CENTER FOR REAL ESTATE
AND URBAN ECONOMICS

WORKING PAPER SERIES

WORKING PAPER NO. 91-195

PLANNING AND MARKETS
IN THE HOUSING SYSTEM

By

JOHN M. QUIGLEY

These papers are preliminary in nature: their purpose is to stimulate discussion and comment. Therefore, they are not to be cited or quoted in any publication without the express permission of the author.
CENTRAL FOR REAL ESTATE AND URBAN ECONOMICS
UNIVERSITY OF CALIFORNIA AT BERKELEY
Kenneth Rosen, Chair

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
Richard Sutch, Director

The Institute of Business and Economic Research is an organized research unit of the University of California at Berkeley. It exists to promote research in business and economics by University faculty. These working papers are issued to disseminate research results to other scholars. The authors welcome comments; inquiries may be directed to the author in care of the Center.
PLANNING AND MARKETS IN THE HOUSING SYSTEM*

by

John M. Quigley
University of California
Berkeley

June 1991

I. INTRODUCTION

II. HOUSING IS PECULIAR

III. HOUSING POLICIES ARE SPECIAL
    A. Efficiency Motives for Housing Policies
    B. Equity Objectives in Housing Policy
    C. Social and Political Motives

IV. SOME IMPLICATIONS OF COMPLEXITY

V. MORE ON COMPLEXITY

VI. CONCLUSIONS

Keynote paper prepared for the
International Housing Research Conference,
Oslo Norway
June 24-27, 1991

* Parts of this paper are based upon joint work and stimulating conversations with Bjorn Harsman.
I. INTRODUCTION

All developed countries have a housing problem in some form, and all nations, regardless of their orientation towards free markets or central planning, have adopted a variety of housing policies. The production, consumption, financing, distribution, and location of dwellings are controlled, regulated, and subsidized in complex ways. In fact, compared to other economic commodities, housing is perhaps the most tightly regulated of all consumer goods.

This paper presents a taxonomy of the various rationales for government housing policies, with particular attention to the economic motivations which underly government policy. In large part, the taxonomy is based on a collaborative project with Bjorn Harsman\(^1\). It is seen that the economic justification for many policies is weak, but that the political and social rationale is often quite powerful.

It appears that the complex justification for housing policies often leads to inconsistent or antagonistic policies and to difficulties in evaluation. I will present some examples of this from policies motivated by distributional or equity considerations. I will then suggest a more sharply focussed rationale for housing policy.

---

In part, the specialized policies which have developed in different societies to regulate or subsidize housing arise from the peculiar economic characteristics of this commodity. Housing is a peculiar economic commodity, and as a result housing policy is too special to be left to social scientists, much less to economists.

II. HOUSING IS PECULIAR

Several of the characteristics of housing distinguish it from other economic commodities:

First, housing is a complex commodity -- complicated to evaluate, complicated to produce, and therefore, complicated for suppliers and demanders to trade efficiently. A variety of different attributes must be considered to characterize a dwelling or building. A household or landlord must gather and process a great deal of information to make housing market choices which maximize utility or profit.

Second, housing is fixed in space. This means that housing choice is also a choice of neighborhood, a choice of access to workplaces, and a choice of access to a variety of local services such as schools and shopping centers. From the producer's point of view, it also means that the most important determinants of site rents may be well outside of
direct control. These site rents may be substantially influenced by actions of the public sector. Fixity also implies that a residential move is quite typically necessary in order to change the consumption of housing.

Third, housing is expensive to produce. This makes renting a common form of tenure. For owners, this makes mortgage repayment an attractive alternative to outright purchase. This also implies that housing consumption generally constitutes a substantial fraction of household budgets and that new construction of residential housing is a substantial component of net national investment in any year.

Fourth, housing has extremely long lifetimes. This implies that new construction provides only a small fraction of the total quantity of housing services supplied for consumption in any one period, and that new construction activity is vulnerable to small changes in the demand for housing. This also means that the consequences of local investment activity will affect the physical environment for a long time.

Fifth, housing is a necessity for any individual or for any household desiring to live a "normal" life in modern industrial society. There may be many substitution possibilities within the set of housing services, but housing
itself has few substitutes. No matter how poor they may be, households "need" to consume housing services.

