Affordable Housing Mandates and Inclusionary Zoning

By Fred Foldvary

Probably the reason we get such bad economic policies is that folks are fooled by the appearance of things because they do not understand economic reality. It is the primary job of economists to uncover and make known the economic reality that lurks beneath superficial appearances.

Naive people believe what they see and hear, without reflecting as to whether the appearance is deceiving. The sophisticated person is skeptical about appearances and only believes something when he obtains the warrants in logic and evidence. The cynic is as bad as the naif, because the cynic disbelieves even when offered logic and evidence.

Confronted with the severe problem of housing that is expensive relative to wages, most policy makers are naive; they seek remedies that superficially seem to treat the effects. They don't inquire as to the cause of the problems, and even worse, they don't inquire as to the total and ultimate reality of the effects of the symptom-treating policies.

So mayors, city councils, and urban planners enact 'affordable housing mandates,' also called 'inclusionary zoning.' Since the early 1970s, many cities have enacted inclusionary zoning, especially in California, which has high real-estate prices. Do low-income folks have a problem because they can't afford housing? Well, let's force developers to provide housing below market value! Presto, problem solved! That is like waving a magic wand to create something out of nothing. It doesn't work.

When developers are forced to sell some houses below market prices, the lost profits have to come from someplace. If the developer bought the land at market prices and sells the newly constructed houses in a competitive market, he will get below-normal profits unless he either raises the price of the other houses or else develops elsewhere.

Economic theory tells us that with lower profits from development, there will be less development, and with a lower supply of houses, prices will rise, making housing less affordable for everyone. Even low-income folks suffer, because with less development and an overall lower supply of housing, only a few lucky poor folk will get that affordable housing.

The skeptic will want evidence in addition to theory. 'I want numbers!' he cries out. Two economists, Benjamin Powell and Edward Stringham at San Jose State University, have analyzed the housing data to obtain the concrete effects of the mandates and zoning. Looking at construction over time, Powell and Stringham find that the construction of new housing gets reduced by 31 percent on average after the adoption of inclusionary zoning. Powell and Stringham found that 'after passing an inclusionary zoning ordinance, the average city produced fewer than 15 affordable units per year.'

There is a great demand for housing in the Bay Area, but the supply has lagged behind. Land-use regulations in general have stifled the supply of new houses, including restrictions on development, zoning that prevents higher population densities, inclusionary zoning, and so-called 'rent control.' Restrictive building codes also unnecessarily add to the costs of construction. 'Rent control,' mandating maximum rentals, does not really control the real economic rent but just shifts some of it to tenants, and then stifles maintenance and new construction. These mandates thus make housing affordability worse. From 1990 to 2000, the San Francisco Bay Area added 550,000 jobs but only 200,000 new homes.

Reducing the supply makes prices higher. Powell and Stringham conclude that inclusionary zoning causes the price of new houses in the median city (half way between the lowest and highest priced) to increase by $22,000 to $44,000. In high-priced cities, this policy raises the price of a house by more than $100,000.

The reduction of higher-priced housing makes the poor worse off, because when rich folks move into better high-priced houses, they move out of their older houses, which middle-income folks move into, and they in turn move out of lower-priced homes that lower-income folks can move into. So reducing the supply of higher-priced houses ultimately makes less housing available to lower-income folks, raising the price and making housing unaffordable.

Restricted supply is only part of the housing story. The main problem is taxes. Wages get heavily taxed, reducing what folks can afford to pay for housing. Meanwhile, public works and civic services, in making locations more desirable, pump up land values and rentals, since the funding comes mostly from wages rather than rent. Policy artificially raises housing prices both from higher demand, due to public works landowners don't pay for, and lower supply, due to restricted development, while wages get pushed down. The gap between housing prices and wages thus does not come from the non-existent free market but from perverse government tax and regulatory policies.

The real remedy for the lack of affordable housing is to eliminate the government interventions that artificially make housing out of reach for poorer folks. Eliminate inclusionary zoning, and indeed all other zoning. Replace zoning with private contractual covenants. Also eliminate taxes on wages: shift taxes from income and sales to site values, so that landowners return to government the value created by its public works. Land-value revenue tapping will also capitalize land values back down to that level prior to the up-capitalization from public works. Even better, let the public works be provided by private communities, which can't tax wages in the first place, so they have to get the funds from assessments on the property of the association members, which are willingly paid in order to get the services.

That's a lot to chew on, so at least the policy makers should be aware that naively treating the effects of high-priced housing with mandates is counterproductive. As Powell and Stringham show, affordable housing mandates don't work and should be abolished.

This article first appeared in the Progress Report, www.progress.org.
Dr. Fred Foldvary teaches economics at Santa Clara University and is the author of several books: The Soul of Liberty, Public Goods and Private Communities, and the Dictionary of Free-Market Economics.