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THE NEGATIVE IMPACT OF GOVERNMENTAL POLICIES ON THE BUILT ENVIRONMENT

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ABSTRACT

Governmental intervention into the economy has exacerbated the negative effects of the energy crisis on the built environment.

Examples considered include three explicit attempted ameliorations of the problem, and two programs originally intended for other purposes, but with harmful impacts on the built environment. These include:

I. construction insulation subsidies;
II. building codes requiring operating windows;
III. encouragement of solar, wind power;
IV. zoning legislation; and
V. rent control.

Facing the international economies in the 1980s is the problem of supplying adequate housing, at affordable prices. Skyrocketing oil costs, moreover, preclude energy-using or energy-intensive housing strategies on a large scale.

Given this difficult economic environment, governments the world over have enacted policies specifically aimed at the alleviation of the impact of the energy crisis on housing. These have included: I. subsidies for extra building insulation; II. requirements that (office) buildings be constructed with operating windows (to economize on air conditioning demands; III. encouragement for the creation of solar power and other alternative or "soft path" energy sources both in new construction and as additions to existing dwellings.

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In addition, governments have enacted legislation which while aimed at other social-economic objectives, have serious repercussions on the on the energy-built environment crisis. These include IV. zoning (which alters the locational settlement patterns, and has consequent implications for energy demands needed for office - home travel; and V. rent control (which discourages new residential rental unit construction, and speeds up the deterioration of older structures).

It shall be the thesis of this paper that these basically well intentioned programs

1) do not efficiently accomplish their own announced goals, and in many cases even retard their achievement;

2) have unintended and deleterious consequences on unrelated markets; and

3) that the price system, if allowed to operate, is tailor-made to coordinate the efforts of the economy to adjust to an increase in the relative prices of energy inputs.

I. There is no doubt that higher fuel costs lead to the type of housing construction which economizes on this particular expenditure. Such activity is indeed derivable from the basic axioms of economics. According to the law of downward sloping demand, as the price of heating oil rises, less of it will be demanded. And according to the law of substitution, if less fuel is purchased, other items will be bought instead, in an attempt to recoup lost utility. One of the ways of maintaining a given level of internal temperature with less fuel is install more building insulation. This is among the market's responses to an oil shortage. We can illustrate this with

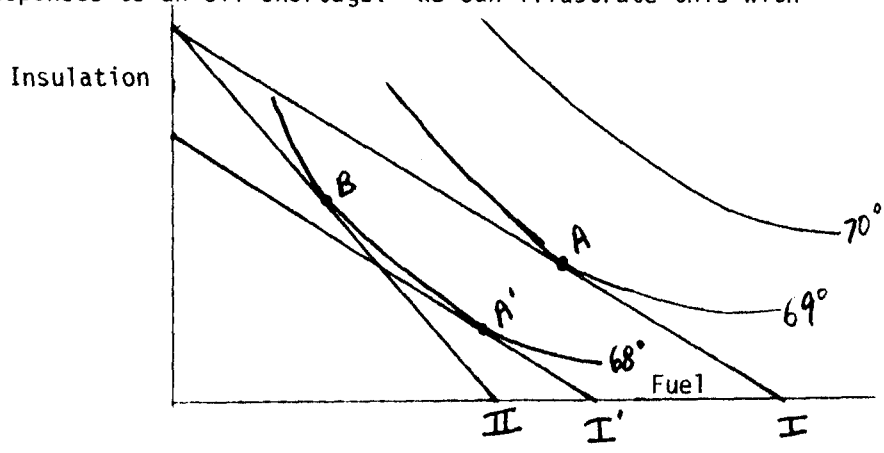

Diagram #1

an isoquant diagram, showing how various temperature outputs are related to building insulation and fuel inputs, holding constant all other determinants such as age and exterior construction of building, care in keeping windows and doors shut, efficiency of heating equipment etc. Starting off with the isocost line I, the consumer finds his optimal consumption point of A. When the relative price of fuel with respect to insulation rises (Budget line II), his equilibrium point shifts to B, a move, as can be expected, from the more

expensive to the less expensive input.[1]

The difficulty with a government subsidy of building insulation because of a rise in the relative price of fuel is that, as we have seen, each individual already has an incentive to economize on the now more expensive oil, and to substitute the proper construction materials in order to maintain temperature levels. If the government comes along with additional encouragement for this movement, it will lead to an overoptimal shift in this direction.

