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Econ 309

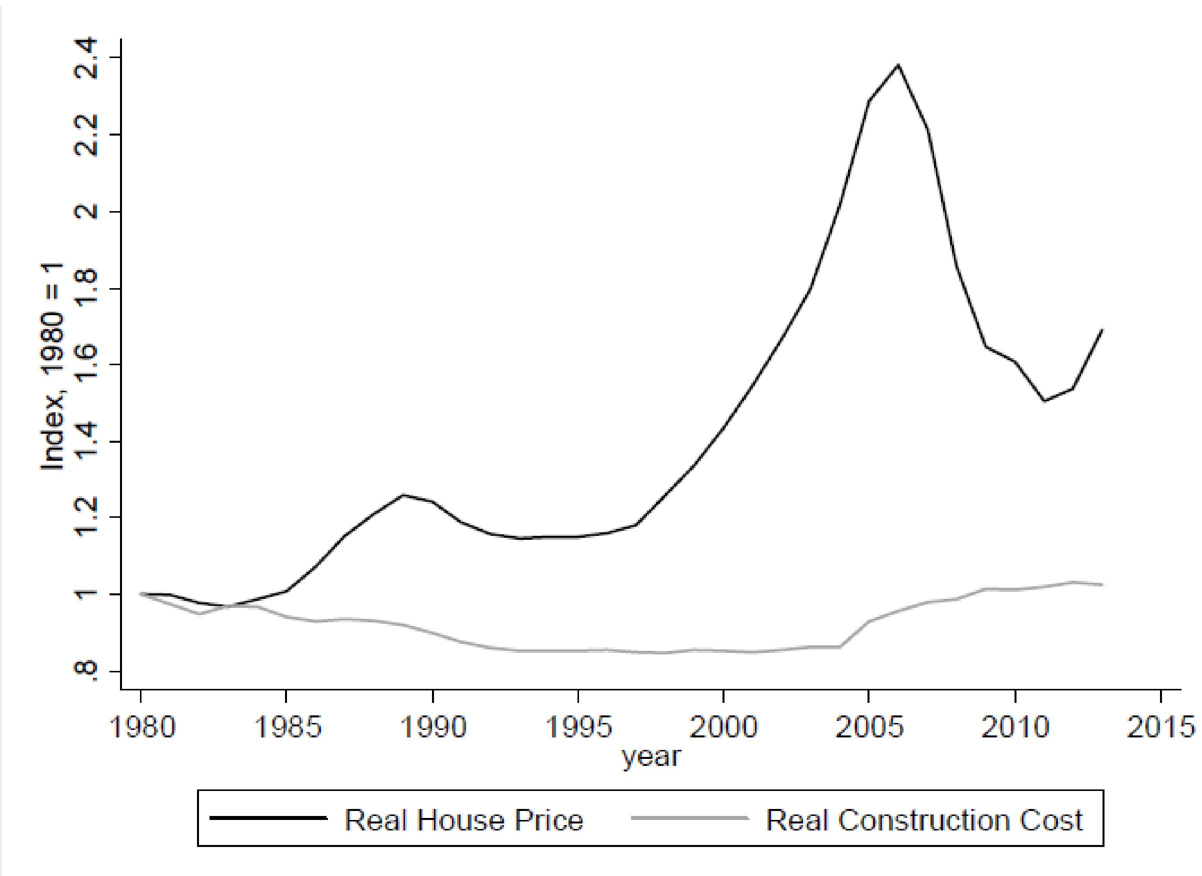
Week 13: Housing Regulation

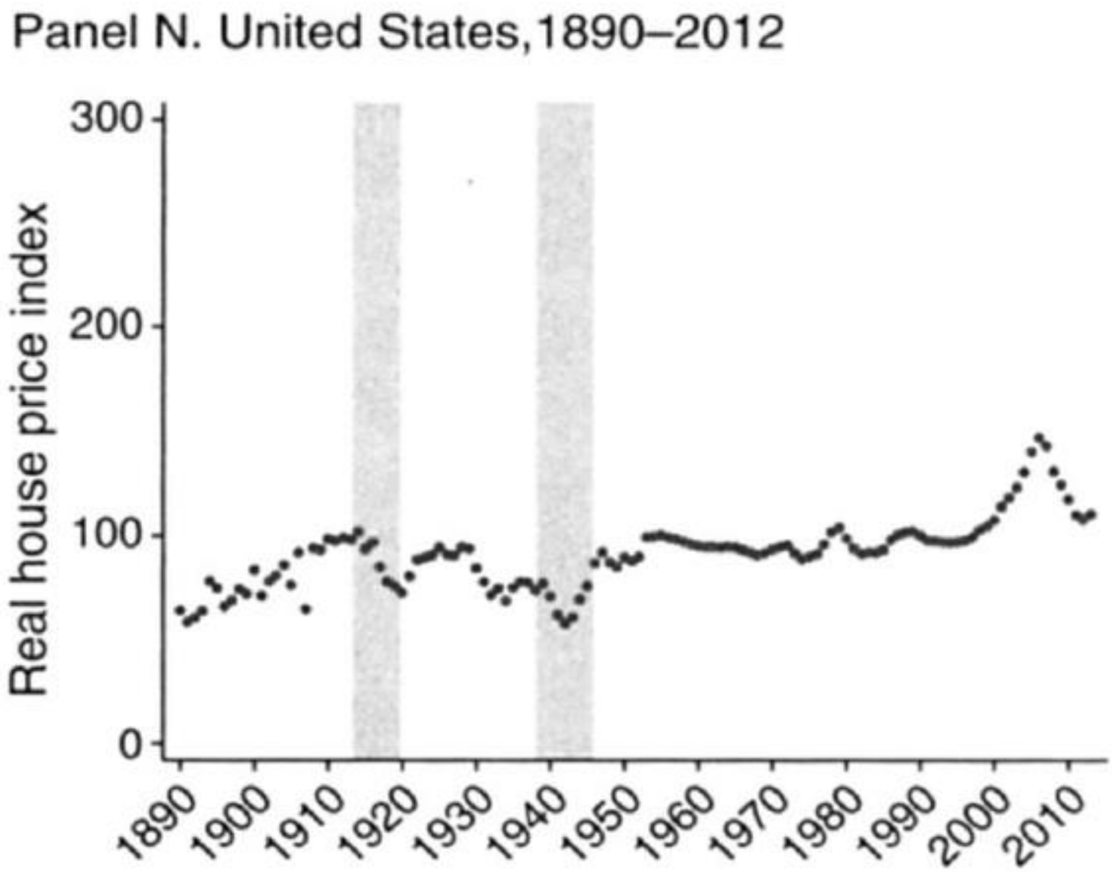
I. Housing Regulation: The Basic Facts

A. Over the last 50 years, US housing prices have increased much more than inflation, especially in the most desirable areas of the country.

