

Economic and Fiscal Consequences of Housing Underproduction



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In the United States, zoning and other forms of land-use regulation have traditionally been seen as a singularly local issue, with decisions made by local authorities on a hyper-local (often plot-by-plot) basis. It has become increasingly clear, however, that pervasive restrictions on land-use have a cumulative impact that is national in scope.

With regard to housing, land-use restrictions are intended to control where housing can be built and what kind of housing is permitted, from single-detached homes to high-rise apartment complexes and everything in between. The inadvertent impact of land-use restrictions, however, has been to impose progressively tighter limits on how much total housing can be built in a given metro

area. These constraints on housing supply have translated in turn into housing shortages, skyrocketing home prices, and affordability crises in cities across the country.

It wasn't always this way. Zoning rules date back more than a century, spreading rapidly with the urbanization and especially suburbanization of the country. In the early days, developers could get around zoning limits on urban density by building homes farther away from the city center. Over time, however, opportunities for sprawl were exhausted and housing construction started to fall behind demand. As documented by Jake Anbinder in *The Atlantic* (2021), beginning in the 1960s, a collection of longtime residents resistant to change, environmentalists skeptical of growth and construction, and homeowners seeking to protect their financial investments expanded zoning's restrictions with environmental review regulations, community input provisions, historical preservation laws, and a host of other rules.

The sum of local decisions to block multifamily housing and keep minimum lot sizes large, street parking available, sidewalks uncrowded, and neighborhoods unchanged has had dramatic consequences for the United States as a whole. As estimated in this report, the cumulative impact as of 2019 adds up to 3.8 million fewer housing units than should have been produced.

Economic and Fiscal Consequences (cont.)

This underproduction of housing is not evenly distributed across the country. On the contrary, this report documents that it is heavily concentrated in the places with the most productive economies, highest wages, and most appealing amenities—in other words, the places otherwise most likely to attract new residents. Looking at the state level, California is a good case in point: Almost a million homes that should have been built by now haven't been. Texas pitches itself as the place to live and do business for people wanting to leave California, but despite its impressive economic growth, it has failed to build over 320,000 units of housing. Florida and New York are just behind Texas, underproducing almost 290,000 and 260,000 homes respectively.

At the regional and national level, artificially restricted housing supply and the resulting inflated home prices in the nation's most desirable locations act as barriers to geographic mobility. Because people are priced out of relocating to many otherwise attractive places by excessive housing costs, they are stuck in less productive cities and lower-paying jobs than otherwise would be the case.

The costs of this spatial misallocation of the nation's population are exacerbated by so-called "agglomeration economies," that is, the stimulus that proximity gives to innovation and growth. For example, according to "The Paper Trail of Knowledge Spillovers: Evidence from Patent Interferences," a study by Ina Ganguli, Jeffrey Lin, and Nicholas Reynolds for the Federal Reserve Bank of Philadelphia (2019), cases of simultaneous invention among patent filers are 1.4 to 4 times more likely for those who live in close physical proximity relative to a random pairing of patent applicants. Accordingly, when workers move to a high-productivity area, they are improving not only their personal productivity, but also creating the general conditions for the growth of productivity overall. Conversely, when they are prevented from moving by bloated housing costs, this "multiplier effect" of aggregation is lost.

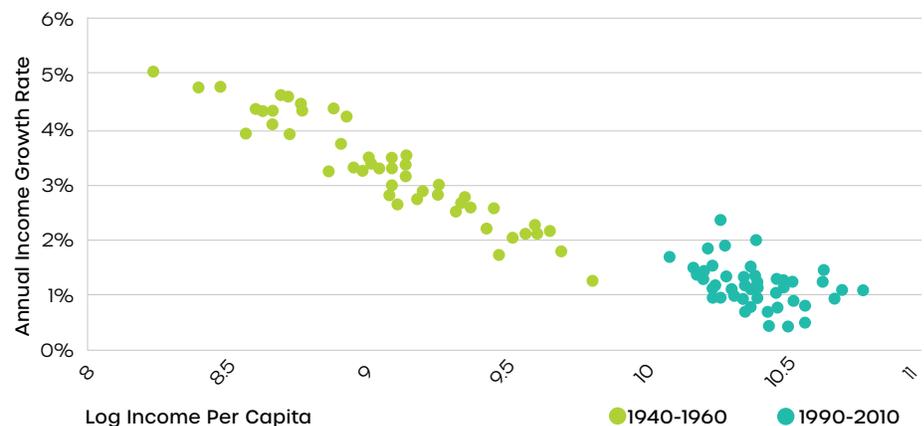
The overall effect of Housing Underproduction on U.S. economic performance is staggering. In a 2019 study, Chang-Tai Hsieh and Enrico Moretti's paper *Housing Constraints and Spatial Misallocation* estimated a counterfactual United States in order to calculate economic output. Their fictional U.S. took the most restrictive cities' housing regulations (New York, San Francisco, and San Jose) and made them as accommodating as those of the median U.S. city. The study shows that under such liberalization and the consequent increase in housing supply, the total GDP of the United States in 2009 would have been 8.9% higher than it was, translating to \$8,775 in added wages for all U.S. workers. Even using more conservative assumptions about mobility, Hsieh and Moretti found GDP in the same period

housing supply on economic growth. Analysis by Kyle Herkenhoff, Lee Ohanian, and Edward Prescott (2017) found that deregulating land use across the United States to 1980 levels would raise productivity by up to 16% and consumption by up to 11%. Applying more conservative assumptions about labor responsiveness to housing prices, Edward Glaeser and Joseph Gyourko (2018) found that the reallocation of labor from deregulating housing supply would boost GDP by up to 2%.

