What do Landlords Do? The Political Economy of Urban Real Estate

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1 Introduction

Today I'm going to talk about a particular problem that comes up more and more frequently in the modern literature on inequality: the housing question. Let me start first with the graph that started me down this surprisingly-gnarled path. Keep in mind that this will be the first of many graphs you'll see where something *mysterious and unknowable* happened between the late 70s and early 80s, generating an apparently structural shift in the distribution of wealth or income.

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This is a secondary result from Rognlie (2015). Rognlie was more interested in a technical point on diminishing returns to capital, *vis a vis* Piketty, but the evidence here, generated from the NIPA tables on income shares, is very interesting to me– when he decomposes the capital share of income for the United States into housing and non-housing components, he finds that a significant portion of the decline in labor's share of income can be explained by an increase in the share going to *housing* capital, rather than corporate capital, which remains relatively stagnant. There are some very glaring measurement issues, which I will get to later, but this serves well as a stylized fact to begin from. From here, the questions arise: are returns to housing, however broadly defined, eating into growth in the productive sector? This has obvious implications for the macroeconomic debates on inequality, but also for formalizing more specific, smaller-scale questions on housing.

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So the question is, why is the rent so damn high? Or to be more precise, why is the rent so high, and also why are housing costs increasing out of proportion of income growth? We can see on the slide that home-price-to-income ratios have increased dramatically over the past 30 years, and the change has been differential across metropolitan areas. I have not broken down housing rents, but I imagine that the story is the same there.

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So the macroeconomic picture of factor shares does not tell the whole story; we have to get examine the local, urban scale. The implications of differential housing costs are widespread; the work of Chetty and Derenoncourt show that mobility and returns to human capital are highly place-linked, and rapidly increasing housing costs can serve to lock disadvantaged populations out from high-mobility and high-productivity regions. The urban economics literature has dealt with this extensively, and the vast majority of work has been done in the neoclassical tradition that I'll call the Regulation View.

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This work is based entirely around the spatial equilibrium models first developed by Von Thunen. The biggest headliners of this view are Glaeser and Gyourko who, in several papers, investigate the relationship between regulation and housing prices and find strong correlations between restrictive building regulations, i.e., zoning, and what they term "excessive" housing price growth. Using the spatial equilibrium approach, they then attach a causal explanation to municipal zoning practices, arguing essentially that NIMBYism and state capture by property-owning residents is the driver of housing cost growth in highly productive regions. Hsieh and Moretti extend this approach, and use it to claim that building restrictions are responsible for a 30% contraction in potential growth over the past half-century.

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This argument has been generally accepted both within the discipline of urban economics and outside of it, especially in political circles– Jason Furman argued extensively for the rapid deregulation of local housing markets under the Obama administration. This also fits in relatively neatly with human capital accounts of regional growth and distribution.

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Ganong and Shoag, for example, attribute the decline in inter-city migration to increased housing costs, which leads to low-skilled workers being "trapped" in low-productivity cities that are being sorted increasingly by skill-biased technical change. Diamond (2016) showed that the income divergence between cities could be explained more and more through this type of regulation-driven skill sorting than the college wage premium.

Now, I don't doubt that there is some link between the regional regulatory environment and home prices and rents. I'd like to cast a little doubt, however, on the causal story that is being told by Glaeser and others.

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The root of my dispute lies at the spatial equilibrium foundation of their theoretical approach. In their seminal 2002 paper, Glaeser and Gyourko use the divergence between housing prices and construction costs to show that prices in certain markets are much higher than they "should" be. Under the perfect-competition assumptions of the spatial equilibrium model, this is perfectly valid; any distortions such that prices do not equal marginal costs would be the result of some sort of market failure or government intervention. However, it is not clear to me that that the construction industry can be called perfectly competitive, especially in densely-built areas that require more sophisticated construction tools and techniques. And it is *for sure* not clear to me that land markets can be called perfectly competitive, given the huge externalities involved with locating real estate near, for example, public amenities and infrastructure. Though this seems like a minor theoretical quibble, there are very real and distinct welfare and policy implications here– if this view of real estate and housing is correct, then Glaeser et. al. are also correct in arguing for the relaxation of building restrictions and the deregulation of the housing supply. If not, then deregulation of the housing supply will either do very little or have precisely the opposite of the intended effect.

