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In the search for causes of the sharp increases in the price of new homes, one of the important but neglected factors surely is the rising array of government regulations facing land developers, homebuilders, financial institutions, and all others involved in the housing industry. To clear the air at the outset, this is not going to be an uncritical attack on all efforts of government to regulate the private sector. Rather, this will be an evaluation of the impacts of regulation on industry in general and on housing specifically. The evaluation will end with some suggestions for improving the status quo in business-government relations.

Lest I be misunderstood, let me state the obvious: government regulation often has yielded important benefits -- in terms of less pollution, fewer product hazards, reduced job discrimination, and other socially desirable objectives. It should also be realized that these government programs were established in response to rising public expectations about business performance. But the worthiness of these social objectives should not make the specific methods being used in attempting to achieve them totally immune from criticism. It is sad to see the almost instinctive negative and hostile reaction, especially on the part of some of the so-called Public Interest Groups, to anyone who even questions any of the specific means which are used for social regulation. I find it unfortunate to have to remind these enthusiasts that only in a totalitarian society does the end justify the means.

At first blush, government imposition of socially desirable requirements on business through the regulatory process appears to be an inexpensive way of achieving national objectives. This practice apparently costs the government little and represents no significant direct burden on the taxpayer. But the public does not escape paying the cost. Every time, for example, that the Environmental Protection Agency imposes a more costly (and perhaps less polluting) method of construction on any firm, the cost of the firm's product to the consumer will rise. Similar effects flow from the other regulatory efforts, including those involving product safety, job health, and equal employment (and credit) opportunity.

These higher prices, we need to come to recognize, represent the "hidden tax" of regulation which is shifted from the government to the consumer. It is not inevitable that every regulatory activity increase inflationary pressures. In those instances where regulation generates social benefits (such as a healthier and thus more productive work force) in excess of the social costs it imposes, inflationary pressures should be reduced. But if the costs are ignored and the focus of public policy is only on the benefits, it is almost inevitable that the regulation will be pushed beyond the point where the benefits equal the costs and to the zone of overregulation. Overregulation, to an economist, is not an emotional term, but merely the shorthand for situations where the costs imposed by regulation exceed the benefits from the regulation.

The basic point of this presentation is that the regulatory process should be revised so as to derive, at lower costs, much of the same benefits as are now achieved. But before we turn to the subject of change, let us first examine more closely the various economic effects of regulation.

The Range of Housing Regulation

Government regulation can increase the costs of new homes in many ways, driving up land and land development costs, increasing the number of expensive building code features to be incorporated, raising overhead expenses of real estate and financial institutions, and increasing financing costs due to project delays.

In recent years, there has been a rapid expansion of regulation affecting housing at all levels of government. Newer federal regulations of special significance cover a wide range. They include standards for water quality, pollution discharge, and dredge and fill operations; sanctions against localities that do not restrict developments in flood-prone areas; requirements for state and local governments to regulate activities which pollute the air; and regulations affecting closing and settlement procedures and the extension of mortgage credit.

Several states have extended their regulations affecting housing development. New types of rules include those governing building in "critical" areas such as wetlands, floodplains, and shorelands. States have also enacted measures to control erosion and stormwater runoff, to control water and air pollution, and to require environmental impact statements.

At the local level, the major change has been toward a fuller and more systematic use of traditional land use control techniques. These are often supplemented with such new departures as development timing and rate controls, higher contributions of land or facilities from developers to the local government, and special standards for marshes and floodplains. Moreover "growth management" has become fashionable in many expanding areas. Such limitations on the supply of developable land, no matter what their motivation, force up the price of land and of homes generally.

The Costs of Housing Regulation

There have been several important efforts to quantify the growing costs that result from the rising array of regulation of homebuilding and housing activities. A study in Colorado found that changing regulatory requirements and practices had added \$1,500 - \$2,000 to the cost of the typical new house built between 1970 and 1975. The added cost consisted of higher water and sewer tap fees, increased permit fees, greater school and park land dedication requirements, and new mandates for wider and thicker streets, fences, underground storm sewers, and environmental impact studies.