Beyond its large negative impact on overall economic output, housing underproduction also works to lock in geographic inequality. According to research by Peter Ganong and Daniel Shoag in their paper entitled "Why has Regional Income Convergence in the

The Decline of Income Convergence

Incomes overall have increased, but states with lower incomes are no longer growing as quickly as their peers.



Source: Peter Ganong and Daniel Shoag, "Why Has Regional Income Convergence in the U.S. Declined?" *Journal of Urban Economics*, November 2017.

would be 3.7% higher, with \$3,685 in added wages. These gains would have come from workers moving to areas with high productivity growth who, in present-day, would stay in less-productive parts of the country.

Other recent research confirms the sizeable impact of artificially constrained

U.S. Declined?" (2017), from the end of Reconstruction to the 1980s, incomes across states converged at a rate of around 1.8% per year, where states with lower incomes experienced higher rates of growth than higher-income states. By contrast, between 1990 and 2010, the rate of interstate income convergence fell by more than half.

As shown by Ganong and Shoag, the decline in interstate income convergence tracks the declining net returns to moving to higher-income states. Living in an area with higher wages typically comes at the price of paying more for housing and other goods and services, but workers still come out ahead so long as their pay increase is more than the increase in the cost of living. In 1940, when unskilled

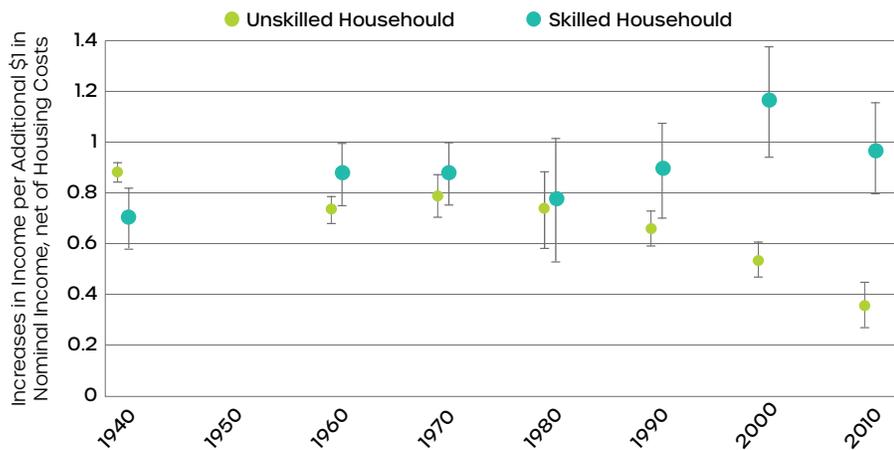
that type of housing is often instead occupied by young people who are unable to find housing that better matches their needs. The ability to move to opportunity applies just as much to families and children as it does to workers.

In addition to these far-reaching and interconnected economic effects, housing underproduction has significant fiscal

officials at all levels of government are taking notice. Incremental reforms in the past few years have slowed the growth of housing underproduction; however, much work remains to address the shortfall that has accumulated over decades. The laws and regulations that make it impossible to build housing of the type people want in the areas they want have generated enormous costs for would-be residents of metropolitan areas, the finances of those local governments, and the U.S. economy at large. The natural migration of people to areas where they can increase their incomes and improve their living situations has salutary effects for both them and the country as a whole. The policies that have impeded this process over the past decades are immensely costly and need to be reversed as much, and as soon, as possible.

Effect of Moving to a State with \$1 Higher Nominal Income

High housing costs mean the returns from moving to a richer state for unskilled workers have declined substantially.



Source: Peter Ganong and Daniel Shoag, "Why Has Regional Income Convergence in the U.S. Declined?" *Journal of Urban Economics*, November 2017.

workers moved to a state with a higher average income, they could expect to gain \$0.88 in income net of housing costs for every \$1.00 increase in nominal pay, gains greater than those for skilled households. This pattern remained roughly the same until the last decades of the 20th century, when the net gains from moving fell from over \$0.70 in 1980 to around \$0.50 in 2000, declining to less than \$0.40 in 2010.

The economic costs of the failure to build housing in places where people want to live and work also comes in the form of fewer people living and working. There is evidence to suggest that increasing housing costs have a negative impact on fertility, and thus population growth (Shoag, 2018). This is due to the expense of housing in general and, especially in urban areas, housing well-suited for families. As found by Whitney Airgood-Obyrcki and Jennifer Molinsky (2019),

consequences. Lower economic output reduces revenue across the board, but the effects are particularly acute for jurisdictions that should be—but aren't—growing. Higher density and population are associated with increased public transportation utilization, positively contributing to the balance sheets of those systems (Mattson, 2020). More people require more public services, but in general, density is negatively associated with the per-capita costs of public services across the board (Mattson, 2021). Furthermore, a larger population means a larger tax base, especially if highly paid professionals who might otherwise move out into the suburbs are instead able to find housing that fits their needs in the city.

The good news is that the housing crisis has attracted increasing national attention in recent years and elected

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