

THE GEOGRAPHY OF THE HOUSING CRISIS, OR HOW NOT TO REPEAT THE MISTAKES OF 2007

SALIM FURTH

Senior Research Fellow, Urbanity Project, Mercatus Center at George Mason University

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Chair Himes, Ranking Member Steil, and members of the select committee, thank you for inviting me to discuss housing affordability. My name is Salim Furth, and I am a senior research fellow at the Mercatus Center at George Mason University. The Mercatus Center uses market-oriented ideas grounded in academic research to address public policy problems at all levels of government.

The primary driver of high housing costs is strict local land use regulations, so most of my policy work takes place at the state and local levels. I have had the privilege of working alongside problem solvers in many of your home districts, such as city staff in Gainesville, Florida, Desegregate Connecticut, and Texans for Housing. One of the best things you can do is to encourage those in your districts who are working to protect property rights and fair housing and draw attention to the barriers they face.

NATIONAL FACTORS IN HOUSING COSTS

With the increase in rent and home prices that has occurred over the past two years, housing is less attainable than ever before in many places. There are some powerful national trends that have led to the recent increase in housing prices, including low interest rates, increased demand for home office space, supply chain interruptions, and lumber tariffs.

The current administration has doubled down on the previous administration's mistake, increasing the tax on Canadian lumber from 9 percent to 18 percent. The administration would have people believe that the Canadians are making lumber too cheap. That's probably false, but even if it were true, why would America not happily accept some housing subsidies from its neighbor and ally to the north? The administration should cancel the tariffs and send a thank-you card instead.

However, these recent developments, which affect the whole country, cannot explain why home prices were three times higher in Los Angeles, California, than Cape Coral, Florida, before the pandemic. To really grapple with housing market problems, one needs to zoom in.

For more information or to meet with the scholar, contact
Mercatus Outreach, 703-993-4930, mercatusoutreach@mercatus.gmu.edu
Mercatus Center at George Mason University, 3434 Washington Blvd., 4th Floor, Arlington, Virginia 22201

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THE LOCAL COST OF LIVING

My colleague Kevin Erdmann has argued that the subprime mortgage crisis and the financial crisis of 2007–2008 were exacerbated by federal policymakers who treated housing as one big market.¹ National reports on housing starts made it seem like the country was overflowing with new homes. But at the same time, Americans were streaming out of metropolitan areas like Los Angeles and New York toward cheaper, lower-wage Sunbelt cities. This was not a housing glut, argues Erdmann, but an unaffordability exodus.

New research by professors at Stanford University and the University of California build on Erdmann's story. Rebecca Diamond and Enrico Moretti use detailed expenditure data to show that high wages do not translate into high consumption at the city level.² A typical household headed by a high school degree holder earns \$18,000 more per year in San Diego, California, than in Grand Rapids, Michigan. But after taxes, and if one adjusts for local prices, real consumption is \$5,000 per year greater in Grand Rapids.³

Housing is not the only thing that makes the cost of living higher in San Diego than in Grand Rapids, but it is a major component and contributes indirectly to higher costs for everything else. And as my own research shows, the concept of unaffordability in such radically different markets describes essentially different phenomena.⁴

How did America get into this situation? Part of the cause is regional differences in demand. But the bigger issue is differences in the way that housing supply responds to demand. Economists use the term “elasticity” to describe how flexibly markets respond to changing conditions. When demand for housing in Grand Rapids rises, the market responds mostly with more houses. That's an elastic market. When demand for housing in San Diego rises, the market responds mostly with higher prices. That's an inelastic market. San Diego's prices reflect decades of rising demand.

THE NEED TO BUILD LOCALLY

Federal solutions that treat the housing market as an undifferentiated mass are likely to widen the disparity. Suppose Congress offered every home buyer \$10,000 to put toward a down payment. That would increase housing demand nationwide. In inelastic markets such as San Diego, the result would mostly be higher prices. Sellers of existing homes would pocket the extra \$10,000, and construction would barely change. But in elastic markets such as Grand Rapids, the subsidy would mostly boost construction.

In the end, a national subsidy would create even more regional inequality and result in even higher prices in the places at the center of the current affordability crisis. These results would echo the run-up to the 2007 crisis, when national averages masked drastically different trends across regions.

1. Kevin Erdmann, *Shut Out: How a Housing Shortage Caused the Great Recession and Crippled Our Economy* (Lanham, MD: Rowman and Littlefield, 2019).

2. Rebecca Diamond and Enrico Moretti, “Where Is Standard of Living the Highest? Local Prices and the Geography of Consumption” (NBER Working Paper No. 29533, National Bureau of Economic Research, Cambridge, MA, December 2021).

3. Another paper, by Nobel laureate David Card, Jesse Rothstein, and Moises Yi, uses even more detailed data (on wages) and paints an even grimmer picture. The authors find that the apparent boost in wages from moving to San Diego is mostly due to selection bias: the type of person who ends up in a high-wage city is the type of person who would have had higher-than-average wages anywhere. So for any who are thinking that they would happily give up \$5,000 a year worth of consumption to have San Diego's weather instead of Grand Rapids', I have bad news: it is going to cost even more. David Card, Jesse Rothstein, and Moises Yi, “Location, Location, Location” (Center for Economic Studies Working Paper No. CES 21-32, Census Bureau, Washington, DC, October 2021).

4. Salim Furth, “Decomposing Housing Unaffordability,” *Critical Housing Analysis* 8, no. 1 (2021): 62.

Instead, the solution to sky-high housing prices has to involve greater housing supply, specifically in markets where supply is more constrained. New Rochelle, New York, showed one way to achieve this: increasing downtown height limits and eliminating several sources of uncertainty from its permitting process. The result is 7,000 new apartments, a revitalized downtown, and fiscal improvement for the city.⁵ Helena, Montana, showed another way. Rather than fighting explosive growth in demand with stricter regulation, which would only raise prices, it repealed minimum lot sizes and loosened other standards. State action is also appropriate. For example, bipartisan legislation in California has required cities to allow accessory dwelling units, with tens of thousands being built or legalized in the past four years. These are small steps, but for the first time in decades they are going in the right direction.

I encourage you and other federal policymakers to look deeper, all the way down to city councils and neighborhood meetings, to understand the causes of and solutions to our national housing affordability crisis.

5. Salim Furth and Philip Wharton, *Case Study: New Rochelle: Zoning and Permitting Innovations Unlock Opportunity* (Paradise, NV: Better Cities Project, 2021).