Other commodities may have one or more of these distinctive features. For example, automobiles are complex commodities that are expensive to purchase. Aircraft are also long lived, farmland is fixed, and food is a necessity. But it is difficult to think of another commodity having all these special attributes. The combination of these attributes defines the special features of the housing market. For example, the complexity and fixity of housing ensure that transactions costs are very high in this market. Consumers must evaluate alternatives personally and must incur substantial monetary and psychic costs to change consumption bundles. The monetary costs include substantial expenditures of time and money in searching for dwellings, as well as the costs of moving and of concluding lease or purchase transactions. The psychic costs may include the loss of attachment to neighbors, schools, and local amenities, attachments which may change with the duration of residence at a particular location.

Fixity and longevity mean that the entire future course of geographical areas is determined when housing investment decisions are made. The consequences of this are likely to be substantial, so substantial that long-range planning by some
economic actors is highly appropriate. The expense and the necessity of housing emphasize the fact that even the lowest income households need some of this expensive commodity; without some form of subsidy, shelter expenditures as a fraction of income will be quite high for poor households.

III. HOUSING POLICIES ARE SPECIAL

As befits a somewhat peculiar commodity, housing policies as a class are somewhat special. First, since housing is a necessity and since it occupies such a large fraction of household budgets, considerations of housing policy affect all citizens in developed societies. This means that the distribution of housing is an important real issue for producers and consumers, and an important symbolic issue for politicians and government officials.

Second, the direction of housing policy can be changed only rather slowly, especially if subsidies are specific to long-lived dwellings. Even large changes in new commitments to housing programs will affect the stock of subsidized dwellings only slowly over a long time horizon. In the parlance of budgeteers, housing subsidies are likely to be "uncontrolables" in the government budget.

Third, housing policy is closely related to many other important objectives of economic and social policy, for
example macroeconomic stabilization, social welfare, public health, appropriate land use, economic development, and regional balance. Without coordination, activities and policy initiatives in these other spheres may affect housing outcomes and may thwart housing policy. Even with coordination, desirable housing policies may be inconsistent with other government policies.

Finally, it should be recognized that housing policy is difficult to design and may be difficult to evaluate in many cases. In part, this is because a long time perspective is required, and, in part, it is because uncertainty is magnified over long time horizons.

The evaluation of housing policies in industrial societies can be made on the basis of the efficiency objectives, equity objectives, and social and political objectives that underly government action.

A. Efficiency Motives for Housing Policies

One clear reason for the adoption of housing policies is to promote allocative efficiency in the economy. There are many different bases for the argument that government policies in the housing market can promote an efficient use of scarce resources. It appears that government regulation in the market for the building, occupancy, financing, or pricing of
housing services may promote or thwart efficiency in rather distinct ways.

First, there are the public good aspects of housing. Many analysts, especially physical planners, believe that certain aspects of dwellings, and indeed some aspects of the entire housing stock, are public goods consumed by all without one's consumption infringing on another's. Obviously, individually occupied dwellings are private commodities, rival in consumption, and enjoyed by particular households. Nevertheless, many attributes of individually owned and occupied housing are consumed collectively. The physical appearance of a building, its architecture, and its arrangement in relation to infrastructure and transportation may benefit all. A well-designed building can provide benefits not only to its owner occupant or its tenant, but also to those who view it, visit it, or hear about it. Many argue that a well-designed and planned urban landscape arising from the placement of housing in relation to infrastructure is also a public good and a benefit available to all without congestion. Certainly, for these aspects of housing, a free and competitive market with divided ownership will ignore, or at least undersupply, many attributes. From this perspective, some government role is virtually required to foster economic efficiency.
These externalities associated with the housing stock, its design, arrangement, and external quality, have fiscal and pecuniary effects. These externalities can prevent private landlords from investing to maintain quality and to maximize their collective profits. The recognition of these prisoners' dilemma problems for landlords has provided the basis for many kinds of public urban renewal activities. These externalities, however, may be social and fiscal as well as physical. Under a variety of tax arrangements, particularly property taxes, the occupants of large and desirable dwellings may confer fiscal benefits to other residents; conversely, small inexpensive dwellings may increase the financial costs of public services to others. These fiscal externalities provide a clear motive for government regulation and zoning. Prejudice, racial discrimination, and other manifestations of private behavior may lead to outcomes in which negative social externalities are intensified. Public controls over land use and housing can, at least in principle, internalize the positive externalities from dwellings and mitigate their negative consequences. It is clear that free markets with divided ownership do not provide the appropriate incentive for internalizing these market effects.