Nor is there much weight that can be given, in this case, to a possible counterargument based on monopoly or externalities, the usual justifications made for government interference with market allocation. For at the old resource allocation, the one predating the oil price rise (point A in diagram #1) there was never any justified criticism put forth on these grounds. To use the monopoly or externalities argument now, in defense of vetoing choices arrived at in the marketplace, would be to imply that these phenomena are relevant for a price change, but not to industries where prices are relatively stable. But no such argument has ever been offered in behalf of monopoly or externalities.[2]

II. A similar analysis applies to the builder's decision with regard to including operating windows in new construction. In favor of these old fashioned devices are the economies which can be attained in avoiding air conditioning expenses on days in which an open window will serve just as well. On the other side are ranged aesthetic considerations, and savings which can be effected at the time of the initial investment (glass walls have fewer moving parts and are thus cheaper to build, than walls with operating windows).

At the time before the OPEC-inspired quadrupling of oil prices, the non-windows option may have made better sense. But in an era of high energy costs, the fuel savings, because of lessened air conditioning usage throughout the entire life of the building, may outweigh the extra initial investment in windows. (All stocks and flows discounted by a suitable rate of interest.) It may even, in extreme cases, justify window installation after a building has been in operation.

The case for government non-interference in this decision is not that the private entrepreneur cannot make mistakes. From the ex ante vantage point

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[1] We assume all goods to be "normal", that is, to have positive income elasticities.

[2] If anything, the situation is the very opposite. Take the monopoly argument, for example. If the view that monopoly brings about inefficient resource allocation has any application at all, it is to the static model of reality where prices, among other things, do not change. It would not apply to the dynamic model with anything of the same force if at all. See, in this regard, Israel Kirzner, Competition & Entrepreneurship (Chicago: University of Chicago, 1973); Joseph A. Schumpeter, Capitalism, Socialism and Democracy (New York: Harper & Row, 1962); Murray N. Rothbard, Man, Economy and State (Los Angeles: Nash Publishing, 1970) chapter 10; Walter Block, "Austrian Monopoly Theory - A Critique", Journal of Libertarian Studies, Volume 1, Number 4 (1977).

of high fuel costs, the market's non-inclusion of windows in the cases of hundreds and even thousands of office and residential towers can be seen to be in error. Had these private investors been able to foretell the future in this regard, they would have gladly included windows in their buildings. Nor can it be denied that there are bureaucrats who might have been able to make better decisions -- even in the absence of any such advance knowledge.

The case for leaving control of the built environment in the hands of markets, not governments, is solely[3] that when the businessman makes an error, he loses financially, thereby, and if he chooses wrongly too often, or on large projects, he is forced into bankruptcy and must divert his energies into other areas.[4] This has a "chilling effect", to say the least, on the continuation of entrepreneurial error.

The contrast with the government sector is stark indeed. When the bureaucrat invests public funds ineffectively, or when the politician passes a law which creates large scale financial losses, no automatic feedback mechanism comes into play. Public decision makers risk the money of other people (taxpayers) and need not suffer any personal financial reverses as a result of error.

The conclusion of this section, then, is that despite the possibility of entrepreneurial error in building glass walled skyscrapers right before an era of high fuel prices, it would be unwise to substitute the judgment of the government which is artificially protected from market forces. There is always the distinct possibility that after compelling or subsidizing the inclusion of operating windows in new construction, a new era of low fuel prices may come along and upset present bureaucratic calculations. And if the present energy price trends continue, the entrepreneur is as fully capable as anyone else of judging the merits of operating windows -- and risks only his own money in his decision.[5]

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[3] We abstract, here, from the moral justifications for the operation of private property rights. See in this regard, Robert Nozick, Anarchy, State and Utopia (New York: Basic Books, 1974) and Murray N. Rothbard, For a New Liberty (New York: Macmillan, 1973).

[4] We abstract from cases such as the Lockheed or Chrysler bailouts, which of course are not examples of the operation of free markets. In such instances, consumer sovereignty has been abrogated. The market has rejected the products of these corporations, but this choice has been short-circuited by a government decision to force people to pay as taxpayers what they had refused to purchase as customers.

