



Institute of
Business and
Economic Research

University of
California,
Berkeley

**CENTER FOR REAL ESTATE
AND URBAN ECONOMICS
REPRINT SERIES**

REPRINT NO. 16

HOUSING AND THE POLITICAL
ECONOMY OF "SOCIAL SCHIZOPHRENIA"

BY
LAWRENCE F. KATZ

Reprinted from Commencement Speech,
Department of Economics, University
of California, Berkeley, June 12, 1981.

GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

**CENTER FOR REAL ESTATE AND URBAN ECONOMICS
UNIVERSITY OF CALIFORNIA, BERKELEY**

The Center was established in 1950 to examine in depth a series of major changes and issues involving urban land and real estate markets. The Center is supported by both private contributions from industry sources and by appropriations allocated from the Real Estate Education and Research Fund of the State of California.

**INSTITUTE OF BUSINESS AND ECONOMIC RESEARCH
J. W. Garbarino, Director**

The Institute of Business and Economic Research is a department of the University of California with offices on the Berkeley campus. It exists for the purpose of stimulating and facilitating research into problems of economics and of business with emphasis on problems of particular importance to California and the Pacific Coast, but not to the exclusion of problems of wider import.

Housing and the Political Economy of
"Social Schizophrenia"

Lawrence F. Katz*

University of California, Berkeley

I would like to speak today on a subject on which I have done a great deal of research over the last few years: Housing and the Political Economy of "Social Schizophrenia." I believe this discussion has much relevance for today's commencement ceremonies since it deals with one of the most important present and future concerns of today's graduates: the affordability and availability of adequate housing.

I would like to begin my discussion with the following observation. This observation is that although it is fairly well-known that California in general and the San Francisco Bay Area in particular hold the dubious distinction of having the highest housing prices in the country, exceeding the national median by well over 50%, I believe it is not nearly as well-known that this is a very recent phenomenon and that as little as 10 years ago California house prices were not much greater than the national median.

* This paper is a revised version of a speech presented on June 12, 1981 at the commencement ceremonies for the Department of Economics of the University of California, Berkeley.

As my fellow graduates surely must be thinking, a primary economic issue here is the identity of those supply and demand factors which can account for this sharp relative price acceleration. The standard explanation has relied solely on demand factors such as the recent upsurge in California household formations and California's vibrant economy. Yet, the empirical evidence suggests that the strong demand for housing can only partially explain this rapid house price inflation. The fact that California experienced even greater demand pressure in the late 1950's and early 1960's without a similar relative price explosion supports the view that the demand side does not provide a full explanation. Thus, there is a missing ingredient, and I contend that this missing ingredient is some sort of supply constraint.

When we turn to the supply side, we find that the major change in recent years in the Bay Area has been the growing shortage of development opportunities and of land allocated for development. While many may imagine that this simply indicates the region has been built out and run into the natural constraint of a limited land supply, the fact is, as Berkeley's David Dowall has documented, that the Bay Area has a tremendous supply of vacant land. While much of this land is too environmentally sensitive or too topographically problematic to develop, much more could be developed without serious environmental problems but is prevented from development by local government restrictions.

Thus, the major change on the supply side has actually been the rapid proliferation in recent years of restrictive local government land use controls and growth management techniques which among other goals, have seemingly been designed to stop, slow, and/or increase the cost of new residential development. These regulations, which in traditional zoning and subdivision ordinance form serve to reduce some of the unnecessary costs associated with unplanned development and which in new more restrictive and sophisticated forms are justified as serving to preserve environmental quality and "community character" as well as preventing increases in local public service costs, often generate the serious corollary effects of significantly increased housing costs and a substantial reduction in the flow of new units onto the market. The spread of restrictive forms of these regulations especially if combined with continuing chaos in the housing finance system may severely diminish the possibility of homeownership for a large proportion of this nation's households.

I believe the upsurge in the use of these regulations is directly related to a more general phenomenon that can be described best by the term "social schizophrenia." I am sure you may be wondering what I mean by this strange term. Well, by "social schizophrenia," I am actually attempting to describe the situation that prevails when people's perceptions of general

social goals or needed policies directly contradict their individual behavior and/or their perceptions of their own individual goals. I label this phenomenon as schizophrenic, although it typically represents rational self-interest, since the results are the same as they would be if each individual had two distinct political personalities: one personality used for deciding on general social goals and policies, and a distinct, often opposite one, used for evaluating the merits of social actions directly affecting that individual.

Important economic policy issues almost always seem to involve some "social schizophrenia." In the current situation, we find that the same individuals who advocate general budget cuts and a reduction in the size of government, almost always vigorously oppose any cuts in programs that directly benefit them as individuals. Even our leading budget-cutter, David Stockman, has requested an increase in the budget of his own office, the OMB. Social schizophrenia seems to appear whenever potential solutions to economic problems involve imposing substantial economic losses on some group in society, or in other words, whenever a decision involves a substantial zero-sum element. "Social schizophrenia" and the problems associated with it in our political system seem to a large extent to be exacerbated by what MIT's Lester Thurow has described as our poor to nonexistent systems for compensating those individuals who legitimately lose when projects are undertaken supposedly in the general interest. The result in our system seems typically to be either that each potentially affected group is able to thwart

policies that would put costs on it so that policy paralysis prevails, or that action is taken that places almost all the costs on particularly powerless groups or, as in our case of land use controls, on groups not represented in that particular decision-making process.

