Be careful when messing around with supply and demand

by Randy Bright http://www.tulsabeacon.com/?p=3087#more-3087

Bubba was a manager overseeing maintenance work on his city's sewers. The description of his oversight might have been a bit of a stretch, since most of what Bubba did on the job was walk around and look busy, while some other poor saps were down in the manholes doing the dirty work.

One day Bubba was walking from manhole to manhole, "inspecting" the work, and after making his rounds he sat down in the shade and lit up a cigar. After taking a few puffs, he thought it made for a better appearance to keep moving, so he began his rounds again. Stuffing his still-burning cigar deep into his cheek, he walked over to a nearby manhole.

This manhole was kind of deep, and kind of dark, so he leaned over to get a better look. Suddenly, there was a loud boom. Workers who were in the next manhole heard the noise and looked down the pipe, only to see a fireball hurtling down the pipe in their direction. In inspired panic, they scrambled out just in time to escape the explosion and to see several other manholes down the line blow their covers off.

Although Bubba's hair was singed off and his cartoon-like exploded-cigar appearance was a bit embarrassing, he was otherwise unhurt by the explosion.

Bubba, who took his supervisory role a bit too seriously, did something he should have known better than to do. Anyone with a lick of common sense would know better than to stick his face, complete with an ignition source, into a manhole full of methane. Bubba's arrogance led him to a life-altering experience. You can bet he never did that again.

The point of this story is when we mess around with the natural way of things, nature will always win, and one of those natural things is the simple law of supply and demand.

A lot of cities have been messing around with the law of supply and demand for the past thirty to forty years. But the housing bubble that occurred last year wasn't the first one. There have been several, one about every ten years beginning in the early 1980s, and each one has been more intense than the last.

A housing bubble can be described as an increase in the value of homes until some trigger causes the values to fall, but the values don't fall nearly as far as they had previously risen. The problem occurs when home values stay relatively high, but incomes fall far more than the home value rises. This becomes the classic "affordability" problem.

So if the law of supply and demand really works, why would not the lower demand (by people whose incomes have fallen) also cause prices to fall in proportion?

Randal O'Toole addresses this issue in a Policy Analysis paper entitled "How Urban Planners Caused the Housing Bubble", released on October 1 of this year by the Cato Institute. It is his contention that the root cause of the problem was not the Community Reinvestment Act, Fannie Mae or Freddie Mac (although all of those played a role). He makes a strong case that it was growth management policies leading to land shortages that have triggered all of the housing bubbles that have occurred since the early 1970s, when Los Angeles, San Diego, San Jose and San Francisco were among the first in the nation to impose urban-growth boundaries in an effort to curb and control growth. Much of the data that O'Toole presents shows a strong correlation between areas where growth management policies had been enacted and how severely the housing bubble affected those areas.

Correlation does not necessarily mean causation, and although the global warming crowd doesn't mind equating the two terms when it serves their purpose, the urban planning crowd will likely scream bloody murder over O'Toole's use of correlation to prove his point. Only in this case, the circumstantial evidence, or the correlation between growth management and housing bubbles, is a bit overwhelming to dismiss out of hand. O'Toole, as he always does, makes a very methodical presentation of many anecdotal and statistical examples to prove his theory to be correct.

He wrote, "Between 2000 and the bubble's peak, inflation-adjusted housing prices in California and Florida more than doubled, and since the peak they have fallen by 20 to 30 percent. In contrast, housing prices in Georgia and Texas grew by about 20 to 25 percent, and they haven't significantly declined. In other words, California and Florida housing bubbled, but Georgia and Texas did not…This suggests that local factors, not national policies, were a necessary condition for the housing bubbles where they took place…The most important factor…(is) a regulatory system known as growth management."

Like Bubba, Tulsa is about to get burned, that is unless we are smart enough not to impose growth management policies. I'll explain more next week.

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