

The UK's stamp duty land tax raises substantial revenues for the government, but as research by **Christian Hilber** and **Teemu Lyytikäinen** shows, it exerts powerful constraints on household mobility. They explain how replacing stamp duty with better-designed local taxes could help to alleviate the country's crisis of housing affordability.

Stamp duty, mobility and the UK housing crisis

Stamp duty – a tax to be paid on the transfer of certain legal documents – has a long history in England. It was first introduced in 1694 to help finance a war against France. Although initially conceived as a temporary solution, the tax was so successful in raising revenue that it eventually evolved into a permanent form of UK taxation.

While in recent decades global competition has reduced the scope of stamp duty on trading of financial assets, stamp duty on transactions of land and property is today more significant than ever. UK revenue from the stamp duty land tax (SDLT) has almost tripled over the last eight years: from £2.9 billion in 2008/09 to £8.6 billion in 2016/17.

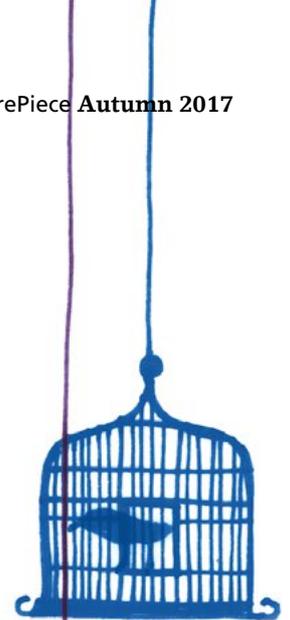
The SDLT (commonly referred to as 'stamp duty') has long been criticised by economists as being inefficient. The central case against its use is that it hampers household mobility. The 2011 Mirrlees Review neatly summarises the key argument:

'By discouraging mutually beneficial transactions, stamp duty ensures that properties are not held by the people who value them most. It creates a disincentive for people to move house, thereby leading to potential

inflexibilities in the labour market and encouraging people to live [...] in properties of a size and in a location that they may well not otherwise have chosen.'

There are some prior studies documenting a negative effect of stamp duty on housing transactions and mobility, but to date we know little about the nature of affected moves. Specifically, there is no evidence of the relative importance of the SDLT for the functioning of housing and labour markets. In our research, we provide some answers by exploring the impact of the SDLT on different types of mobility.

Before 2014, stamp duty bore the



Stamp duty jams the housing market by preventing households from moving to more suitable homes



Stamp duty prevents moves to a more suitable dwelling locally but has little impact on long-distance relocation

lowering them at the bottom end and increasing them at the top end of the price distribution. Thus, the tax-induced disincentive to move remained.

Figure 1 illustrates our research design and key results. We use data from the British Household Panel Survey (BHPS) to analyse how the two percentage points increase in the SDLT affects the mobility of homeowners. The BHPS includes homeowners' own estimates of the value of their home. When we plot mobility rates in house value bins around £250,000 in Panel A of Figure 1, we find a clearly visible reduction in the rate of mobility when the self-assessed house value exceeds £250,000 and the tax rate rises from 1% to 3%.

The BHPS also contains information on the distance of moves and the main reasons for moving. When we split moves by distance of move (shorter versus longer than 10 kilometres – Panels B and C of Figure 1), we find a large effect on short moves but no effect on long moves. The SDLT appears to prevent moves to a more suitable dwelling locally but has little impact on long-distance relocation.

A similar picture emerges when we divide moves into three groups based on survey responses regarding the main reasons for moving (Panels D, E and F of Figure 1). The SDLT affects housing and area-related moves but has little effect on job-related or major life event-related mobility.

We should note that job-motivated mobility is overall very rare among owner-occupiers. Nevertheless, all in all, our findings strongly suggest that stamp duty jams the housing market by preventing households from moving to more suitable

