

The Big Cost of Restrictive Housing Policies

By Enrico Moretti

Metropolitan areas in the United States are characterized by enormous differences in worker earnings, productivity, and firm innovation. The hourly wage of workers located in metropolitan areas like San Francisco, San Jose, or New York is more than double that of workers with similar demographics, education, and work experience located in metropolitan areas like Flint, Modesto, or El Paso.

For example, average yearly earnings of workers with a college education in San Francisco, San Jose, and New York is \$92,432 compared with \$48,564 in Flint. These differences have been increasing over the last three decades and reflect growing differences in worker productivity. Labor productivity is 60 percent higher in San Francisco and New York than in the average U.S. city. This difference keeps growing year after year.

Unfortunately, some of the areas that have the strongest local economy and the highest productivity—like San Francisco, San Jose, and New York—have also adopted some of the

most restrictive housing policies in the nation, thus limiting the number of workers that can take advantage of these strong local economies.

In a recent study with Chang-Tai Hsieh of the University of Chicago Business School, we argue that the restrictive housing policies of municipalities with high productivity impose a large cost on the rest of the U.S. economy in terms of lost output and income.

Despite an enormous demand for housing and skyrocketing rents, it is difficult to add new housing to accommodate more workers in San Francisco, San Jose, and New York. Because of the constraints, hundreds of thousands of workers are simply unable to move to the area and fill available job openings. The lack of new housing in high-productivity cities means that those American workers who would have moved to access those high-productivity jobs end up with lower wages. It also means that local employers end up with fewer workers than they could hire and higher labor costs.

An essay prepared for the October 2016 SIEPR Policy Forum on gentrification and affordable housing.

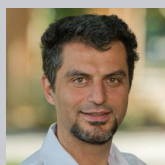
Some of the constraints to new housing production are geographical in nature. For example, the San Francisco Peninsula is surrounded by water. Unlike Dallas or Indianapolis, for instance, development is to some extent limited by land availability.

But geography is only part of the story. A growing body of evidence indicates that to a significant degree constraints to new housing production are political. San Francisco, for example, is a notoriously difficult place for developers to start new projects. An overly politicized planning process, byzantine local regulations, and an endless appeal process can stop new housing developments for years and sometimes decades. Data collected by researchers at the Wharton Business School indicate that municipalities in the Bay Area have housing policies that are among the most restrictive in the United States.

In essence, the volume and degree of regulations make it very difficult for housing supply to keep up with a vibrant housing demand.

This imbalance has two economic effects, and both are negative. The first effect is local. Lack of new

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housing supply—coupled with strong job creation—means that rents tend to be among the highest in the nation. The average rent for a two-bedroom apartment in San Francisco, for example, is \$4,800. That is almost twice as high as the average rent in Austin, a city with an equally strong tech-induced labor market boom, but a much more accommodating housing supply. Paucity of new housing has long been understood to be a major factor in the high cost of housing faced by Bay Area renters.

The second effect is national in scope. Unfortunately, the negative consequences are not limited to the local economy, but they extend to the broader U.S. economy. Because workers are so much more productive in San Francisco, San Jose, and New York than in other areas, United States GDP is kept artificially lower by these housing constraints.

Indeed, in our study, we find that U.S. GDP would have been significantly higher if high-productivity cities accommodated more workers. We estimate that holding constant geographical features, but lowering land-use regulations in New York, San Francisco, and San Jose to the level of the median U.S. municipality, would increase GDP by 9 percent, and this

would in turn result in significant increases in employment and salaries in the U.S.

In essence, political constraints to housing supply limit the number of workers who can work in the most productive of American cities. This lowers income and welfare of all U.S. workers and amounts to a large negative externality imposed by a minority of cities on the entire country.

In principle, one way to minimize the negative externality created by housing-supply constraints in high-productivity cities would be for the federal government to constrain the ability of municipalities to set land-use regulations. Currently, cities and towns have had almost complete autonomy in setting those regulations because their impact has long been thought of as only local.

But if such policies have meaningful nationwide effects, then the adoption of federal standards intended to limit negative externalities may be in the aggregate interest. This type of federal reform is unlikely to be politically possible, however. An alternative is the development of public transportation linking local labor markets characterized by high productivity and high nominal wages to local labor markets characterized by low nominal wages.

For example, a possible benefit of high-speed trains currently under construction in California is to connect low-wage cities in California's Central Valley—Sacramento, Stockton, Modesto, Fresno—to high-productivity jobs in the San Francisco Bay Area. This could allow the labor supply to the San Francisco economy to increase overnight without changing San Francisco housing-supply constraints.

An extreme example is the London metropolitan area. A vast network of trains and buses allows residents of many cities in Southern England—including far-off cities like Reading, Brighton, and Bristol—to commute to high-wage employers located in downtown London. Another example is the Tokyo metropolitan area.

While London and Tokyo wages are significantly above the U.K. and Japan averages, they would arguably be even higher in the absence of these rich transportation networks. Our argument suggests that U.K. and Japan GDP are significantly larger due to the transportation network.

The United States could enjoy similar benefits if it allowed more housing supply in its most productive cities or if it built a vast network of public transportation to connect its most productive cities to a much broader region.

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