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The American Worker Project

Housing and the American worker

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As the *American Worker Project* analysis shows, real wages have increased over time. Real wages are nominal wages corrected for changes in the price level, and a natural approach to understanding the way in which housing policy affects real wages is through (housing) prices.

But the importance of housing to the economic well-being of the typical American worker extends well beyond its immediate role in household budgets. Housing and housing policy can play important roles in shaping the spatial distribution of economic activity, in driving household formation decisions, and in structuring policymaking in areas from education to immigration.

Unfortunately, decades of disastrous housing policy have produced egregious outcomes that reverberate through the economy. While technocratic solutions certainly exist, tricky political economy challenges remain.

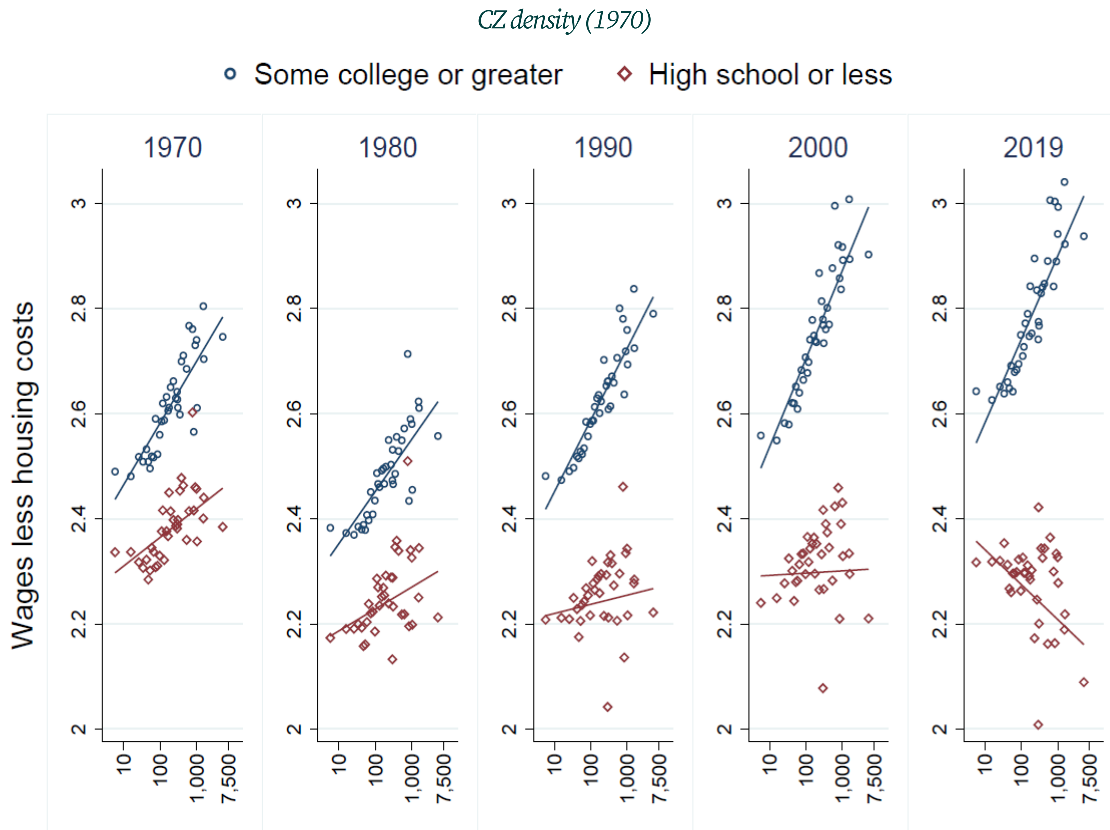
The problem

To set the stage, let us inspect the figure below, taken from a recent paper by Philip Hoxie, Danny Shoag, and me. It shows the evolution over the past half century of hourly wages net of spending on housing. The figure consists of five snapshots, roughly a decade apart. Each snapshot shows the relationship between population density in 1970 and “net” hourly wages for workers with and without (some) college education. Wages are net wages in the sense that we subtract hourly housing costs.[1]

If we look at the snapshot for 1970, we immediately observe what is often referred to as “the urban wage premium”. Wages, even after accounting for the cost of housing, were dramatically higher in high-density places than in low-density areas. This was the case for both workers with at least some college education (blue line and dots) and those without (red line and diamonds). Note that the scale for the vertical axis here is logarithmic: an increase from 2.5 to 2.8 corresponds to an increase of about 35 percent in dollar terms.

