Mobility Barriers and Public Policy

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Introduction

This paper discusses the relationship between the "barriers" concept in industrial organization and in the area of geographical mobility. It is argued that Demsetz's (1982) critique of the barriers literature has a wider relevance that is not generally understood. Two traditions now exist side by side. In the first, a barrier is a departure from an imaginary and frictionless situation (e.g., Lott 1986). In the second, a barrier is a departure from a desirable and attainable situation of optimal friction (e.g., Demsetz 1982). The former approach implies that the existence of a barrier can in itself have no particular policy significance. The latter is policy relevant, but the complexity of most situations, combined with the subjectivity of the costs and benefits associated with proposed changes, makes it impossible to construct measures of barriers that are noncontroversial.

The next two sections of this paper trace the development of these ideas in the literature on entry barriers and discuss their relevance to the case of geographical mobility. The dilemma implied by these two approaches to barriers is illustrated in the fourth section, by reference to the impact on mobility of housing policy, and in the fifth section, by other contractual provisions that have the effect of restricting mobility. The final section suggests that the dilemma is ultimately irresolvable and that the term "barrier" has similar qualities to other items of economic terminology such as "subsidy" and "rent seeking," over which there is similar disagreement for substantially similar reasons.

Barriers in Economics

Bain (1956) provides the traditional starting point for a discussion of barriers to entry in economics. Starting from the observation that

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in competitive conditions entry will occur until price is equal to the average cost of production, Bain concludes that the persistence of prices above this level indicates the existence of entry barriers. Translated to the analysis of geographical mobility, Bain's conclusion would imply that barriers could be detected by observing, if it were possible, the rent accruing to labor.

Thus, suppose that Southern laborers were offered terms of employment that were much more favorable than those required to compensate Northern laborers for the marginal effort expended. Migration (i.e., entry) would be expected to compete away some of the rent accruing to Southern labor as "net advantages" were equalized between North and South. The persistence of differential returns to labor would then indicate a barrier. Because the relevant returns are not merely pecuniary but also include other highly subjective components of Adam Smith's "net advantages," we cannot infer the existence of barriers simply by observing wage differentials. But where physical restrictions on movement exist, queues of potential emigrants would be a measure of the size of mobility barriers.

Stigler (1968, p. 67) defines a barrier to entry as "a cost of producing . . . which must be borne by a firm which seeks to enter an industry but is not borne by firms already in the industry." If instead of the new entrant we substitute the migrant, and instead of incumbent firms we think in terms of existing residents of an area, Stigler's definition of a barrier might be interpreted as including all the costs of physical movement such as transport, insurance, and search; the costs of buying and selling residential property; and so forth.

In the industrial organization literature, both Bain's and Stigler's approaches can lead to different conclusions about the sources of entry barriers. Economies of scale, for example, may constitute a barrier for Bain but never for Stigler, providing new entrants have access to the same technology as incumbents. In the field of geographical mobility, the two approaches are mutually compatible with Bain concentrating on the *effects* and Stigler on the *sources* of barriers. If migrants faced zero costs of change, no mobility barriers in the sense of Bain could persist.

Consider now the case of a local jurisdiction that decrees that everyone living in it should inhabit a house larger than a certain size and designed to a given set of specifications. Would such regulations constitute a mobility barrier? Given that the rules were to apply to established residents as well as to potential migrants, there would appear to be no barrier as defined by Stigler. Neither, in a world in which people could move costlessly, could the net advantages of living in the jurisdiction be greater than living elsewhere; thus, no

barrier would exist as defined by Bain. Clearly such regulations *would* affect the geographical distribution of the population, however. Certain (probably poorer) people who might otherwise have moved to the area will not be able to do so. Whether they can be said to face a barrier in the form of the local ordinances will depend on opinions concerning the desirability of the regulations. This criticism is essentially the one that Demsetz (1982) levels at the use of the term "barriers" in economics. By concentrating on the distinction between insiders and outsiders, Bain and Stigler "divert attention from other types of barriers" and "hide the value judgements implicit in the barriers notion" (Demsetz 1982, p. 48).

Although Demsetz does not provide a clear definition of a barrier, his approach clearly focuses on property rights. All systems of property rights imply barriers to entry: "The problem of defining ownership is precisely that of creating properly scaled legal barriers to entry" (Demsetz 1982, p. 19). Because there is a cost of transacting in property rights, social outcomes will be affected by how they are defined and allocated. A patent system, for example, may imply a barrier to the production of various goods, but the absence of a patent system would be a barrier to the introduction and discovery of new ones. Communal fishing rights imply a low barrier to entry into fishing but a high barrier to fish conservation. The licensing of taxis may be an entry barrier even when the licenses are tradable, but licensing might also be regarded as a barrier to unsafe, low-quality service.