In addition, according to many there are merit good aspects to housing. Housing is durable and is expensive to alter. It is expected to be used by future as well as current
generations. If not, transformation and demolition costs are substantial. Housing is also consumed by many of the current generation who are incapable of evaluating it appropriately, for example, children whose needs, preferences, and demands are not taken into account in market transactions. Housing standards and norms could be considered much like educational standards or medical standards, intended partly to meet the minimums prescribed for captive consumers with few dollar votes: children, the elderly, handicapped, future generations, etc. The merit good argument implies that the needs of these groups will not be appropriately taken into account by an unregulated market, and that society has some collective obligation to take these preferences into account.

A related efficiency argument concerns the effect of expectations on market behavior. It has been widely argued that individuals behave as if they have higher discount rates in private transactions than the so-called "golden rules" of capital accumulation would warrant. With very long-lived investments in housing structures, which may have useful lives of fifty or a hundred years, differences in the appropriate investment strategies for society and for individuals will be magnified. Thus the enforcement of regulations could narrow the difference between the investments undertaken using individual discount rates and the appropriate investments using collective social discount rates. Inefficiencies in
resource allocation would otherwise arise -- if, for example, the high discount rates of current consumers led to underinvestment in infrastructure.

As we have noted, housing markets are also characterized by substantial transaction costs both for consumers and producers. Some standardization could reduce these costs for both producers and consumers. A set of common design standards may facilitate the negotiations and actions of intermediaries in construction, and uniform rules and codes may result in information economies in consumption as well. This standardization may not only reduce the cost of information about alternative dwellings for potential housing consumers, but also reduce the cost of inspection for health and safety and for the enforcement of police powers of the state.

Moreover, the promulgation of standards and norms for the housing market may encourage economies of scale in production which would not otherwise be feasible. These economies of scale may arise because of the technical character of the production process. Under these conditions, it is not at all clear that the variety of housing produced by an unregulated market is socially efficient.
Intervention in the housing market to stabilize production may also promote dynamic efficiency in house building. In most industrial countries, output per manhour in residential construction lags other sectors, and changes in total factor productivity in housebuilding are notoriously low. If government programs reduce the cyclicality of housing production, they may foster the substitution of capital for labor in production and promote labor saving innovation in the building trades. Expectations of a more stable output may promote the use of more specialized inputs in the building process and a more appropriate capitalization of the sector.

Finally, government intervention in this market may have beneficial efficiency effects from a macroeconomic perspective. Given the high cost of housing, new construction is quite sensitive to variations in interest rates and in housing demand. Thus, residential construction is quite variable and is subject to cycles with large amplitudes. Explicit policies about the level of housing construction can provide an additional instrument for national and regional development policy.

B. Equity Objectives in Housing Policy

The equity objectives furthered by housing policy are at least equal to efficiency objectives in importance. In many countries, governmental authorities articulate an explicit
policy objective concerning the provision of housing. For example, in the United States every housing bill since 1949 has articulated the goal of a "decent home and suitable living conditions to all citizens." In many cases, such a statement seems to be related to an income distribution objective. This is certainly not the case in all countries; but even in the United States, for example, housing goals are often espoused by those who see housing policy as a second best way of redistributing income (in-kind, as compared to a distribution in cash). In other countries, for example, here in Norway, housing provision relates to a more sharply and explicitly drawn equity objective. The importance of housing in consumer budgets may make housing policy an attractive tool for achieving equity objectives.

Most economists, of course, would argue that these income distribution objectives are better pursued by explicit transfer policies rather than through the distribution of housing services. Yet in most societies, transfers earmarked for housing consumption are explicitly related to distributional objectives. One reason, noted above, is that some political environments favor redistribution in kind. Under so-called "commodity egalitarianism," redistribution in kind is more palatable than redistribution in cash. In the United States, food stamp programs and medical programs appear
to be far more popular than programs that distribute cash to needy households.

Housing subsidies for the poor provide the opportunity for a coalition between profit oriented developers and radical social planners.

A second and less noble reason for intervention in pursuit of equity objectives is the visibility of poor housing. It need not be evident how much or how little people earn in the marketplace or how much or how little people eat, but it is impossible to ignore the existence of low-quality and unsightly housing. The visibility of substandard housing makes the issue salient to politicians, voters, and the owners of property whose value would be improved through housing upgrading.