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In addition, Knoll et al (2014) find that 87% of shifts in housing prices in the United States in the last century can be attributed to changes in the price of land. So it is again unclear whether we can attribute prices in excess of marginal costs solely to regulation or to something else. In fact, this theoretical approach deals pretty poorly with the question of land rents in general, treating it identically to capital income. Let's take a little bit of history of economic though. When John Bates Clark wrote *The Philosophy of Wealth* in 1886, the political milieu that he was in was arrayed against the rising Socialist movement in Europe and the Georgist movement in the United States, who opposed the classes of capitalists and landlords, respectively. He rolled returns to land ownership into general marginal returns to capital, and from that point on, land essentially disappeared from the production function despite having been an essential part of classical political economy, with its own economic and class dynamics. Land returned in a lobotomized form to urban economics as "distance," appearing largely as the effect of transportation costs on a Cartesian plane. This means that "landlords" as a class no longer exist except as a special case of capitalist, earning the marginal product on the land and structures that they own.

It is here that I think a fundamental intervention is in order– a re-spatialization of real estate markets in the vein of George and Marx. In national accounts, land and capital both count as wealth, but capital in the Marxian sense contributes to the expansion of value, while land rents are sinks of produced surplus value. Dymski and Harvey classify this as a form of fictitious capital, whose value depends on the future value of productive enterprises located on or near to it. The amount of rent accrued to the owners of real estate represents a division of the surplus product between corporate capital, landlords, and workers.

For example, consider a worker with a yearly income of $100,000. Of this, he pays $30,000 dollars towards rent. This $30,000 payment actually constitutes a transfer from the industrial capitalist to the landlord. Harvey (and Marx, and George) argues that the basis for this extraction of the surplus arises from the peculiar features of land ownership– namely that its non-reproducibility and the durability of structures added to the built environment give landlords monopoly pricing power over their particular piece of land. Now consider a relative decline in the productive capitalist sector, in whose interest it is to keep wages low– this leaves space for the class of landlords to capture greater and greater amounts of the surplus.

It is this theoretical that I want to develop. Harvey argues that this gives landlords monopoly power in the form of "class monopoly rents." The prediction that rent extraction is relatively higher for poorer renters has been born out by some empirical work, especially in Sociology. The hypothesis about speculator-developers remains to be convincingly argued, and this theoretical argument also requires a theory of the urban state. It is at this point that we intersect the mainstream literature, except from the opposite direction– in this case, restrictive zoning laws are *caused by* the increase in economic power of the landowning class, rather than a *cause of* them. This could be the result of, for example, increased monopolization of real estate firms in high-productivity areas. This argument of mine needs to be developed further by trying to figure out just what Karl Marx was talking about in Capital Vol. 3 with respect to ground rent and the transformation problem.

Finally, the ideas of Henry George, I think, are relevant. Leaving aside the idea of the land value tax, as well as the creepy moralizing around the nobility of wealth generated by work and work alone, he has several arguments relevant to the dynamics of landownership:

1. Once unowned land is occupied, economic rent becomes determined by *locational* advantage, i.e. through externalities. He was talking about agricultural land. My goal is to extend this to urban land as well. In the urban context, locational advantage derives from access to global networks, infrastructure, and human capital.
2. Most relevant to the questions of inter-regional inequality and growth is that as the productivity of a region increases, the ability of landlords to capture greater shares of the surplus increases. Likewise, as productivity declines during recessions, this power is weakened.

So in the end, I am left with several questions that I intend to answer.

1. What do landlords do? You'll notice I haven't actually answered this question…
2. How do I systematize this hybrid Georgist-Marxist view of the ownership of real estate? Can I extend this to cover large landowners and small landowners, who may have contradictory interests?
3. Perhaps the most important question is– is this a better account of the real estate sector than the mainstream one? Desmond and Wilmers bear out one of David Harvey's hypotheses on class monopoly rents– in Milwaukee, they find that landlords are able to exploit poorer renters much more effectively than richer renters. This is an analysis I could repeat elsewhere.

4. I don't yet have a coherent theory of the state, but since the state is the vital mechanism for class monopoly rents, this is something I definitely need to do more work on.
5. There is actually surprisingly little work in the Marxian economics tradition on ground rents in urban development, outside of critical geographic approaches. Does anyone know anything about this?
6. I don't know anything about finance. But the link between finance and housing is critical, especially with respect to crises.
7. What to do with the empirical approach? As I noted earlier, there are several very major problems with macroeconomic data on rents and housing. First of all, "returns to housing" as recorded in the NIPA tables and GDP figures includes capital gains from housing sales, as well as imputed rents. Imputed rents are hypothetical values that owner-occupiers pay to themselves for housing services. These are counted on the capital-income side but not on the labor-income side. In fact, as Stiglitz notes, there is no distinction between *productive capital* aggregates and *wealth aggregates* in the national accounts.
8. I have not talked about land speculation, but it is clear that land speculation is a very important function of property owners and developers.

Rognlie, Matthew. 2015. "Deciphering the Fall and Rise in the Net Capital Share: Accumulation or Scarcity?" *Brookings Papers on Economic Activity*, 1–54. https://www.jstor.org/stable/43684097.