From the point of view of public policy, the issue is whether existing property rights allocations are producing results that might be improved upon by some alternative system of barriers. Because the specification of a better alternative framework of property rights requires both clear predictions about the consequences of this postulated alternative state of affairs and a means of ranking one social state relative to another (i.e., a social welfare function), agreement about barriers is extremely difficult to achieve. Demsetz (1982, pp. 56–57) observes that the process of devising a framework of barriers is "rich in intuition and faith, and poor in discernible measurements. . . . Our utterances in this regard may be accorded the skepticism appropriate to fairly unadorned opinion."

In a series of papers, Lott (1986, 1987a, 1987b) has investigated the nature of barriers to entry and discussed their effects on the operation of political markets. Lott concentrates entirely on the question of the *transferability* of property rights. Barriers, he argues, exist when property rights are not tradable. For example, if barbers were licensed and if trade in the restricted number of licenses were not

permitted, a barber would continue to ply his trade, providing the return were sufficient to compensate him for the costs and effort involved. The existence of more efficient aspiring young barbers anxious to take his place would not affect the existing barber's retirement decision. With tradability, however, new and more efficient barbers can bribe the existing ones to sell their licenses at prices that leave both parties better off than they would have been in the absence of tradability. In other words, the absence of tradability creates a barrier to entry, mobility is inhibited, and an efficiency loss is added to the traditional loss associated with restriction of output equal to the difference in costs between existing and aspiring barbers. Similarly, Lott argues that because political reputations are person-specific and cannot be traded, new entrants into politics face a barrier, and incumbent politicians remain in office longer than would otherwise be the case.

Lott's approach is easily applicable to geographical mobility. Restrictions on the right to trade location-specific rights would constitute mobility barriers. Thus, suppose that I have a right to use a certain asset that cannot be moved from a given location. If I am not permitted to trade my rights in this asset, any decision to move will involve my sacrificing the present value of the flow of benefits derivable from the use of the asset. Clearly, I am less likely to move in these circumstances than I would be if I could sell my rights to this asset on the open market. The most celebrated example of this principle in action is the observed relative immobility of people with rights to use housing at below-market rents (e.g., Hughes and McCormick 1981).[1]

Transactions Costs and Mobility Barriers

Although there is no single definition of a "barrier" in the economics literature that commands universal assent, each approach mentioned in the previous section is related to the existence of transactions costs. Consider a world in which all property rights are exchangeable and the transactions costs associated with exchange are zero. Clearly, there are no mobility barriers in the sense of either Bain, Stigler, Demsetz, or Lott. In this frictionless world, all rents accruing to the inhabitants of an area would be instantly competed away by new entry. Insiders and outsiders would face the same cost

[1]Brittan (1977) was the first to argue that tenants in the public sector should be free to trade occupation rights as a solution to the mobility problem there. For the private sector, Ricketts (1986) puts the case for tradability of occupation rights as part of the process of deregulation.

conditions. If we invoke the so-called "Coase theorem," the final allocation of resources would be efficient, irrespective of the initial rights assignment (see Coase 1960) and no barriers as defined by Lott would exist by definition. It would seem reasonable, therefore, to focus on transactions costs as the ultimate source of barriers. A mobility barrier might then be defined as *any institutional arrangement that increases the cost of transacting in location-specific property rights.*

This definition highlights the unavoidable conceptual difficulties encountered when discussing barriers. The most important point is that any definition that refers to costs must implicitly be comparing what *is* with some alternative state of affairs. If a barrier is a "high" cost of transacting, we must face this question: "relative to what?" The analyst has various possible options.

First, an ideal and entirely fictional situation in which there are *no* costs of transacting might be used as a benchmark. This type of benchmark seems to be implicit in some of the work of Lott. It is not possible for one politician to sell his reputation for honesty, reliability, and service to someone else. Given that investments already made in establishing such a reputation are "sunk" costs, insiders and outsiders (those yet to make these investments) do not face the same cost conditions. Lott uses this observation to explain differences in campaign expenditures by challengers and incumbents. To describe the higher cost facing a challenger as a barrier in this situation, however, is to take as a point of comparison either a situation in which personal reputations are tradable at zero cost or are "creatable" at zero cost.