The merit good aspect of housing, discussed above, may make housing an attractive vehicle for politicians in accomplishing distribution goals. This merit good rationale is also quite paternalistic: politicians or government bureaucrats know more than a badly housed individual about the negative consequences associated with inadequate housing. For example, it is often argued that parents at the lower end of the socioeconomic scale do not realize the importance of good housing or good nutrition for the well-being of their
children. Thus unaided, they would use disposable income in ways that were not consistent with this higher knowledge.

Regardless of the motive, however, the existence and importance of equity objectives in developed societies have important consequences for the design and for the evaluation of housing policy measures. Finally, the equity objective may be broader than those objectives associated with particular individuals and may extend to the distribution of income across regions, provinces, or states. An active housing program can greatly further such objectives.

C. Social and Political Motives

It is sometimes difficult to distinguish social and political motives for housing policy from the narrower equity and efficiency motives. Nevertheless, the distinction is real and is important. The promotion of order and public safety is perhaps the most basic reason for government. It is also the oldest political motive for housing policy. Governmental policies aimed at improving health and safety have regulated housing since the days of the Romans. For example, in ancient Rome, Caesar Augustus reorganized the water supply system and organized fire brigades to make residential areas safer for the citizenry. To reduce urban flooding, he regulated the water level on the Tiber and forbade private citizens to construct buildings taller than twenty meters.
It was not until the nineteenth century that European countries enacted comprehensive legislation to assure minimum standards of health and safety in residential dwellings. Regulation of the interior conditions of housing -- overcrowding, sewage, and water supply -- was undertaken because such regulation was seen as inhibiting epidemics of cholera, tuberculosis, and other contagious diseases. The first housing legislation in Britain, the Public Health Act, adopted in 1848, was followed by the more comprehensive Salesbury Act. The latter made local governments responsible for proper sanitation and for enforcing a variety of health and safety measures. The Swedish Health Code, enacted in 1874, instructed the local authorities to control housing conditions and to prevent the occupancy of unsafe dwellings. By the end of the 19th century, similar housing regulations were introduced in Amsterdam to improve sanitary conditions. In Vienna, the capital of the Austro-Hungarian Empire, a comprehensive building code was introduced in 1859. This legislation was designed explicitly to protect safety and health. The minimum standards enacted in Vienna were not considered satisfactory in light of the rapid city growth that followed, so further regulatory measures were enacted. These examples seem to suggest that concern about the most basic functions of government was the driving force justifying housing policy.
It is not clear that these activities are best described merely as efforts to internalize "external effects" related to housing consumption. Many will argue that these policies were not just intended to correct individual decisions, but that the regulations were also a way of codifying the social character of urban life. The discussion of special housing policies in most industrialized countries during this century gives further credit to this view. Much of this discussion concerns the rights of citizens to health and safety conditions and to the expectation that government will ensure minimum standards in these dimensions. These can be thought of as the minimum requirements of a social contract in the increasingly dense urban areas arising after the industrial revolution.

The rapid development of housing policies per se after World War II may be attributable merely to rising income and expectations. However, housing policies have also been an important part of a more explicitly political welfare state which has arisen. Scandinavia provides a conspicuous, if somewhat extreme, example of this development. In the general guidelines for housing policy decided upon Sweden in 1946, the proposed policy measures were explicitly seen as part of a broader social policy, and hence as complimentary to other policy instruments such as child allowances and pension reform. The revisions of the guidelines undertaken some twenty-five years later strengthened this explicitly political
view -- holding that decent housing should be regarded as a "social right" rather than merely as a commodity. At the other extreme, in the United States the Housing Act of 1949 explicitly established the goal of a "decent home and a suitable living environment for all Americans." This slogan has subsequently appeared in the preamble to all American housing acts and policy statements since then, but it does not appear to have infiltrated the dominant political ideology.

Related to this welfare statist view is another: poor housing conditions have high social costs in the form of crime, juvenile delinquency, alcoholism, and other forms of maladjustment. Empirical support for these claims is quite weak; nevertheless, the arguments certainly have played an important role in motivating housing policies in many welfare states.