As we move toward the present, this pattern gradually shifts. While college workers continue to earn a significant urban wage premium, even after housing is taken into account, that is not the case for those with a high school degree or less. The red line is practically flat by 2000 and turns starkly negative by the time we get to 2019.

Figure 1: Wages less housing costs by skill group and commuting-zone population density



Source: Hoxie, Shoag, and Veuger (2023). Hourly wages are expressed in 2000 USD terms using the PCEPI.

These broad patterns are key to understanding housing in America in recent decades. They are very robust—they do not depend on the specific assumptions used in this figure. The results are broadly similar if we rank community zones by their productivity, if we focus only on households with two-bedroom dwellings or assign everyone a two-bedroom dwelling, if we classify households by income instead of education, etcetera.

And they are very important for policymakers: America's densest cities remain its most productive places, but increasing numbers of Americans are either excluded from them or punished for living there. This is particularly true for lower-skilled workers, and for the highest-productivity places.

A counterpart to this development is that lower-skilled workers are increasingly concentrated, and in fact better off at least in the short run, in low-productivity places. Empirically, this is in fact reflected in the decreasing presence of cross-state migrants in the highest-productivity places. Perhaps surprisingly, even cross-state migrants with a college education have become less common in these places.

Note that this does not necessarily, or at all, mean that places with lower housing costs do not have their own housing-related problems. While some places have produced ample housing to accommodate rapid growth, there is a different set of places that are simply in decline. Negative demand shocks lead to population losses, especially of the most productive workers. As Edward Glaeser and Joseph Gyourko explain in their 2005 paper,

the housing stock is durable, which means it is prices, not quantities, that adjust in response. A low cost of living combined with public services of reduced quality attracts low-productivity workers, and social distress ensues.

The causes

The main reason why so many workers are now excluded from America's most productive places is relatively clear, which is potentially helpful but certainly frustrating. For decades, local governments all over the country have restricted the housing supply, including in many of the highest-productivity places.

These restrictions come in many forms. They can be explicit controls on density, such as minimum lot sizes and bans on multifamily housing. They can complicate the development process by giving politicians and community members the opportunity to weigh in on minute details. They can involve lengthy time periods to issue even routine permits. They can constitute restrictions on all aspects of building design and, through so-called affordable-housing or inclusive-zoning requirements, on the prices at which housing can be sold or leased.

The seminal reference demonstrating that these restrictions on land use drive up home prices not just in theory, but also in practice, is a 2017 paper by economists Peter Ganong and Daniel Shoag. They proceed in various steps. First, they link various measures of the stringency of land use restrictions to the elasticity of the housing supply with respect to housing prices. By doing so they demonstrate that more restrictive land use policy blunts the responsiveness of new housing production to price increases. Such restrictive policy has been particularly common in high-income parts of the country. As a result, home prices can get bid up in higher-income places without triggering a supply response. This is particularly problematic for lower-income households, who spend a larger portion of their budget on housing and are therefore more likely to be excluded from high-productivity places.

Now, one may wonder what has in turn driven the increase in land use restrictions, especially in high-productivity regions. This is less immediately obvious. The leading theory, most closely associated with William Fischel (whose book *Zoning Rules! The Economics of Land Use Regulation* is a must-read), is that local homeowners use the political process to restrict land use. They do so to protect the value of their homes, which are typically a major, illiquid, and undiversified asset for them.

We saw earlier that land use restrictions increase home prices by letting incomes be capitalized into home prices, as buyers bid up the prices of a small number of desirable homes. Restrictive zoning that makes neighborhoods relatively homogenous has another benefit for the owners of expensive residential real estate. To the extent that local publicly provided goods and services are funded with locally collected property taxes, such land use restrictions prevent freeriding. Finally, land use restrictions can simply keep out various disamenities that reduce property values through their mere presence.

Interestingly, not that long ago the conventional wisdom surrounding urban development was a very different one. Sociologists, in particular Harvey Molotch, had conceptualized cities as "growth machines" controlled by landowning elites in a relentless competition to attract economic activity. It is worth quoting from Molotch's 1976 paper at some length:

“I speculate that the political and economic essence of virtually any given locality, in the present American context, is growth. I further argue that the desire for growth provides the key operative motivation toward consensus for members of politically mobilized local elites, however split they might be on other issues, and that a common interest in growth is the overriding commonality among important people in a given locale—at least insofar as they have any important local goals at all. Further, this growth imperative is the most important constraint upon available options for local initiative in social and economic reform. It is thus that I argue that the very essence of a locality is its operation as a growth machine”.