[5] To be sure, there are externality effects in this case, since some of the costs of operating an air conditioner spill over to third parties in the form of uncomfortable and unasked for extra heat. It might appear that this would give scope for government intervention -- for example, a special air conditioner tax. But the external diseconomy arises, here, because of incomplete specification of private property rights: the streets are unowned. This case is not one of "market failure", but one in which the competitive enterprise system has been precluded from operating. If metropolitan streets were allowed to be privately owned, there would be no heat spill over effects of air conditioning upon third parties. The external diseconomy effect would be banished in one fell swoop. The heat would pertain to second parties, the

III. The Three Mile Island scare and the jump in conventional fuel prices have led, not unexpectedly, to an increased interest in different sources of energy. These have included solar energy, windmills, wind power hydro-electric and tidal power, and the use of geothermal and organic alcohol fuels for electricity. Reliance on these so called "soft path" alternatives have been strongly urged by such public figures as Barry Commoner, Tom Hayden, Jane Fonda and Robert Redford. Unhappy, however, with the limited business interest in these alternatives, and not content to wait for the lure of the profit motive in developing them, these and other like minded people have instead advocated government subsidies for "soft path" energy sources.

But this strategy is sadly mistaken. For the reason businessmen have shown little interest in these "counter culture" sources has little to do with the operation of free markets. On the contrary, it is mainly because of government subsidies to other, competing energy supplies.[6] The Price-Anderson Act and the Atomic Energy Commission, for example, have given support to nuclear resources; billions of dollars from the public purse have been allotted to shale oil and synthetic fuel experiments.[7]

The Rural Electrification Administration, established in 1934, and the various state electrical rate structure laws, although not specifically created for this purpose, have also had a retardant effect on the "soft path" energy industry.[8] These policies were implemented in order to ensure "equal access" to electricity for customers at great distances from the source of supply even though it cost much more to service them. Rural inhabitants, in other words, were not asked to pay the full marginal costs of transporting electricity made necessary by their out-of-the-way location. Instead, they were subsidized, in part, through higher rates charged to those at closer, less costly places.

This had two adverse effects. One, people could ignore the costs of shipping electricity in their site location decision making, and were thus overly encouraged to settle in rural areas; and two, bankruptcy was imposed on

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street owners, and the usual law of contracts could be relied upon to settle matters; i.e. in the absence of overwhelming transactions costs, the street owner would impose a charge per air conditioner, (ideally, per unit of heat emitted by air conditioners on hot days) which would maximize his returns both from users of air conditioner units and passersby on the street below. The externality would be internalized, and we would be left with the usual situation of two different groups bidding against each other for the use of scarce resources (cold air) through the inter-mediation of an owner of the property rights in question.

[6] Battelle Memorial Institute, An Analysis of Federal Incentives Used to Stimulate Energy Production, U.S.

[7] M.L. Weidenbaum and R. Harnish, Government Credit Subsidies for Energy Development, American Enterprise Institute for Public Policy Research (1976)

[8] John Baden, "Subsidized Destruction of Alternative Energy," mimeo, Center for Political Economy and Natural Resources (October 1979); Richard Stroup and John Baden, Literature of Liberty, Volume II, No. 4 (1979), especially pp. 26-33.

the private windmill and solar power companies of the day which were already effectively competing with conventional energy supplies for rural customers. These early purveyors of "soft line" technology were driven out of competition by the subsidy program, even though they might well have been able to continue to supply their "ecologically sound" product in the free market in the absence of this misguided policy.[9] One of the great (although unmeasurable) losses arising out of this subsidy program are the more than 40 years of research and development that could have been invested in these alternative technologies, which we have lost for all of time.

IV. In the absence of zoning, the post-1973 price rise for motor vehicle gasoline and oil would have had great repercussions on the urban/rural settlement pattern. Since fuel is an important input in commuting, we could have expected rising prices in this sector to have reduced the demand for suburban and country living. And with fewer people in the country, and more in the city, and with an all around decrease in commuting distances, the society would have economized on this suddenly more expensive fuel supply.

But with zoning legislation in all major North American cities,[10] this process has been slowed down. It is impossible to determine the rate of retardation, since settlement patterns depend upon so many other factors as well, but building height limitations, minimum acreage requirements (for single family units), the prohibitions of multiple apartment residential units from many zones, etc. have all interfered with the orderly process of relocation.