A second political motive for adopting housing policies relates to the division of windfall gains and losses among social and economic classes. The profits made by landlords during periods of rapidly increasing housing demand provide a conspicuous example. In some countries, for example, the Netherlands, "excessive" profits have been a major motive for controlling rents in many parts of the housing stock. However, this motivation for intervention is somewhat broader than the rationale for rent control during wartime shortages. Many other activities undertaken routinely as legitimate
manifestations of governmental power and collective responsibility provide windfall gains. These unearned profits are in the form of increased site values accruing to particular owners of residential or commercial properties, landlords, and the owners of tracts of land. For example, decisions about the location of infrastructure, the type and routing of roads, public transport, hospitals, and other spatial aspects of urban life may have no explicit distributional motivation. Nevertheless, the outcome of these activities can greatly increase the profits of landlords or landowners in particular areas of the economy. Policies regarding land use, housing, and residential and commercial rents may be derived from political considerations about the "fair" division of these unearned windfalls among different economic actors.

Another set of political motives for housing policy is related to the process itself. There is a very long tradition, especially in Europe, of considering overall urban development as a question of common concern for those living within the area. Thus, integrating housing with other public functions is a matter of common social concern. Of course, this involvement in town planning is partly motivated by efficiency reasons. But it is also strongly rooted in a political and culturally based belief that participation in the resolution of development issues is natural in a democratic society. Moreover, the expectation is that the
process itself can foster an improved democracy. Thus participation in the process of planned development or zoning regulation is itself viewed as a politically and socially desirable activity, useful in forming some kind of consensus about the way local areas should develop. This importance of process, for example, provides an explicit rationale for the methods of local decision-making adopted in Holland. Although this political value seems currently less pronounced in North America, "maximum feasible participation" provided a rationale for community action programs and other urban development activities in the 1960s and 1970s.

A fourth important political reason for housing policy is related to the physical characteristics of real estate and its long life. Specific housing investments are lasting monuments to the particular politicians or the political forces initiating them. The promise of housing improvements in the South Bronx is a tangible campaign pledge, and the outcome of housing development can be a lasting monument to the far-sighted politician who facilitated the investment. There are no greater opportunities for monuments and plaques and ribbon cutting ceremonies than investments in physical urban infrastructure.

Control over the spatial development of housing of different kinds also provides local politicians with some mechanism for affecting the socioeconomic mix of area
populations and thus of guiding population development in ways that can influence election outcomes. The possibilities for exercising this control are greatest in societies with strong traditions of class and party loyalty. The distribution of households of different economic classes within a metropolitan area can then have important effects upon the makeup of city councils and regional governments; these considerations are themselves of importance to politicians.

In addition, the paternalistic motives for providing housing for those with less knowledge and lower incomes can support a larger governmental structure. Larger governmental structures make the elected and appointed officials who manage such agencies more powerful, as they control larger staffs. Such power can be legitimized by the equity concerns which motivate government policy, and the prestige of officials can be increased by the employment of experts, scientists, engineers, and planners to serve under their guidance and direction.

Finally, an important political reason for housing programs can be seen in the link between regional development policies, labor market policies, and the housing market. Housing investment is a stimulant to a local or regional economy and may be used politically and economically as a tool for redistribution across regions. Similarly, the link between labor market policies and housing availability is
close, not only within metropolitan areas (the availability of housing near work sites) but also among regions (the availability of suitable housing in areas with rapidly growing demands for labor). The political and social aspects of these regional development programs are, of course, inextricably linked with the narrowly economic. Nevertheless, it would be a mistake to view these activities as merely economic in scope and lacking a particular political or ideological dimension.

IV. SOME IMPLICATIONS OF COMPLEXITY

The fact that housing policies have many justifications need not imply that the interventions actually chosen are very "good" or that the programs adopted are internally consistent. Indeed, the converse may well be more likely: the complicated rationalizations of policy make it more likely that those adopted will be inconsistent. Here we consider three examples from the equity concerns discussed previously.

Consider first the choice between demand side and supply side subsidies provided to households to increase their housing consumption. Virtually all studies of the cost of housing subsidies indicate that it is cheaper, in terms of resource costs per household served, to subsidize deserving demanders directly rather than to subsidize additions to the supply of housing. This finding is in accord with common sense -- housing for lower income households is more efficiently provided from the existing stock than from new
construction. Yet until quite recently most western governments pursued, almost exclusively, costly construction projects with the specific intention of subsidizing deserving, i.e., poor, households.