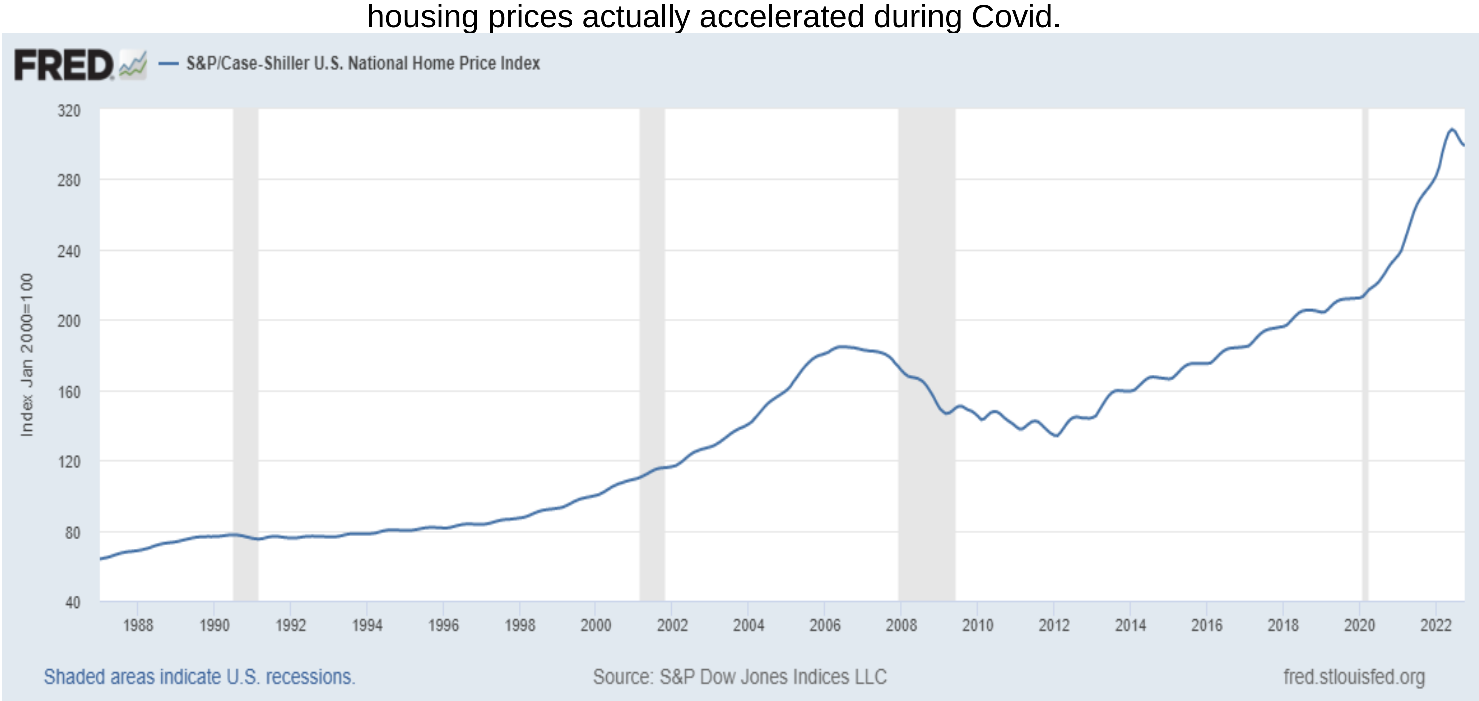
B. Historically, even large increases in demand had little long-run effect on housing prices. Instead, builders just made more housing until prices fell back to the "breakeven" level.

Figure 1: Real Construction Costs and House Prices Over Time





C. Despite regional differences, the national trend toward higher housing prices actually accelerated during Covid.



D. This is a big deal because Americans spend about 20% of their income on housing.

E. What happened? The go-to answer, as usual, is just "supply-and-demand."

    1. Population keeps going up, so shouldn't demand constantly rise?

F. The puzzle: S&D used to bring housing prices back down to cost in the long-run. Why doesn't this happen anymore?

II. The Effect of Regulation on Housing Prices

A. Almost all economists who study this issue converge on the same story: regulation. Getting permission to build homes is very hard, which keeps housing prices permanently well above cost.

B. The main regulations:

    1. Building height limits
    2. Multi-family restrictions
    3. Minimum lot size
    4. Parking requirements
    5. Government land ownership, especially federal
    6. Environmental regs
    7. Conflicting uses zoning
    8. Historic preservation
    9. Pure delay

C. Hard to say exactly which regulations matter most, but much easier to measure the *total* effect of all regulations. Standard approach:

    1. Look at value of similar homes with slightly different amounts of land.
    2. Use this to estimate the pure value of land.
    3. Then combine with standard estimates of construction costs to see how much homes physically cost to make.
    4. Then, we look at the difference between this estimate and actual market prices.

D. Earlier work found enormous "zoning taxes" in the most desirable areas, but not much elsewhere.

E. Later work with better data on vacant lot prices also finds large zoning taxes in almost all major cities.

    1. If many people actually live somewhere, the zoning tax there is probably very high.

F. Key point: People spend vastly more on housing that on, say, gasoline. So doubling this cost has *large* negative effects on living standards.

    1. Rough estimate: Without regulation, the cost of living would be 10% lower, implying living standards 11% higher.

G. Additional effect: High prices discourage people from migrating to high-productivity areas, further depressing living standards.