And, although zoning programs have been launched with the best intentions in the world, they have numerous other flaws. Zoning is primarily intended to preclude the location of "incompatible uses" in close juxtaposition, e.g., pickle works and single family homes, chemical refineries and golf courses, glue factories and restaurants. Ignored, however, are marketplace mechanisms which effectively prohibit such occurrences: land values in attractive residential areas form a barrier against the incursion of lower valued uses such as factories, refineries, etc. And in the case of poorer residential areas, where high real estate prices cannot form an effective barrier against the incursion of commerce, there is evidence that the inhabitants look upon such mixed land uses as external economies, not diseconomies, because of the nearness of job opportunities.[11] The entrepreneur simply has no financial incentive to locate an automobile filling station and repair shop in a quiet residential neighborhood, or on a cul-de-sac. True, it might annoy the neighbors there, but it would be too far removed from the stream of traffic to be profitable.

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9 A paradox is that the liberals and leftists who now favor subsidies to solar, air and water power are the intellectual and spiritual descendants of those who favored REA-type subsidies which made impossible the private operation of these "soft path" technologies in the first place.

10 The honorable exception is Houston, Texas. See Land Use Without Zoning by Bernard H. Siegan (Lexington, Mass: D.C. Heath & Co., 1972); Walter Block, ed., Zoning: Its Costs and Relevance for the 1980s (Vancouver: Fraser Institute, 1980), especially "Houston: City Planning Without Zoning" written by Roscoe H. Jones, Director of City Planning, Houston, Texas.

11 Block, Zoning, pp. 47-48.

Zoning has failed, too, because it is simply impossible for a group of bureaucrats to sit down and plan the future organization of a large city better than the millions of people who make it up, and whose actions can be coordinated by the price system. For one thing, they cannot have as much information at their disposal. For another, their mistakes are not automatically penalized by the profit and loss system, as are those of the private real estate developer.

Evidence for this contention abounds in the numerous rezonings that are part and parcel of the ordinances of every large city with this program. If a small band of bureaucrats really could successfully plan for a wide-scale and long-term land use, it would not have to continually revise the "master plan"; it would not have to resort to documents which rival telephone books for size, scope and detail; it would not give rise to the speculation, bribery and profit which accompany every actual or potential change in the rules of the game.

V. Rent control is another popular program that has been enacted for benevolent reasons (to clamp a lid on the rents impoverished tenants may be called upon to pay). Yet it has had profound and negative implications on the built environment; it further exacerbates the energy crisis.[12] If its proponents had been forced to file "environmental impact statements" or "energy impact statements" of the sort imposed upon those opening new factories and mines, there is little doubt that such legislation would have stood convicted of despoiling the urban setting many years ago.

In freezing rents, or keeping them below the levels they would otherwise have reached, this program functions as a "skull and crossbones": it warns investors that residential rental units are no longer a safe haven for their funds, and thus diverts their capital, energy and talents to other fields.

Older rent controls applied to all residential housing: luxurious and deteriorated, large and small, built or unbuilt. Much to the dismay of the lawgivers, however, they would soon realize that while owners of existing housing might have been trapped in this field by their previous decisions, owners of money capital had no such disadvantage and were staying away, in droves, from this form of investment. So they would modify their rigid laws, and exempt new units from controls.

This exemption had some beneficial effects. Housing shortages (promulgated by the original rent control enactments) made new rental construction a profitable venture, and many new apartments were built. (Although the fear of later control imposition kept new building below levels which would otherwise had obtained in the complete absence of rent control.) But in many cities the high rents landlords were able to charge for these new units gave their tenants impetus to clamour for still additional controls -- on the very apartments which were supposedly to be free of controls forevermore. When politicians lacking in courage and vision gave in to these

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[12] Walter Block and Edgar O. Olsen, eds., Rent Control: Myths & Realities (Vancouver, B.C.: The Fraser Institute, 1980).

demands,[13] the cat was out of the bag. Landlords had been put on notice, once and for all, that new construction, although exempted from controls in order to encourage it to come into being in the first place, was always liable to control at a later date. From then on, the value of the exemption was discounted in the marketplace, and the possibility of new private rental accommodation construction took a further turn for the worse -- even under the "second generation", "sophisticated" rent controls, which specifically exempted new building.