The reasons for this anomaly are not altogether clear. I suspect, however, that this arises from three causes:

First, as a political matter, new construction subsidies for poor households represent a convenient alliance between those who care about the income distribution and the well being of the lowest income groups and those whose profits or positions depend upon the demand for newly constructed dwellings. Social workers and poverty activists can be allied with builders and developers in promoting their version of the common good.

Second, also as a political matter, supply oriented subsidies provide clear opportunities for ribbon cutting ceremonies and for monuments to politicians. Demand side subsidies are far less visible to voters. But it is this invisibility that makes them desirable to recipients.

Third, a program of subsidized new construction for poorer households can also be described as if it served several other of the goals noted previously. For example, in The U.S. and Canada expensive supply oriented subsidy programs were often justified in terms of their stabilizing effects
upon housing production. When private credit is scarce, public programs to increase housing supply smooth out the production cycle.

Consider next the decision about which households to subsidize. The goals of distributional policy would seem to indicate that subsidies be given in some inverse relation to income, perhaps adjusted for household size and composition. Yet in most countries the majority of public subsidies for housing go to middle class or wealthier households.

In the U.S., about one eighth of housing subsidies, broadly conceived, accrue to households of low incomes. Much of the rest is paid to homeowners in the form of special tax benefits whose value increases with income. In most European countries, mortgage interest rates for upper middle class households are heavily and disgracefully subsidized and, in addition, owner occupied housing receives favorable tax treatment. Housing consumption and home ownership are income elastic and tax rates are progressive (or at least proportional). Thus, on balance these subsidies provide disproportionate benefits to non poor households.

These policy outcomes are predictable, but the rationalization of these policies is quite difficult. They could, so it seems, be justified only by appeal to outmoded (and incorrect) notions of the economics of filtering or by explicitly political considerations -- home ownership is sold
politically as the "American dream" and, for all I know, as the "Norwegian dream" as well. The constituency for such policies includes vocal and politically active consumers as well as other interest groups.

Consider finally the pricing policy for rental housing. In many cities, I daresay most of the cities represented at this conference, rental rates are restricted by some Thomistic view of the "just price" or by an extreme distrust of competitive market mechanisms. The efficiency costs of such arrangements are undoubtedly high. Not everyone agrees with this evaluation, but I do not want to debate it here.

Instead, however, I want to point out that the equity costs of the allocation mechanisms used instead of prices are inordinately high. Rationing systems typically provide lower prices to sitting tenants than to new entrants, and regulated prices are often related to the vintage of dwellings. This means that younger households of lower incomes (with fewer years of tenure) pay higher prices than older more established households, and that more accessible dwellings are often cheaper than newly constructed dwellings of the same quality located on the periphery. The black markets that develop invariably reward those with influence and connections.

The variance in rents paid for housing of the same quality is high, and little or none of this variation is
related to any obvious measure of the deservingness of housing demanders.

Most of the redistribution is simply capricious.

V. MORE ON COMPLEXITY

What are the more general implications of the collection of policy rationales and justification in housing? There seem to be two -- one trivial and one quite profound.

The first is quite simple. A very large number of specific acts in regulating and subsidizing housing and in defining a relation between government and housing can be "justified" by recourse to this set of theory. The economic and political rationales that I have noted do not justify any public activity in markets, but they are regularly trotted out to rationalize a variety of hare brained proposals.

The second and more troubling implication is that so many -- if not most, specific policies -- have been inconsistent or counterproductive in their effects upon outcomes. We thus find ourselves confronting housing markets in Sweden in which housing allowances to increase demand coexist side by side with rent control, and housing markets in Finland in which the rules governing resale markets for certain kinds of ARIVA financed owner occupied housing are not clear (even after inquiry by housing experts to the central government). Household mobility is freer in most countries in Asia and
Africa than it is in Holland, given the operation of rules governing "urgency certificates." In my country there currently are proposals to permit the tax free accumulation of down payments for first time homebuyers through a national law supported by rather influential politicians. Rough estimates suggest that the taxpayer cost of this system would almost equal the cost of shelter at the market rate for the homeless population of the country.

Even closer to my own home, in my community local rent regulation and national subsidy policies interact in a most peculiar way. Price regulation has frozen rents in Berkeley for more than a decade. But national law supercedes local housing law in the following way: The rental prices charged in nationally subsidized units are not subject to local rent regulation. Thus there is a strong, indeed an almost irresistible, pressure to take units from the local stock and convert them to federal subsidy programs -- the rent will be higher and in some cases the tenant will pay less. It is estimated that more than a third of the landlord applications for the federal subsidy program in the San Francisco Area are from Berkeley -- which contains less than fifteen percent of the stock of units and which is by no means a poor community.

