

Prices, construction costs and competition in the Swedish housing market

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During the past 25 years, housing prices in Sweden have increased at a rate that exceeds that of most neighboring countries. While international studies typically attribute most of these price increases to rising land prices, the direct effect of rising land prices can only explain about a third of the increase in housing prices experienced in Sweden. The report, however, points to an interdependence between rising land prices and rising construction costs. When land prices rise, it becomes profitable to build on brownfields or other sites, which entails higher construction costs. There are also incentives to use more capital relative to land, which may be reflected in higher quality, taller buildings, and smaller apartments.

The report also highlights that the prices of building materials in Sweden have been rising at a much faster rate than in neighboring countries. This may partly reflect the practice of giving large professional buyers steep discounts, a practice that may distort competition and official statistics. Loyalty discounts may reduce market transparency and soften competition, while exaggerating the true rate of inflation. Another concern is that tenders for the construction of new multi-family housing units by municipal housing companies attract relatively few bidders. One study showed that 40 percent of the tenders received only one or two bids.

Sweden stands out among comparable countries by having an extensive rent regulation that applies equally to privately and publicly owned rental apartments. A relatively recent adjustment of rent control improved incentives for new construction, but also reduced incentives to contain construction costs. In addition, rent control is typically associated with less efficient utilization of the current stock of housing. In fact, Sweden is among European countries with the largest housing area per inhabitant. Among European countries outside of the old eastern block it had the largest population living in crowded apartments.

Against this background, the report presents a reform proposal that would open up for voluntary and piecemeal deregulation of the rental housing market, in which owners of rental housing can offer tenants compensation in exchange for allowing the owner to set the rent freely. Should the tenant deem the offer non-satisfactory the rent control would remain unchanged. The agreements could be individual or negotiated for one or several buildings at a time. Either way, safeguards would have to be in place to prevent tenants from being exploited. The authors argue that such a reform has the potential to improve the housing market's efficiency, while leaving current tenants at least as well off – and that this latter feature increases the likelihood that such a reform would be politically viable.