Second, instead of an imaginary zero transactions cost reference point, we might use some arbitrary, but realistically attainable, position. It might be argued, for example, that transactions costs will always exist and that our standard of comparison should be a situation in which public policy permits freedom of contract within a given framework of rights. The problem here is that there is no compelling logic behind the choice of any particular benchmark. The cost of transacting in location-specific rights depends on how they are assigned in the first place. Suppose, for example, that all the established residents in an area have to be compensated for loss of environmental amenities by any newcomer. Such a system will produce less mobility than a system in which the residents have to purchase the development rights from local landowners if they wish to conserve an area. In the former case, transactions costs impede mobility. In the latter case, they stand in the way of preserving the status quo.

Whether a mobility barrier exists will depend arbitrarily on which system we adopt as our point of reference.

Third, to provide a rationale for adopting a *particular* benchmark, the analyst may use a normative approach. A barrier becomes a cost of transacting in location-specific rights higher than would occur if property rights were defined and allocated in the best feasible way. This approach seems to represent Demsetz's view of the problem and explains, given the practical impossibility of identifying the optimum, his somewhat despairing opinion that barriers are almost completely subjective. Where one person sees a barrier, another sees the open road. Whether restrictions on the right to trade in slum housing, for example, represent a barrier to mobility will depend on opinions about the desirability of such restrictions. Similarly, processes of development control will be seen as inefficient mobility barriers by some people, but as efficient methods of environmental protection by local conservationists.

Location-Specific Rights and Housing Policy

Public policy in the field of housing has historically been associated with the creation of nontradable location-specific rights. At the end of the second section, I noted that below-market rents in the public and private sectors could be regarded as barriers to mobility if occupation rights were nontradable. The argument of the third section implies, however, (following Demsetz) that certain unstated normative judgments are hidden in this claim. In the public sector, for example, tradability of occupation rights would deprive housing authorities of control over the characteristics of their tenants. Whether this control is considered an important issue depends on opinions about alternative means of ensuring the availability of housing to relatively poor people, and upon opinions about the success or otherwise of the existing system in achieving socially desirable objectives other than maximum mobility of labor.

That restrictions on exchangeability will not always represent mobility barriers in the sense of Demsetz can be seen by considering cases in which they arise spontaneously in market settings. Consider the case of a housing cooperative or housing association. My rights as a member of a cooperative may not be exchangeable. Is this a mobility barrier? Clearly, if certain rights are costly or impossible to trade, I will be less inclined to move than otherwise would be the case. But in institutional settings, such restrictions on trade may be essential for achieving other purposes. Any private club that produces collective benefits, and not merely access, to a purely private

good is likely to restrict exchangeability in order to control the characteristics of new members. Willingness to pay the highest price may not be the appropriate criterion for choosing replacements. There may even be instances where the least-appropriate people are prepared to pay the highest price for membership, and nonexchangeability can be seen as a protection against adverse selection. In some regulated trades, such as medicine, where quality cannot be ascertained ex ante, this adverse selection problem has been used as a justification for restricting the exchangeability of licenses (e.g., Leland 1979). Thus, insofar as trade in the housing market encounters logically equivalent problems, restrictions on the tradability of property rights can be seen as both predictable and efficient.

If observed restrictions on tradability may be efficient, it is also true that the absence of restrictions is compatible with a barrier in the sense of Demsetz. In the owner-occupied sector, for example, it is possible to argue that mobility barriers are absent because there is a free market in this type of housing. The *regional housing mobility* index computed by Minford et al. (1987) is based on this assertion. Minford defines the mobility index to be 100 × (free-market rent ÷ actual rent) in the rented sectors and then sets the index equal to 100 in the owner-occupied sector. The argument is that under rent restrictions the market price of housing (i.e., the price that would exist if rent restrictions were removed) exceeds the actual price and, for the reasons discussed earlier, creates a barrier. The higher the index, the greater the barrier. The problem is that the free market position is not unambiguous. Suppose that development rights were held by all owners of property and no restrictions existed on residential development. In such a situation, it would be expected that the free market rent would be lower than that predicted under a system of rigorous planning controls. Thus, with the free-market rent calculated on this basis, the *lower* the mobility index, the *greater* the implied existing mobility barrier deriving from planning restrictions. There would be no presumption that mobility barriers were zero in the owner-occupied sector.