A study in St. Louis County, Missouri, of the increase in lot development and homebuilding costs during 1970-75 found that the expense of meeting new government requirements came to \$1,600 - \$2,500 for a typical 1600 square foot house on a 10,000 square foot lot. The new governmentally-imposed requirements included street lighting, greater collector street widths, higher permit and inspection fees, added features to electrical systems, and smoke detectors.

A study covering 21 residential development projects in the New Jersey Coastal Zone estimated the direct regulatory expenses for a single family house at \$1,600 during the period 1972-75. The costs covered some 38 separately required permits, including preliminary plat, performance improvement bond, sewer plan, tree removal permit, final plans review, road drainage permit, and coastal area facilities permit.

Several studies have examined the adverse impacts of overly stringent or outdated building codes. A study at Rutgers University developed estimates of such costs as somewhere between 5 and 10 percent of total unit costs. Yale University economists have done some interesting work on identifying the extent to which building codes serve as barriers to innovation. They point out that the "bewildering variation" in local regulations may bar potentially profitable innovations in some areas. This reduces the size of the market for technical change in the homebuilding industry, with a negative effect on the incentive of building materials suppliers to perform research and development in this field.

The federal government is beginning to get into the building standards area. The initial results are not promising. The new ruling on architectural glazing materials issued by the Consumer Product Safety Commission is estimated to cost an additional \$30 - \$50 per house. The average benefits are expected to be a small fraction of that amount.

More fragmentary, although intriguing, estimates are available of the indirect costs of regulation to the home buyer. Giving borrowers the booklet required by the Real Estate Settlement Procedures Act costs about 35 cents. Completing the forms required by Truth-in-Lending legislation may cost no more than "a few dollars." But the regulatory delays in carrying out a construction project may be far more costly. The National Association of Home Builders states that financing and carrying charges for homebuilding come to \$10 - \$18 a day per lot. Thus, using the \$10 figure, six months' delay comes to \$1,825 of additional costs for each new home.

I find particularly fascinating a recent newspaper article quoting the Undersecretary of the Department of Housing and Urban Development. The federal official recalled a conversation that he had with a county commissioner when he was a builder in Florida. The county commissioner was explaining his "pinball" technique for protecting the environment: "When a builder comes in with a certain project, I just bounce him around from one department to another."

The rising paperwork and ancillary requirements of government agencies inevitably produce a lengthening "regulatory lag," a delay that often runs into years and is a costly drain on the time and budgets of private managers as well as public officials. Ten years ago, the director of planning of the Irvine Company obtained in 90 days what was then called zoning for a typical residential development. A decade later, the company received what is now called an entitlement to build for one of its developments, but only following two years of intensive work by a specialized group within the company's planning department, aided by the public affairs staff.

The Need for Change

What can be done to improve the situation? Before we tackle that question, we all need to remind ourselves that important and positive benefits have resulted from many of the government's regulatory activities. We also must realize that these government activities were established in response to a surge of rising public expectations about corporate performance. Thus, reforming government regulation involves striking balances among many laudable objectives and is hardly a search for villains. Indeed, the magnitude of the unresolved problems in the regulatory area requires efforts by government, business, academic researchers, the various interest groups, and the media. Here are some of those tasks, at least as I see them:

1. Role of Government. The basic task of government in the regulatory reform area is not to be preoccupied with either technical measurements of benefits and costs or administrative procedures, although good can be achieved by some sensible changes. But more fundamentally, the government leadership -- at federal, state, and local levels -- needs to take a dramatically different view of the regulatory mechanism than

they now do. Rather than relying on regulation to control in detail every facet of private behavior, the regulatory device needs to be seen as a very powerful tool to be used reluctantly, and with great care and discretion. A good deal of judgment is required in sorting out the hazards that it is important to regulate from the kinds of lesser hazards that, in Charles J. Schultze's terms, can best be dealt with by "the normal prudence of consumers, workers, and business firms." When the device of regulation is relied upon, the emphasis should be placed on identifying the least costly and most effective means of achieving social objectives. To state what is obvious to an economist but so often ignored in more popular discussions, you do not protect the consumer by punishing business.

