A Study on the U.S. Housing Market and How to Fix It

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Abstract. What's wrong with the housing market depends on who you ask. In order to answer such a general question, all stakeholders, and their interests, must be considered. The principal stakeholders of the housing market include homeowners, renters, real estate developers, and the un-housed.

Keywords: housing market, stakeholders, homeowners, rental price.

1. Introduction

Homeowners have contradictory interests when it comes to the housing market. On the one hand, homeowners benefit from increases in the price of housing. For homeowners who rent out properties (landlords), increases in rental prices mean more income. Increases in the price of the property itself mean they can sell their properties at a profit. On the other hand, increasing property values can lead to an increased proportion of the population being unable to afford to own or rent a home. Homelessness poses problems to nearby homeowners. The un-housed may commit crimes in desperation. The lack of medical and sanitary facilities can also cause public health problems that spread from the un-housed to local residents.

Renters and the un-housed have more coherent interests regarding housing. Both groups benefit from decreases in rental and property prices. Lower prices would save renters money and make it easier for them to purchase their own properties. Lower prices would likewise make it easier for the un-housed to secure housing.

Lastly, real estate developers are driven by a profit motive that depends on housing prices increasing. In order to make a profit in the real estate industry, developers must sell properties for more than it cost to buy the land and develop it.

Ultimately, the principal stakeholders of the housing market have competing, and in one case self-contradictory, interests. In order to assess what's wrong with the housing market, and propose solutions, I will use a utilitarian approach. In other words, I will investigate how the housing market could maximize utility for the greatest number of stakeholders.

For the remainder of this paper, I will argue that the vast majority of people would be much better off with affordable housing, while a small minority of developers and homeowners would be better off with prices increasing. I will do so by showing why it's detrimental to treat houses as a speculative asset, rather than a necessity for all citizens. In addition, I will explain providing more public housing is the best way to fix the housing market.

2. Speculation on Housing

The housing market is an abstract concept. It refers to the system in which buyers and renters come together with sellers and landlords to negotiate the price of renting or purchasing homes. The demand for housing refers to the quantity of residences that buyers (and renters) are willing to purchase (and rent) at a given price. The supply of housing refers to the quantity of residences homeowners are willing to sell or rent out at a given price.

From the neoclassical school to the Marxian school, nearly all economists agree that people selling or renting out homes are driven by the desire to profit from those sales. In theory, a perfectly competitive market would yield a price that satisfies both buyers and sellers. I contend that the housing market is not only not perfectively competitive, but that sellers have much too much market power. As a result, a small number of homeowners have used various tactics to push up the price of housing to a level that harms the majority of stakeholders.

Ideally, a housing market should follow the model of monopolistic competition. Unlike a perfectly competitive market, this type of market structure involves many different buyers and sellers coming together to negotiate the price of varied products. Residences are, and should be, varied. Some people prefer living in small apartments, while others prefer living in farmhouses or mansions. Some people prefer living close to the city center, while others prefer living in the countryside. Houses all have different layouts, features, and styles to match different consumer preferences. Accordingly, there will not be a single market price as there would be for roughly identical products seen in perfectly competitive markets, such as raw wheat or palm oil. In addition to having similar, but not identical products, the monopolistic competition market structure ideally has many sellers who have a relatively low degree of market power, meaning they set prices but respond to competition amongst other sellers [1]. In theory, economic profit for sellers should be positive, but approach zero in the long run because demand is heavily elastic.

There are two problems occurring in the housing market that have made it less competitive, thereby leading sellers to have too much market power. First, income and wealth inequality in many countries has given a small minority of firms and individuals the power to buy up real estate. This process has enabled this group of homeowners to act more like a cartel than competitive price makers. Although not coordinating directly like a cartel, these economic actors have the ability to raise rents and housing prices beyond a socially beneficial equilibrium. What I mean by this is that in a more competitive market, a firm that raises the price of a product too much will lose out to competitors. Those competitors would have an incentive to offload their products at a lower price in order to maximize profits. If income and wealth disparities were not so extreme, home ownership would be more common amongst people and therefore more decentralized, and this competition would exist to bring prices back to a more socially beneficial equilibrium. In reality, however, the small minority of homeowners have the ability to forego selling or renting out housing until they can secure a higher price. Overall, this lack of competition has led to many homeowners treating housing more as a speculative asset than the necessity that it is.