H. Thought experiment from Hsieh and Moretti: What if the zoning tax in New York, San Jose, and San Francisco were pushed down to the national median city's?
    1. Caveat: I found an error in H-M, and they confirmed it.
    2. Their conservative GDP estimate: +3.7%→+14%; their optimistic estimate +8.9%→+36%.

III. The Pigovian Defense
    A. You could accept that housing regulation drastically increases housing prices, but defend this outcome using CBA.
    B. How? Argue that each of the notable regulations is a wise response to negative externalities.
    C. Building height limits? They keep builders from blocking the light of existing owners, and protect aesthetics.
    D. Multi-family restrictions? They reduce parking and traffic problems, and prevent congestion of public services.
    E. Minimum lot size? They, too, reduce parking and traffic problems, and prevent congestion of public services. Plus aesthetics.
    F. Parking requirements? They reduce parking problems.
    G. Government land ownership? They protect the aesthetics of the entire country.
    H. Environmental regs. They protect the air, water, climate, wildlife, and more.
    I. Conflicting use zoning. To prevent industrial use from bothering commercial and residential establishments, and to prevent commercial establishments from bothering residential.
    J. Historic preservation: "We all benefit from preserving our history."
    K. Pure delay. It takes careful study and deliberation to detect and measure negative externalities.
    L. Big Problem #1: Pigovian corrections allow people to create all the negative externalities they want as long as they pay the price. Few actual regulations, in contrast, allow you to just buy your way out.
    M. Big Problem #2: Many of the so-called "negative externalities" could easily be solved with normal market pricing!
        1. Modern tech allows market-clearing driving and parking fees, but almost no government uses these techs.
        2. Conflicting uses naturally separate. Industry wants to locate near ports and rail to get low transportation costs; commercial wants to locate near main roads to get drive-by customers; luxury homes are worth more next to other luxury homes.
    N. Big Problem #3: Pigovian corrections match the severity of the negative externalities. Actual regulations don't.
        1. How severe can the negative aesthetic externalities of adding a skyscraper really be?
        2. How many beloved historic buildings would builders *want* to demolish?

O. Big Problem #4, the biggest problem of all: These defenses only consider the negative externalities of construction, but there are also enormous *positive* externalities!

1. How do we know? Actions speaker louder than words: You can escape almost all negative externalities by living in a remote rural location, but almost no one chooses to do so.
2. Prices show that the NET value of all the benefits of density minus all of the costs of density is strongly positive.
3. What are the positive externalities? Work, consumption, and social opportunities.

P. If it's unclear that housing has net negative externalities, standard CBA of markets makes sense. U.S. housing regulation really does waste roughly 10% of GDP per year, plus additional massive GDP losses from discouraging migration to high-productivity regions.

IV. The Panacea Policy

A. Housing regulation also amplifies other social ills.

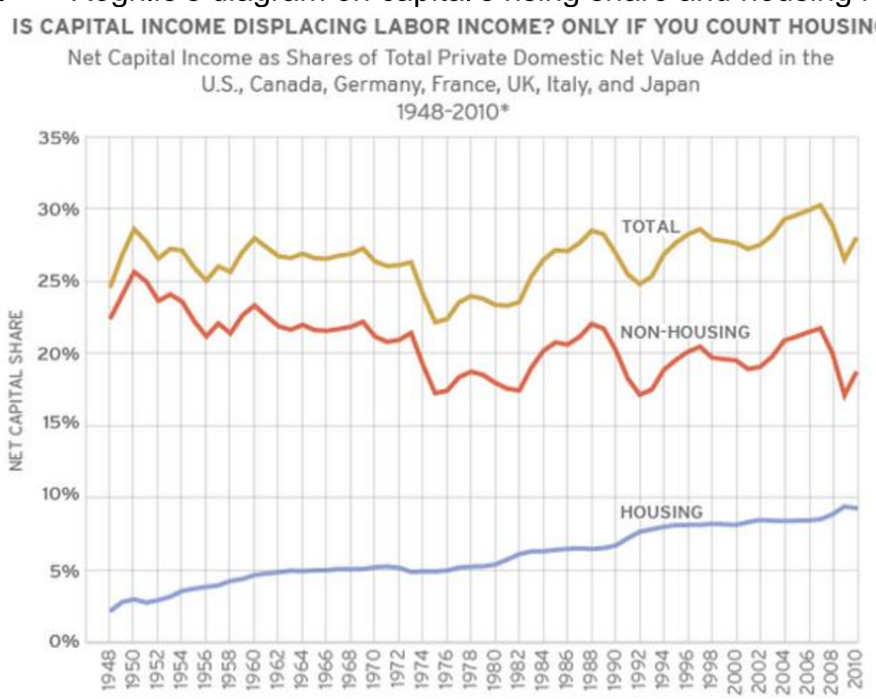
B. Inequality and poverty: The poor spend more on housing, and homeowners are richer than renters.