These anomalies and inconsistencies do not arise simply from sloppy design or bad planning, and there are no particular culprits in the tale. They arise because the
rationales and justifications for housing policy are so diverse (and individually plausible, I might add), that there is an irresistible temptation to add rules and regulations, subsidies and programs to those already in existence.

It is often the accumulation of programs, quick fixes to existing programs, which complicate and frustrate the larger goals of housing policy.

The evident success of conservative governments in the recent past in focussing attention on market incentives does not, by itself argue for changed objectives of housing policy, but the increased integration of financial markets provides limits to the resources which can be mobilized for housing -- if they cannot be mobilized efficiently. A protected, subsidized sector in nontradeables becomes more costly as financial markets make its magnitude more explicit.

Housing must compete with other uses in the allocation of capital, and the principal allocative mechanism is the rate of return. Investors in Oslo already have the opportunity buy instruments secured by physical dwellings in San Jose, California -- through a variety of collateralized mortgage instruments. These are attractive, relative to other investments, as their risk adjusted rate of return varies. As the European community integrates and as it expands, these opportunities, the discipline of the market in housing is
bound to increase. Paternalistic policies have become quite costly indeed.

VI. CONCLUSIONS

What are the conclusions of this line of analysis? They suggest that as market incentives become more important in the operation of housing markets, there is an opportunity to rethink the complex motives for policy and to search for simpler principles.

Let me propose substituting as far as possible the complex rationale for policy with two simple principles. First active housing policy should stimulate the effective demand of the lowest income households for housing. There is no doubt, especially after several days at a conference such as this, that many view housing subsidy policy as a means of redistributing resources. I share that view, especially since in my own country I see little prospect of more explicit distributional policies.

Yet we endorse, or encourage, programs whose benefits accrue to non needy households, and even to the well-to-do. With fixed budgets, this is too costly. We also endorse, or at least tolerate, expensive supply side programs for low income households which inhibit the development of competitive markets in housing supply. This too is increasingly costly -- not only because it provides less benefit to deserving
recipients, but also because it does not foster productive efficiency.

It is very hard to understand why the physical capital used to house upper middle class Europeans or Americans ought to be supplied at lower prices than the physical capital used to provide their offices and factories. It is quite clear that the income available ultimately for housing and other goods will be higher without these capital subsidies to housing. People will be housed better.

Second, active housing policy should control carefully, swiftly and efficiently what the market cannot -- namely external effects arising from land use, co-location and environmental damage.

No amount of competitive behavior in markets will insure that unpriced pollution or unpriced congestion will be taken into account appropriately by housing suppliers in their location choices. Moreover, the long run profitability of sites depends crucially on the availability of infrastructure and its reliability. The challenge to housing policy is to supply these behavioral signals to market participants in ways that promote efficiency in production rather than costly delay in development. Delay and complexity in the permit process really reduces the efficiency of residential construction. All construction activities are highly leveraged transactions with borrowed money. Thus delay can increase the cost of
supplying housing in important ways. It was recently estimated, for example, that 8-10% of the costs of new construction in San Mateo California could be attributed to the lengthy and costly permitting process. Ineffective control of externalities uses up real resources and makes people worse off.

Administrative delays in housing production by government also foster monopoly supply. Builders with permission to construct can charge higher prices since the permit process shields them from competitive pressure.

These general exhortations to housing policy are somewhat different from the traditional and complicated rationals for housing policy in the postwar period. One: increase the effective demand, as far as possible, of those whom government policy will subsidize. Two: use regulation and planning to get the market signals right and to force suppliers to face efficient prices. Neither of these would be easy to achieve from first principles. Given entrenched interests served currently the problem of politics is doubly hard.

If housing policy is to serve the broader economic interests of lower income households, and higher income households as well, the efficiency costs of various policies need to be calculated. This is not a less challenging role for housing policy, but one whose principles can be succinctly stated: Subsidize low income demand directly; don't reduce
economic income and output by subsidizing higher income demand; use planning and regulation to promote efficiency in the production and distribution of housing. Non governmental, non subsidized entities, private firms, and cooperatives can do just fine in this environment.