Other Sources of Barriers

In a world where information is not perfect or available on the same terms to everyone and, hence, where transactions costs are significant, institutions will often cope by *imposing* mobility barriers as defined by Lott. Incentives within a firm, for example, may involve employees accepting a rising profile of remuneration over time. This explanation of earnings profiles is discussed by Lazear (1981). A

rising profile implies that termination of employment will impose a cost on the employee. It is equivalent to a bond-posting device by which a person expresses confidence in his or her ability to do a good job by providing a hostage that will be forfeited in the event of poor performance. The whole purpose of the device is to induce loyalty and ensure the *durability* of a relationship that would otherwise be under threat from shirking and recontracting. It is a mobility barrier in the sense of Lott because it depends on existing workers not being able to sell to newcomers the value of their accumulated credibility or firm-specific reputation. If they wish to capitalize on past investments in good behavior, they simply have to stay where they are. Another similar example is the company pension, which is not portable in the sense that a change of employer greatly reduces the value of the pension. This device is clearly designed to discourage mobility and reward loyalty.

Some institutions, therefore, may require mobility barriers if they are to survive. Ban the company pension, insist that workers are paid entirely on observed performance at each point in time and not on the basis of seniority, and the result might logically be to render impossible certain hierarchical arrangements necessary for the production of particular goods. Economists are familiar with the basic proposition of a second-best welfare theory that technical conditions for efficiency, which are applicable to each and every market in an ideal world, do not continue to be applicable everywhere else when they are, for some reason, unavoidably contravened in one particular market. In a similar way, it appears that reducing mobility barriers is equivalent to a first-best policy and may not be appropriate where the costs of transacting can never be altogether avoided. In a world of transactions costs, in other words, artificially contrived mobility barriers may represent a second-best response.

Barriers and Economic Terminology

The difficulties that are associated with the concept of barriers in economics are encountered elsewhere and are not completely confined to this specific area. Indeed, there seems to be a class of terminology that is well established, yet is susceptible to logically similar problems.

First, the definition and measurement of a "subsidy," for example, requires a benchmark that is either normative (i.e., the subsidy implies a departure from some desirable alternative situation) or is arbitrary and, therefore, equally difficult to justify. In Ricketts (1985) I have given an example of the subsidy to owner-occupied housing.

The wide agreement among economists that there is such a subsidy depends on the consensus (to which I subscribe) that it would be desirable in the interests of economic efficiency if the rate of tax on owner-occupied housing were higher relative to the rate of tax on other types of housing or capital assets.

Second, another example of disputed terminology concerns "rent seeking." Usually this concept is defined in a normative way as "self-interested behavior which results in the use of resources in activities which are socially wasteful." As with the normative approach to barriers, this definition of rent seeking requires that we can identify alternative available situations that are not wasteful. Indeed, the barriers notion and the concept of rent seeking would appear to be closely connected since they both relate, when defined normatively, to situations in which property rights are inappropriately defined and assigned. Rents require barriers if they are not to be destroyed by new entry, and rent seeking may, therefore, be seen as investment in the creation of undesirable barriers or in the circumvention or sabotage of desirable ones. The lack of agreement characteristic of the debate about rent seeking (Ricketts 1987) can, therefore, be seen as rooted in precisely the same conceptual problems as the debate about barriers. As DiLorenzo (1988, p. 330) expresses the point, "one person's waste is another's cherished activity"—just as one person's barrier is another's justifiable protection. Virtually every kind of economic activity including research, development, and advertising (Cowling and Mueller 1978); efforts to pass examinations (Tullock 1980); hustling for legacies (Buchanan 1983); amateur rules in sport (Goff, Shughart, and Tollison 1988); political pressure (Pasour 1985); technological development in the fishing industry (Dnes 1985); and so forth have been described as rent seeking. In each case, the relevant analyst has argued that the system of barriers implicit in the established structure of property rights is inappropriate.

The term "barrier" figures prominently in discussions of many different areas of public policy. It is not the intention of this paper to argue that use of the term should be avoided or that it is inherently meaningless. However, it is very important to recognize the ambiguities that surround it and, in particular, to be aware of the overtly normative way in which it is very often used. In the context of the debate about rent seeking, DiLorenzo (1988, p. 319) argues not that economists can have nothing to say about the issue but that "making value judgements more explicit is likely to advance economic understanding." In the same way, arguments about barriers and the role of public policy in erecting or removing them will only lead to greater

understanding if protagonists are clear about the terminology they are using.

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