1. Poorest quintile expenditure share: 24.5%; richest quintile 17.7%.
2. Median 2015 family income for renters: \$34k; for owners, \$52k.

C. So deregulation clearly reduces inequality, and is especially helpful for the poor.

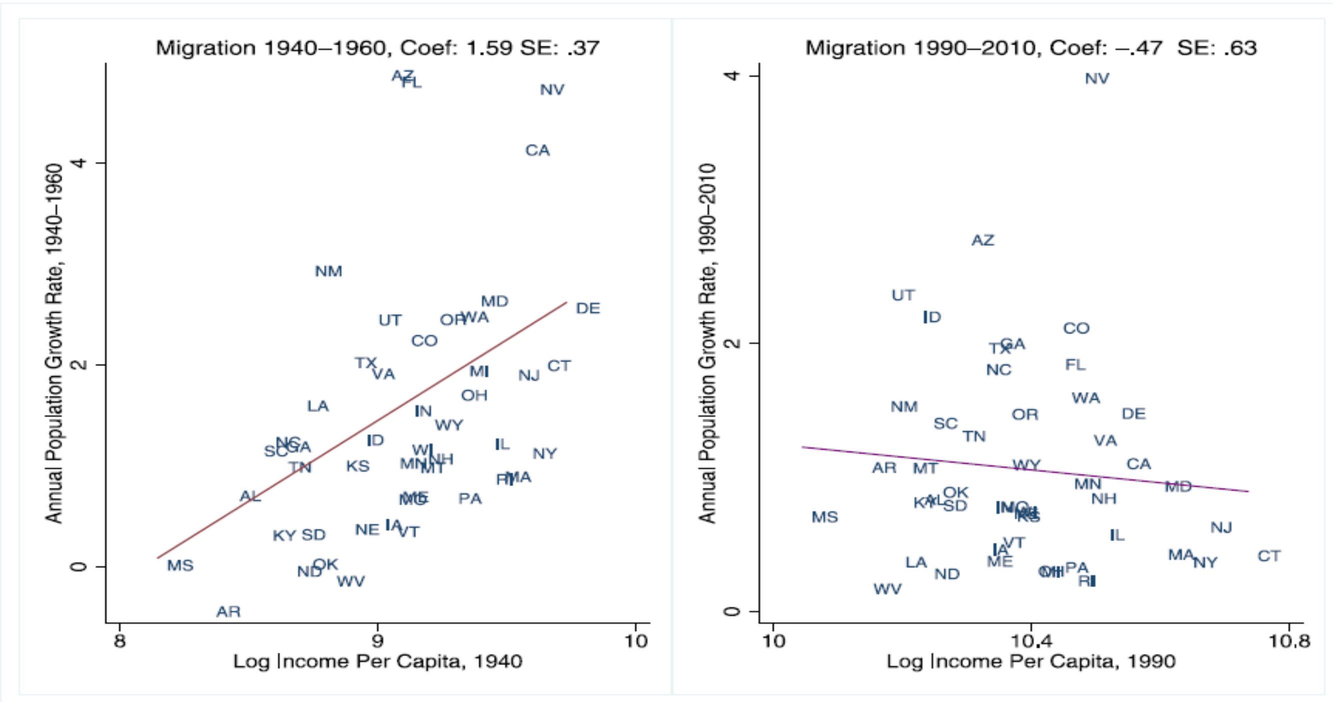
1. How should CBA count this?