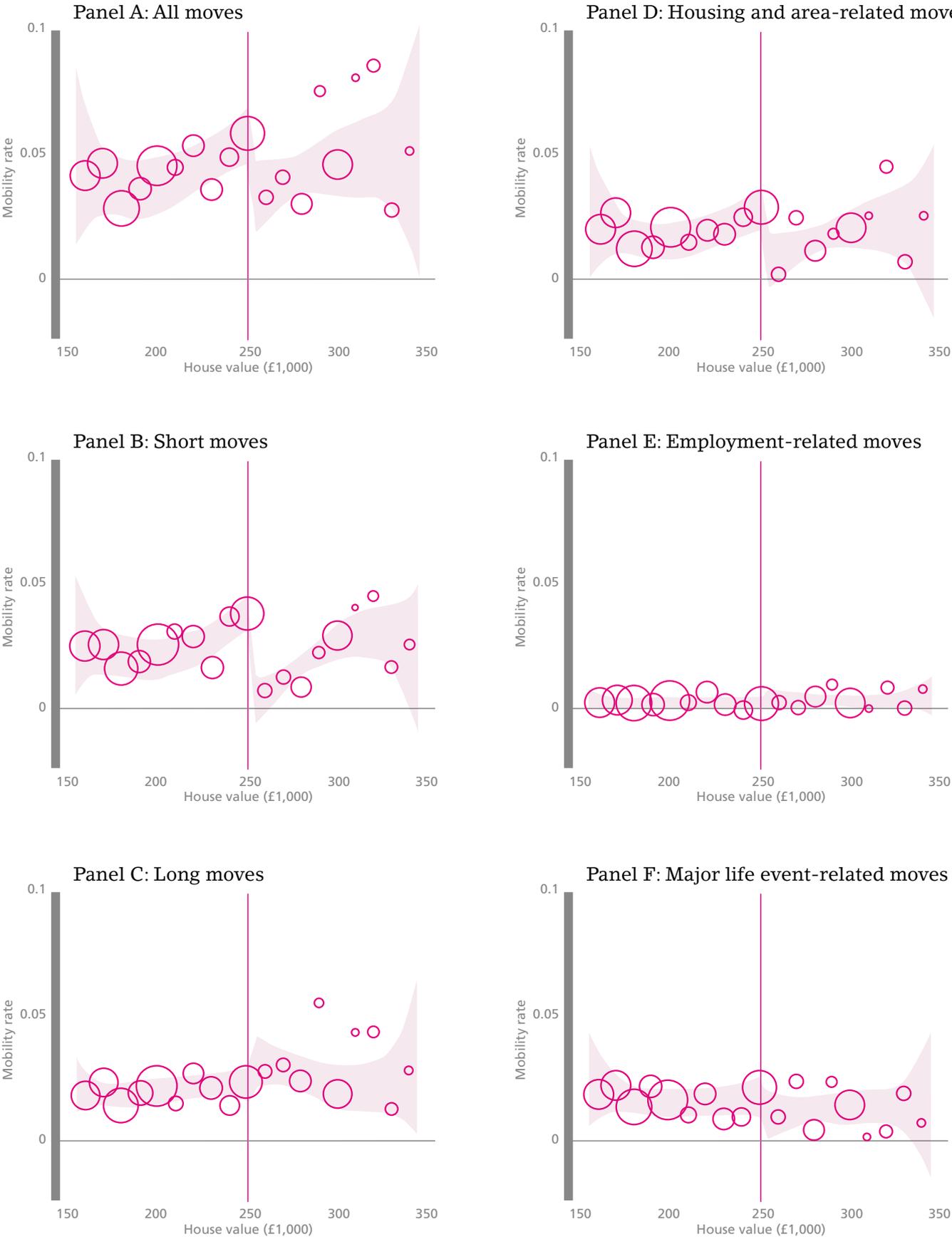
odd feature that the tax rate for the whole purchase price jumped at certain thresholds. For example, at £250,000, the rate jumped from 1% to 3% of the value: a £5,000 increase in the tax liability. We make use of this discontinuity to isolate the impact of stamp duty from other determinants of mobility. Essentially, we compare mobility rates of otherwise similar homeowners with self-assessed house values below and above the threshold of £250,000.

The 'slab' structure of the SDLT was

replaced with a more progressive 'slice' schedule in 2014. Our data is from a period before the reform and we use the discontinuities of the old system to identify the impact of the SDLT. But the results are also informative of the effects of the SDLT on mobility in the current system.

The reform removed the discontinuities in the tax liability and the bunching of transactions just below the old thresholds. But it did not substantially alter the overall tax burdens, somewhat

Figure 1:
What happens to mobility when stamp duty increases from 1% to 3%?



homes, but its effect on relocation of the labour force appears to be quite limited.

