

MISSING the **POINT!**



Labour's plans to deal with the UK's escalating cost of living recognise the symptoms – but not the cause. Using regulation, price caps and subsidies just won't work, says

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The Labour Party's 2013 annual conference in Brighton was dominated by the issue of living costs. In principle this is good news.

It shows that the Labour Party now recognises that the surge in living costs is a determinant of living standards in its own right, which is independent of the general state of the economy.

This recognition places the party miles ahead of economics commentators such as the Independent's John Rentoul, who still denies the existence of a cost of living crisis, and insists that the decline in living standards was simply another consequence of the general economic flatlining.

He is wrong. The Labour Party is absolutely right to address the issue of living costs separately, because on its own, an economic recovery will do nothing to solve this problem. The cost of living crisis is a matter of supply-side constraints.

Unfortunately, while the Labour Party conference speakers aptly describe the problem and its consequences, the solutions they propose are not solutions at all. The basic problem is that the party is trying to solve problems which have been caused by undue government interference with more government interference, inadvertently providing an illustration of what Ludwig von Mises called the *interventionsspirale* (spiral of intervention).

It should be noted that they are not the only party falling into this

trap. Conservative politicians have proposed rent controls and higher minimum wages and the Liberal Democrats have proposed more childcare subsidies.

Housing, energy and childcare have been among the areas with the most rapid cost increases (see Figure 1). Senior speakers at the Labour Party conference have announced that they will cut housing costs by expropriating developers who are sitting on undeveloped land, cut (real-terms) energy costs through a price freeze and cut childcare costs by raising the entitlement to free childcare to 25 hours. Each of these proposals is a symptom treatment that ignores the causes of the prior cost increase in the respective sector, and each of these proposals would be counter-productive even when taken as a mere symptom treatment.

An energy market oligopoly?

Energy is probably the most obvious example. Labour leader Ed Miliband's argument is simple: energy corporations are ripping off consumers, which is why the state, the natural ally of the underprivileged, has to intervene.

The reality is a bit different, though. It is true that the energy market is fairly concentrated, and there is surely scope for greater competition. But the sector is more competitive than it is often assumed to be. Profit margins in the energy sector are only about 4-5 per cent (The Economist, 2013), so even if shareholders could be persuaded to

supply capital for free, energy prices would not tumble.

A much larger share of energy retail prices – 16 per cent in the case of electricity, 10 per cent in the case of gas – is explained by legal obligations to buy energy from renewable sources (Niemietz, 2012, p124-132). If there were a special 'renewable energy tax' levied on each energy bill, with the revenue being handed over to renewable energy producers, public anger would be directed at the government responsible for this levy.

In effect, the current

THE MOST STRAIGHT-FORWARD WAY TO REDUCE ENERGY BILLS IS TO ABOLISH RENEWABLE ENERGY OBLIGATIONS

arrangement works precisely like that, except that renewable energy taxes are not officially called 'taxes', and renewable energy subsidies are not officially called 'subsidies'.

The most straightforward way to reduce energy bills is to abolish renewable energy obligations. These obligations do not reduce carbon emissions, since the latter are already capped at the EU level through the Emissions Trading Scheme (the cost of which is not included in the above figures). All renewables obligations do is redistribute resources from energy consumers to a politically favoured industry. Imposing price controls while leaving these distortions untouched can only lead to a reduction in capital investment, which will make energy price rises in the future more likely.

The folly of reducing childcare costs through subsidies

Another key announcement was formulated by shadow chancellor Ed Balls, who plans to raise the number of free childcare hours for three- and four-year-olds from 15 to 25 per week. That, of course, would do nothing to change the fact that the UK has some of the highest childcare costs in the world. The policy would simply move the cost

At the Labour Party's annual conference in Brighton, party leaders announced several measures to deal with the UK's escalating cost of living. They plan to:

- address runaway housing costs by expropriating developers who are sitting on undeveloped land ('use it or lose it')
- address runaway energy costs initially through a price freeze and, later, through tougher regulation
- address runaway childcare costs by raising the entitlement to free childcare (for three- and four-year-olds) from the current 15 hours to 25 hours

All of these are misguided symptom treatments, which do not address the causes of the prior cost increases:

- The housing costs escalation has been a result of decades of under-building, caused by planning restrictions and 'nimbysm' – not land hoarding.
- The energy cost escalation is mainly caused by renewable energy subsidies, paid by consumers through their energy bills – not 'excessive' profits.
- The escalation in childcare costs has been caused by the exaggerated formalisation of the sector – not a lack of demand-side subsidies.

to the taxpayer so that the standard of living of taxpayers in general would be reduced.