D. Rognlie's diagram on capital's rising share and housing regulation:



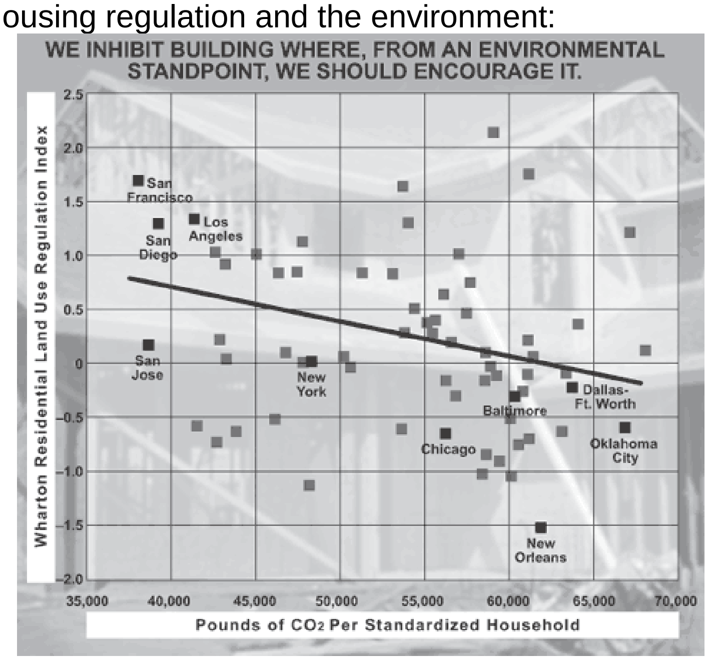
E. Mobility: When housing prices were close to cost, moving from a poor state to a rich state was a reliable way to raise your income. And many Americans took advantage of this opportunity.

F. Due to regulation, the extra housing cost in high-income states often exceeds the wage gain. Now Americans tend to move *away* from high income areas to get cheaper housing.



G. Housing regulation and crime: Notable experiment shows that vacant lots cause crime. So allowing construction should cut crime.

H. Housing regulation and the environment:



        1. Central cities are 5-10% greener than surrounding areas.
        2. California is greenest; the South is least green; Northeast is in-between.
        3. New homes, though bigger, are greener.
        4. Areas with most housing regulation are (coincidentally!) greener.
        5. Upshot: Housing deregulation would move development into greener locations (and greener buildings).
    I. Regulation and low birthrates: Multiple papers find cheaper housing raises fertility.
    J. "Deaths of despair" and non-college males.
        1. "Revive construction, not the Rust Belt."

V. Parking, Traffic, Schools, and Pricing
    A. Remember the problems with gratis pricing?
    B. Congestion often amplifies the waste, because crowding degrades the quality of the product.
    C. Standard complaints about new housing:
        1. Parking
        2. Traffic
        3. Schools
    D. All of these problems arise because governments refuse to charge market-clearing prices (or often, any price at all).
    E. Obvious remedy: Deregulate housing and raise prices on congested goods.
    F. If local redistribution is an excuse to exclude the poor from your locality, why have local redistribution in the first place?!

VI. CBA Versus Voter Self-Interest
    A. Most critics of housing regulation – including economists – blame crafty NIMBYs. ("Not In My BackYard.")
    B. The story: Even though regs fail CBA, they are in NIMBYs' self-interest. "I'm just protecting my property value here."
    C. But this story is grossly overrated.
        1. If true, people would happily allow development if existing owners got a property tax discount, and new owners paid a property tax premium.
        2. "Let's make a deal!"
        3. What about owners who want to upgrade? Who want their adult kids to live nearby?
        4. Renters favor regulation, too.
        5. In polls, just mentioning developers' profits sharply reduces public support.
    D. Alternate stories:
        1. Economic illiteracy
        2. Status quo bias/myopia ("The history of the future.")
        3. Innumeracy
        4. Paranoia