If only we could be so lucky.

The consequences

The scale and scope of the negative consequences of these developments are significant. Not only do they raise the cost of living for working families, but as we saw earlier they have changed the relative wage premium from living in high-density areas, especially for lower-skilled workers. Ganong and Shoag emphasize a related consequence: Lower-income states have become less likely to catch up with higher-income states as poor residents no longer migrate from the former to the latter. When poor residents move from a poor region to a rich region, they raise incomes in the former and lower them in the latter through a straightforward compositional effect.

But there is more at stake here. The residents of the poor region—or perhaps their children—are likely to be more productive in their new, high-productivity place of residence. High-density places are essential to the creation of agglomeration economies, especially in the many industries where remote work is at best an imperfect replacement for in-person interactions. The benefits of agglomeration include more specialization through the division of labor, increased supply of specialized services, deeper labor markets, and protection from idiosyncratic shocks.

The solutions

How then can we reignite the urban growth machine? In a narrow, technocratic sense the solution is straightforward: to loosen some of the restrictions that have gradually accumulated on land use over the past few decades. While the so-called YIMBY movement has made real progress on this front in some parts of the country, the politics remain tricky. The aggregate picture does not look pretty as a result, whether one looks at households as we did earlier, or at measures of land use restrictions.

Results from the surveys underpinning the Wharton Residential Land Use Regulation index suggest that land use restrictions only grew tighter between 2006 and 2018. In fact, economists Joseph Gyourko, Jonathan S. Hartley, and Jacob Krimmel claim that at the metropolitan area level, “there is no case of a highly regulated market as of 2006 becoming substantially (or even modestly) less regulated over time”.

A major obstacle to more significant reform remains the political economy of housing policy. Home voters still worry about the impact on property prices of new housing and are therefore motivated to oppose many of the proposed reforms. It is therefore of the utmost importance that housing reformers design policy solutions that are compatible with the incentives facing homeowners.

Broadly speaking, that means policy changes should not have an unnecessarily large negative impact on the prices of concentrated sets of properties. I see two key considerations here.

First, make sure to upzone generally instead of selectively: High-density construction is significantly more attractive to nearby homeowners if they are free to develop their own land as well. We see the success of this approach reflected in the political success of moves to legalize the construction of accessory dwelling units.

Second, do not make mixed-income neighborhoods the enemy of high-density neighborhoods. As explained earlier, high-income households and the owners of expensive homes incur a fiscal cost when cheaper homes are added to a neighborhood, as lower-income neighbors will to some extent freeride on public services financed through income and property taxes. Policymakers need to accept that increased density in and new construction of homogeneous neighborhoods add to the housing supply just like any other form of construction does, and that they drive down the cost of shelter in the aggregate.

A key takeaway from these principles is that focusing on adding so-called affordable housing is a dangerous temptation. Affordability requirements, like other price controls, make development less attractive to the private sector. To compensate for that, local governments will sometimes waive certain land use restrictions or provide other subsidies to developers. But that does not take the first consideration presented earlier into account: Nearby residents do not benefit from the loosening of land use restrictions along those lines and as a result have no monetary incentive to embrace the new development. In addition, to the second consideration above, affordability requirements by their nature impose fiscal and other externalities on incumbent homeowners and will trigger opposition as a consequence.

Some forms of affordability requirements are of course less harmful than others. The most cynical form—requirements that effectively make any new development unprofitable—exists simply to disincentivize new development while sounding like one is deeply concerned about housing costs. Another common form—requirements that certain units within a building be rented out or sold below market price—is an entirely misguided form of redistribution from the developer and a small number of residents to a small number of low-income households. There is no good justification to do income redistribution at that scale instead of through the tax code or other broad-based federal or state programs.

Loosening land use restrictions in the highest-priced housing markets does not solve the problems faced by regions that have lost population or continue to do so. But housing policy alone is not the most appropriate tool for addressing those problems. Facilitating remote work, or designing new immigration policies that give people who would otherwise not have a legal pathway to U.S. residence the chance to live in these areas, are more promising options for those parts of the country.

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Explore the Economic Innovation Group's American Worker Project here.

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[1] We scale income and housing to be hourly by dividing them by 48 weeks worked and 40 hours of work per week.