housing as means of delivery

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### Education/Access to Employment/Safety

- Impacts of schools on health very limited
- Instability – temporary accommodation
- Administrative costs
- Association with stress
- Positive impacts of housing investment/design

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### Interactive/Intergenerational Externalities

- Prisoners' dilemma and the generation of slums
  - Rationale for government intervention at any level of income?
  - Interaction with information/relative power
  - Evidence on regular v. irregular repair and maintenance
- Private v. social discount rates → under-investment
  - Capital market imperfections
  - Risk aversion

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		I	NOT I
I		8, 8	1, 10
A			
NOT I		10, 1	2, 2

BOTH A and B max utility s.t. the other's expected behaviour  
 $10 > 8$ ;  $2 > 1$  so decide NOT I → sub optimal result

Figure 2: Interactive Externalities

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## MONOPOLY/IMPERFECT COMPETITION

- $P > MC$
- PRICE DISCRIMINATION  
PRICES differ between  
consumers  
producers

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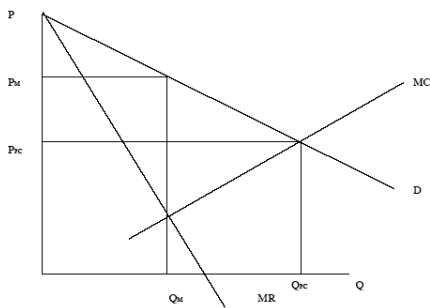


Figure 3: Monopoly Power

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- INFORMATION
  - TRANSACTIONS COSTS
  - PUBLIC GOOD
  - ASYMMETRIC INFORMATION - POWER
  - MORAL HAZARD
- TIMING/WHO MAKES DECISION?

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• RISK and ATTITUDES TO RISK

- RISK AVERSION
  - Individual
  - Markets: Finance

• INSURANCE

BUT

• LARGE SPECIFIC PROJECTS

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INTERDEPENDENCE of UTILITIES

- PATERNALISM?
- MERIT GOODS

Who Pays?

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### Housing as a Merit Good?

- Distinguish merit good arguments from
  - Externalities
  - Distribution of income
- Social utility > private utility
  - Interdependence of utilities v. paternalism
  - v. 'no such thing as society'
- Housing as a means of achieving social objectives of distribution

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