2. Role of Business. The basic task of conducting business successfully in a regulated environment is extremely difficult. On the one hand, business firms need to respond to the rising public expectations for producing safe products in a healthy work environment, free of discrimination. To the extent that businesses increasingly respond voluntarily -- and a great many already do -- the pressures for government intervention may subside. Yet, I do not advocate a passive role of automatically agreeing to every demand on the part of each interest group, public or private. Those demands that do not make sense should be opposed -- lawfully and strongly -- and where appropriate more sensible alternatives developed and presented. Rather than vague speechifying on the evils of big government or the glories of the free enterprise system, business needs to concentrate its efforts on more effectively communicating the specific impacts of regulation on its production, sales, employment, and prices.

3. Role of Interest Groups. A little humility might go a long way in reducing the shrillness of many of the representatives of the so-called Public Interest Groups. It is no simple task to identify the public interest in any specific issue of public policy. As a sometime participant in government policymaking, it is apparent to me that good policy consists of properly balancing and reconciling a variety of bona fide interests. This is far more difficult than merely choosing in a simple-minded fashion between "public" or "consumer" interests (which are presumably good and to be endorsed) and "special" interests, which are presumably evil and to be opposed. To quote Allen Ferguson, the head of the Public Interest Economics Foundation, "There is an appalling lack of information as to the nature of economics and the economy among some of the public interest leadership. There is some failure to recognize that economic considerations are important in issues of most concern to much of the public in each community." That is a model of tactful and diplomatic understatement.

4. Role of Academic Research. Unfortunately, there seems to be a parallel between generals fighting the last war and academics researching issues of public policy. Whether I speak to business executives, labor union representatives, public interest groups, or government officials, I find that their key concerns with government regulation of business relate to the newer cross-industry type of regulation, typified by EPA, OSHA, EEOC, ERISA, and CPSC and their counterparts at state, county, and municipal levels. Yet my academic brethren still seem preoccupied with railroads, television, and airlines.

My point is not that the ICC, FCC, or CAB do not deserve professional attention. Rather, academic literature and teaching need to take fuller account of the basic expansion in the scope and character of government regulation of business which has been occurring in the past decade. The expansion in regulation -- whether measured by the size of regulatory budgets or in numbers of rules -- by and large is in these newer areas. The prevailing theories and models of regulation need to be reworked to take account of the revised institutional structure. Whether the railroads and their unions "capture" the Interstate Commerce Commission is a far more trivial concern than understanding the full range of impacts of environmental, safety, and employment regulation. That improved understanding is essential for developing support for reducing the many adverse side effects of regulation that we have been discussing -- higher costs, loss of jobs, reduced productivity and capital formation, and a slower rate of innovation of new and better products.

5. The Role of the Media. Fundamental improvements in the regulatory system will not come about until the public demands become strong enough to force the subject on to the legislative agendas. This will require communicating to the public a far greater understanding of the actual operations of the entire gamut of government regulation. Stereotypes need to be avoided. Indeed, reality is extremely complex. That is, neither business nor labor nor consumer groups are consistently on one side of the regulatory reform issue.

For example, business firms and labor unions in a given regulated industry often become strong supporters of the traditional industry-oriented commission which they have learned to live with, if not to dominate. They may join ranks to oppose efforts by consumer groups and academics to cut back on the extent of the "protective" regulation. In contrast, consumer groups advocate expanding the newer types of cross-industry regulation. They often are joined by labor groups, particularly in the occupational health area. Here, reform efforts are led by business groups and academics. These alliances shift from time to time. Specific regulations affecting homebuilders may be opposed by unions and companies in the construction industry -- although the two groups may differ strongly on job safety standards. The older consumer organizations are becoming concerned with the ultimate cost to the consumer of government rules. The newer consumer groups still emphasize public control over business.

In contrast to a widely held viewpoint, in my own experience I have yet to come across the business executive who enjoys polluting the environment or producing unsafe products. What I have found is honest disagreement as to the most sensible ways in which to proceed in attempting to attain the nation's social objectives. A better understanding of the complicated reality surely needs to be communicated to the public and to government decision makers.

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This is an ambitious agenda for public and private action. But I have encountered no "quick fixes" that would cure all the shortcomings of the many efforts to regulate business. Perhaps recognition of that fact would set the stage for durable reforms of this aspect of business-government relations which has such vital impacts on the consumer.