The second problem that has made the housing market less competitive is that the elasticity for the demand for housing is inelastic for low income individuals. Many people’s demand for housing is sensitive to changes in the price. However, that is not the case for the least wealthy. Housing is an absolute necessity and therefore people will be willing to spend nearly any percentage of their income in order to purchase at least some form of shelter. As a result, sellers have no incentive to sell at low prices. This compounds the problem of the housing market, its lack of competition, which drives up prices to a level that is not socially beneficial.

As previously mentioned, consistent increases in the real costs of housing is bad for the majority of stakeholders. First, it is monumentally harmful to the 0.2% of Americans who are homeless because they cannot afford the cost of housing [2]. The problem of homelessness also extends to local residents near homeless populations, who are exposed to crimes of desperation as well as public health crises. For example, the lack of public toilets and medical care in Los Angeles has led to a resurgence of diseases not commonly seen for hundreds of years amongst the un-housed, which can easily spread to nearby residents [3].

Secondly, it is harmful to renters who want to become homeowners, but cannot afford it. 36% of Americans rent their home and, although many may prefer the freedom of renting rather than own a home, there are many disadvantages to renting. For example, the total costs of rent can often exceed what would be spent on a mortgage [4]. Yet, many of these renters get stuck paying more without the benefits of ownership because banks will not approve them mortgages. Another reason renters are disadvantaged is because they lack the wealth derived from owning property. Whereas homeowners can sell their house, renters have nothing physical to show for their rental costs.

Lastly, the lack of competition in the housing market leads to asset bubbles that have the potential to hurt homeowners and developers. By using their market power to inflate the cost of housing, homeowners and developers make the housing market unstable. The 2008 financial crisis was largely caused by a housing bubble in which prices rose until it hit a breaking point. Although part of that crisis was caused by new homeowners being unable to pay off their subprime mortgages, it was also driven by individuals and firms buying up multiple houses to flip. This process of flipping houses, in which people speculate on the value of properties going up, drove up prices until sellers ran out of buyers. At that breaking point, not only were banks hurt by borrowers being unable to make payments – these homeowners and developers trying to sell properties also ran out of people willing to purchase properties at such inflated rates. These bubbles, which emerge periodically due to the lack of competition in the housing market, seriously hurt developers and homeowners who invest in properties and then cannot sell them off at the high prices they expected [5].

3. The Need for Public Housing

As outlined above, the lack of competition in the housing market is the underlying cause of problems for homeowners, renters, real estate developers, and the un-housed. The best way to maximize utility for all of these stakeholders is for the government to provide more public housing.

The most obvious beneficiary of public housing is the un-housed. Homeless people are often made homeless because of the high costs of housing and the barriers to public housing. Governments should prioritize providing more cheap or free public housing and dropping the means testing and red tape required to live in public housing.

The un-housed are not the only beneficiaries of public housing, though. Vienna and Singapore provide two excellent models for public housing and demonstrate its positive impact. 60% of Vienna's residents live in subsidized apartments, including both city-owned apartments and limited profit housing associations [6]. According to sociologist Christoph Reinprecht, the Austrian approach to housing is that:

There is a general political consensus that society should be responsible for housing supply, and that housing is a basic human need that should not be subject to free market mechanisms [7].

Meanwhile, 82% of Singapore's residents live in government-built apartments and nine out of ten residents own these homes. [8] According to sociologists S. Vasoo and James Lee, while Vienna uses housing subsidies as a means to minimize wealth inequality, Singapore's approach was designed to promote economic growth in general [9].

4. Conclusions

Both of these models have shown that public housing does indeed promote economic growth for the entire economy, and also helps each group of stakeholders. As previously mentioned, homelessness is a drain on public resources because of the money spent on combatting crimes of desperation and public health problems caused by homelessness. Additionally, affordable housing options enable renters to spend a larger proportion of their income on products besides rent. The extra public and private money spent outside of the housing market can stimulate more productive parts of the economy, making it the best solution for all stakeholders.

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