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Local Governments Also To Blame For Housing Crisis

By Mark Calabria
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Most narratives of the financial-mortgage-housing crisis tend to focus on what are essentially demand-side factors. Whether it is federal mortgage subsidies, like Fannie Mae, or reduced interest rates via loose monetary policy, these policies increase the demand for housing by allowing, and encouraging, more buyers to enter the market. As I've written in more detail elsewhere, this narrative ignores the supply side of the market.

If housing supply could easily adjust to the increased demand that arises from other policy interventions, then prices would be unlikely to increase. In fact, if supply increased more than demand, we could see falling house prices, despite the various federal subsidies. The point is that for a price boom to develop, you need some sort of rigidity in supply (inelastic supply, as we economists would say).

So who has the most influence over housing supply? Local governments. A recent article in the January 2012 issue of the *Journal of Urban Economics* provides empirical evidence "that more restrictive residential land use regulations and geographic land constraints are linked to larger booms and busts in housing prices."

The natural and man-made constraints also amplify price responses to the subprime mortgage credit expansion during the decade, leading to greater price increases in the boom and subsequently bigger losses." A similar argument has been made by Cato scholar Randal O'Toole.

The lesson here is that if we want to avoid future property booms and busts, with their devastating impact on financial institutions, we also need to reform our local land use controls to allow for the more rapid response of supply to changes in demand. Again, it wasn't a lack of regulation that caused the crisis, but too much regulation, particularly of the land/housing market.

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