I would now like to sketch the evolution of the social schizophrenia problems involved with the land use regulation process. Through the mid 1960's, economic growth was almost everywhere viewed positively and suburban development preceded fairly unregulated. Land use regulation in most communities consisted of some community-wide land use plan and traditional zoning and subdivision ordinances which mainly served to mitigate the externalities or nuisances associated with incompatible land uses and to assure adequate residential environments. Yet, the upsurge in environmental consciousness of the late 1960's and escalating public service costs made suburbanites much more aware of the environmental and fiscal problems associated with fairly unhindered suburban growth and helped induce the rapid spread of increasingly stringent and exclusionary land use controls.

A recent survey of Bay Area homeowners by the Builders for Affordable Housing group, traces some of these new attitudes.

The results show that a large majority of the respondents indicated an awareness of a housing shortage in the Bay Area, favored increased housing development to alleviate the shortage, and indicated a belief that regional growth should not be slowed by government regulation. However, at the same time, a majority indicated a strong preference for low-density areas and favored increased regulation to maintain low densities in their communities and to increase the preservation of open space. Thus, the schizophrenic result, albeit a rational seeming one from a self-interest perspective, is that people believe there should be more growth and housing development in the region but they don't want it in their own neighborhoods. In other words, they want to pass all the costs onto someone else.

The political economy of this situation can be analyzed by noting that the relevant land use decisions are almost entirely in the hands of local governments. At the local level, the constituents are only the existing residents, those who have the most to gain from growth control, and not potential future residents, those with the most to lose. Thus, the political incentive for local officials is skewed almost entirely in the

direction of growth control since existing residents are the winners, while almost all the costs can be passed onto groups not represented in the local political process: the other communities hit with the diverted housing demand and potential residents who face higher housing prices and often those costs related to the inability to find affordable housing in one's preferred location.

The result of this situation has been the rapid spread of restrictive land use controls throughout many regions of the country. In the Bay Area, Proposition 13, the supposedly anti-government initiative, has ironically exacerbated the trend towards more stringent local government land use regulation by making local governments less willing to undertake the public improvements needed for residential development and by making residential development much less fiscally attractive. This trend has preceded through both the stiffening of traditional devices and in an increasingly large number of communities by the adoption of sophisticated growth management systems of which Petaluma's is the most famous example. These systems typically limit the number of building permits available annually and by doing so often serve to facilitate builder monopoly power. Land use controls increase housing prices through developable land

supply restrictions that increase the price of developable land, cost increasing excessive or unnecessary requirements and improvements, unnecessarily high fees, and costly delays. Additionally, land use controls often force developers to reorient their projects to a higher income market so that they build larger, more luxurious, and more expensive homes. Thus, land use controls may also change the composition of the new supply of housing so that a higher proportion of larger, more expensive units are built. My own empirical econometric estimates and my work with Professor Kenneth Rosen, the Chairman of the Center for Real Estate and Urban Economics, indicate that growth management systems and building moratoria in the Bay Area have increased the price of all houses from 18 to 28% and of new units alone by approximately 40% in those communities in which they are present. The figure for new units includes both the supply restriction and market reorientation effects.

Additionally, growth controls present a fine example of one of the first terms my fellow graduates and I learned back in our days in Econ. 1. The term I am referring to is "fallacy of composition," a term which basically means what is true for the individual or part may not necessarily be true for the whole. We see this for land use controls since although growth controls

don't present very serious problems when only a few communities use them and there is plenty of substitute housing in surrounding communities, they lead to significant costs in terms of increased housing prices and diminished housing opportunities when many or all the cities in a region utilize them. Also, when many communities in a region become restrictive, development is forced out to the fringes and to exurban areas, as has increasingly become the trend in the Bay Area according to recent Association of Bay Area Governments' housing outlook reports. Ironically, this means that these environmentally motivated regulations may actually exacerbate environmental harms since fringe development often means that prime agricultural land is gobbled up by development. It also leads to the increased energy consumption and automobile air pollution associated with longer commute trips.

When we turn to what economists refer to as the long run general equilibrium, we find that controls throughout a region may seriously reduce its rate of economic growth and alter its economic base. Eventually the region's cost structure will rise and it will become less attractive to business when increased housing and land costs drive up wages and possibly business rents. Potential firms will decide to settle elsewhere and existing firms will relocate often throwing existing residents out of jobs. Firms

unable to relocate and lacking a flexible wage structure, such as our beloved university, will experience great difficulties in recruiting and maintaining employees. Eventually, social and political tensions could be greatly increased between existing homeowners and those denied the opportunity for homeownership and forced into crisis rental housing situations such as many of us have experienced here in Berkeley in the last few years.

Policy suggestions are extremely difficult since at the local level existing residents are the political force and probably only developers can serve as a proxy for potential residents' interests. Of course, the extreme of eliminating all land use regulations and returning to old-style, sprawling, unplanned suburban growth would leave us worse off than we are now and is not a reasonable solution. Yet policies must be found to better trade off environmental and fiscal goals with regional and national housing needs. I believe, regrettably, that this will require some sort of state or federal action that leaves local governments with wide discretion over land use decisions but still requires each community to accept its fair share of regional housing needs given its particular environmental constraints. Overall, requirements that developing areas have adequate land zoned for development, better expedite the processing of housing projects, and permit multifamily units including condominiums as well as some small houses on fairly small lots could greatly increase the supply of affordable housing while enabling local governments to maintain control over the location of development

and to protect agricultural lands as well as important features of the physical environment. Hopefully, the adoption of these types of policies can enable us to both protect our environment and provide our population with an adequate supply of affordable housing.