Enthusiasts of state-funded childcare like to praise Sweden as a role model, but they overlook the fact that government childcare subsidies in the UK already match Swedish levels. Balls' proposal could well send them to the highest level in the world, especially when considering the dynamic implications.

An entitlement to free hours is one of the least efficient ways of subsidising childcare. It is a universal benefit, to which David Beckham's children are just as entitled as the poorest children in the country. Entitlement is irrespective of the parents' work status, so it does not specifically encourage parental employment. There is no co-payment for parents, who therefore have no incentive to choose a cost-effective provider.

It would be much more sensible to address the rules and regulations that push up childcare costs so much in the first place, such as minimum staff-to-children ratios, mandated curricula, Ofsted licensing and inspections etc. Childcare, after all, is not a high-tech sector. If a country pays out more than 1 per cent of GDP in public childcare subsidies, and parents still have to pay high user charges while huge gaps in coverage remain, something is wrong with the regulatory framework.

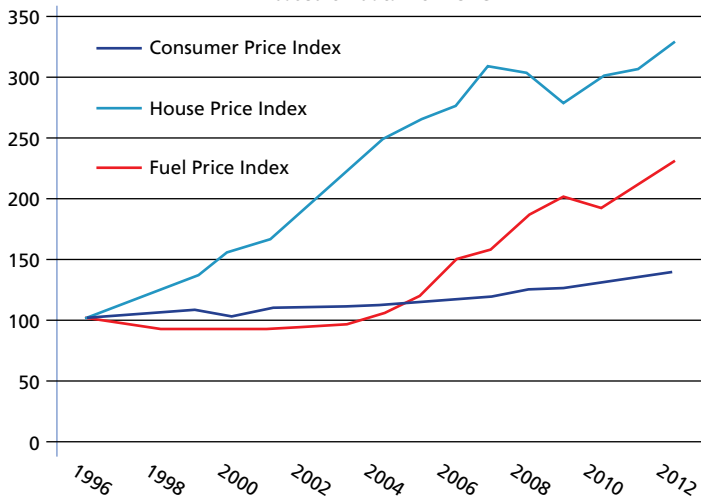
THE MARKET FOR RESIDENTIAL LAND IS ANYTHING BUT COMPETITIVE, BECAUSE SUPPLY IS TIGHTLY CONSTRAINED BY THE PLANNING SYSTEM

Ending land hoarding is no solution to high house prices

Ed Miliband's proposal of bringing down housing costs through the threat of 'landgrabbing' is, at least, a supply-side measure, which contrasts positively with the Conservative Party's belief that a supply-side problem could be solved through a demand-side intervention (the infamous Help-to-Buy scheme).

The escalation in British house prices, however, is the result of at least three decades of a systematic shortfall in housing construction. 'Land hoarding' has nothing to do with this, because hoarding does not affect the total amount of residential development, it only affects its timing. Hoarders do not

Figure 1: House price and fuel price indices in the UK, 1996-2012 based on data from ONS



hoard land forever: they merely release it to the market a bit later than Ed Miliband thinks they should.

But it remains worth considering why hoarding occurs at all. Suppose you own an asset which you could sell for a price of 100 gold coins now. You believe that there is a 50 per cent chance that the price will rise to 120 gold coins next year, but an equal chance that it will fall to 90 gold coins. The expected value of the asset in a year's time is therefore 105 gold coins, which, if you discount it at a 5 per cent

that increase actually occurring, are very high. This is rarely the case in a competitive market, because you cannot control your competitors' behaviour. If you hoard your asset, somebody else with a similar asset might sell theirs, driving down prices and ruining your hoarding plan.

That is the situation in a competitive market. Yet the market for residential land is anything but competitive, because supply is tightly constrained by the planning system, which is why most of the time, prices move in one direction only: upwards. Hoarding would be pointless in a competitive land market, but it can be viable in the UK's artificially supply-constrained pseudo-market.

Miliband's proposal would do nothing to change this. It would leave the barriers which entrench market power untouched, so that the government can then act as the white knight who stands up for the little guy. It would be far more sensible to remove those barriers, so that nobody needs any white knights, but that is not the way politics works.

Taken together, it is commendable that the Labour Party at least recognises the existence of a living-cost crisis that will not be resolved by an economic recovery. But the party has not recognised that the problems it identifies have been caused by misguided government interventions. Their proposals will fail because they will continue that spiral.

interest rate, amounts to a present value of 100 gold coins again. Thus, you might as well sell the asset now.

Hoarding is pointless unless both the magnitude of a potential future price increase, and the likelihood of

References

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