But the negative and unintended side effects of rent controls are by no means limited to diverting liquid funds away from the residential rental sector. They include, as well, the following:

* An expropriation of one particular class, the landlords, supposedly for the benefit of poor tenants. But the basic philosophy of all western democracies is based on the principle that if any such income transfers are to be made to the poor, they should be on the account of the entire population, and not a burden on only one small group of people.

* The deterioration rate of older buildings rises, as landlord incentive to invest money in upkeep falls in proportion to the schedule of allowable rent increases. (Legal rent rises can never be as swift and sure as those that would prevail under free market conditions, otherwise effective rent control could not, by definition, exist.)

* Labor mobility falls, since the continued subsidy conferred by rent control applies only for so long as the tenant remains in his domicile; were he to move to another location where his productivity is higher, he would be forced to give up all these benefits. (It might be more efficient to vest rent control "rights" with the tenant by allowing him, perhaps, to sublet the apartment at a noncontrolled rent; the tenant would then have incentives to maintain the accommodation in good repair, and/or to vacate, should his circumstances change. But this would make so explicit and honest the expropriation of the original landlord that it has never been done.[14])

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[13] British rent control history is a case in point. Ever since World War I, there has been an on-again, off-again crazy quilt pattern of rent control coverage. The federal government of the United States has rescinded previous rent control exemptions in several southern States in the early 1950s, stemming out of housing shortages adjacent to military installations because of Korean War preparedness. (See Leo Grebler, "Implications on Rent Control," International Labor Review, April 1952, pp. 467-8.) Recontrol also occurred in New York City in 1969 with the advent of "rent stabilization" (a polite name for rent control) for post 1947 buildings, which were exempted from controls forevermore, in order to encourage new construction at that time. In Vancouver, B.C., the 1974 rent control law also exempted residential units built after that date; but at the time of this writing, "rent review" (another polite name for rent control) has passed third reading in the British Columbia legislature.

[14] Rent control in Hong Kong has come closest to this extreme, but has not fully approached it even in that case. See Steven Cheung, "Roofs or Stars: The Stated Intents and Actual Effects of a Rents Ordinance", 13 Economic Inquiry 1 (1975); idem, "Rent Control and Housing Reconstruction: The Postwar Experience of Prewar Premises in Hong Kong", The Journal of Law and

* Vacancy rates fall, in the first instance, because demand exceeds supply, the lower the rental level. Vancouver, British Columbia, for example, had a vacancy rate of 0.1% in April 1980. But after the deterioration effect has come into its own, decay, fires, abandonment, etc. raise it to horrendous levels. Certain sections of the Bronx, New York City, have vacancy rates as high as 22.8%, and the vacancy rate for the entire borough was 5.2% in 1978.[15]

* Racial and other forms of discrimination come to play a larger role in resource allocation when the price system is precluded from so doing. When a landlord faces a horde of tenants willing to occupy his premises, and is legally tied to a below-market-rent, he may pick a tenant on whatever basis he chooses. He can indulge his taste for discrimination, nepotism, etc. without fear of financial repercussions -- something denied to the entrepreneur in the free market.[16]

VI. We have seen that government programs such as rent control, zoning, subsidies, and building codes have had negative impacts on the built environment. At one time in our past, perhaps, the economy might have been strong enough to tolerate them without serious and obvious ill effects.

But in this era of inflationary recession, of ecological and environmental concerns, of an ever growing energy crisis, it is especially important to remove these needless and senseless burdens on the free market, so that private businessmen can get on with the job of producing their way out of our crisis. In this age of "less is more", it would be a terrible miscarriage of justice if this aphorism were not applied to misguided government intervention as well.

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[15] Peter Marcuse, "Rental Housing in the City of New York: Supply and Conditions 1975-1978", pp. 122, 125. See also "An Analysis and Evaluation of Rental Housing in the City of New York: Supply & Condition 1975-1978" by Walter Block, International Journal for Housing Science, Volume 4, Number 4, (August 1980, forthcoming).

[16] Walter Block, ed., Minority Rights & Wrongs: An Economic and Social Perspective on Discrimination and Equal Opportunity (Vancouver, B.C.: The Fraser Institute, forthcoming) especially the contributions of Thomas Sowell and Walter Williams.

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