A potential explanation for the differential effects is that when moving to a more suitable house locally – say, one bedroom more or less – the benefits of moving often exceed the costs only by a narrow margin. Therefore even a small increase in the tax wedge can prevent a large fraction of moves. Longer, often job-related, moves – say, a great job opportunity in another city – imply that there are large benefits from moving and in turn that the SDLT burden may not be pivotal in most cases.

Our analysis suggests that abolishing the SDLT (or replacing it with an annual tax on the value of land or property) may do little to improve the spatial mismatch of job opportunities and workers. But it could greatly reduce the allocative mismatch in the housing market via increasing the likelihood of a match between elderly households willing to downsize and young families seeking to expand their housing consumption.

We do not claim that abolishing the SDLT could solve the housing affordability crisis. The latter is caused largely by a flawed planning system: see, for example, Cheshire (2014) for the central argument, and Hilber and Vermeulen (2016) for estimates of the effects of regulatory constraints on house prices. But abolishing the SDLT could help to alleviate the crisis by putting existing housing stock into more efficient use.

The potential caveat of our research design is that people with a higher underlying propensity to move could select into the lower tax group. This could bias our results. It is comforting that we do not find discontinuities in household characteristics linked to the propensity to move. Our results are also robust to dropping data very close to the £250,000 threshold where sorting could be likely to occur. These checks suggest that our research design is valid.

The main scholarly contribution of our study is the analysis of the differential impacts of the SDLT on different types of mobility. Yet from a policy perspective, the sheer magnitude of the impact of the SDLT on mobility is also of great importance. Our estimates come with uncertainty. But taken at face value they imply that the overall effect is very substantial: our central estimate suggests

that a two percentage points increase in stamp duty from 1% to 3% reduces household mobility by almost 40%.

Considering the entire distribution of self-assessed house values in our sample in 2007, our central estimate implies that abolishing (or replacing) stamp duty could have increased mobility of homeowners by around 27% (from 5.1 to 6.5 percentage points per annum). Since 2007, house prices have risen substantially in the UK and the system was reformed in 2014. While the former increased the stamp duty burden, the latter reduced it for the majority of homeowners. Overall, the adverse impact of the SLDT on mobility may be of a similar magnitude.

Our empirical findings suggest that stamp duty induces substantial misallocation of dwellings. This imposes a hefty welfare loss on society as a whole. We can quantify the welfare loss relative to the additional tax revenue generated by stamp duty with the help of some simple calculations. These are based on the observation that for a transaction to take place, the valuation of the buyer has to exceed the valuation of the seller at least by the amount of the tax liability.

Therefore, we can assume that each transaction prevented by the tax rate hike from 1% to 3% destroys the welfare of the trading partners by somewhere between a similar 1% and 3% of the price of the dwelling. At the same time, each prevented transaction depresses tax revenue. Our calculations suggest that the welfare loss associated with the tax rate hike from 1% to 3% is massive, possibly above 80% of the revenue increase.

The same amount of revenue could be collected with little or no welfare losses through an annual tax on the value of property, or even better, an annual tax on the value of land. In contrast to the SDLT, these taxes do not discourage mutually beneficial transactions.

In fact, if designed as local taxes, they would have the additional benefit of providing genuine fiscal incentives to local authorities (and their residents) to release more land for residential development. This would help gradually to solve the housing affordability crisis that cripples the prospects of the younger generations, particularly in the most productive parts of the country.



This article summarises ‘Transfer Taxes and Household Mobility: Distortion on the Housing or Labor Market?’ by Christian Hilber and Teemu Lyytikäinen, *Journal of Urban Economics* 101: 57-73 (earlier version available as SERC/Urban and Spatial Programme Discussion Paper No. 216: <http://www.spataleconomics.ac.uk/textonly/SERC/publications/download/sercdp0216.pdf>).

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Further reading

Paul Cheshire (2014) ‘Turning Houses into Gold: The Failure of British Planning’, *CentrePiece* 19(1): 14-18 (<http://cep.lse.ac.uk/pubs/download/cp421.pdf>).

Christian Hilber and Wouter Vermeulen (2016) ‘The Impact of Supply Constraints on House Prices in England’, *Economic Journal* 126(591): 358-405.

James Mirrlees and colleagues (2011) *Tax by Design: The Mirrlees Review*, Oxford University Press.

Abolishing
stamp duty
could increase
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homeowners
substantially