Regulation CATO INSTITUTE

EDITOR
Peter Van Doren

MANAGING EDITOR
Thomas A. Firey

EDITORIAL ASSISTANT
Nick Zaiac

DESIGN AND LAYOUT
David Herbick Design

CIRCULATION MANAGER
Alan Peterson

PUBLISHER
Peter Goettler
President and CEO, Cato Institute

Regulation was first published in July 1977 "because the extension of regulation is piecemeal, the sources and targets diverse, the language complex and often opaque, and the volume overwhelming." Regulation is devoted to analyzing the implications of government regulatory policy and its effects on our public and private endeavors.

FOR THE RECORD

Master Plans and Rent Seeking

Roderick Hills Jr. and David Schleicher criticize the process of project-by-project negotiation in modern zoning and planning law ("Can 'Planning' Deregulate Land Use?" Fall 2015). Robert Nelson and I have argued that this process leads to more efficient outcomes than would be obtained by rigid adherence to a city's master plan and zoning ordinances. I further argue, relying on the Coase theorem, that reducing transaction costs between regulators and developers will result in developments that maximize the value of real estate in the city. Both Nelson and I commend institutional reforms that would make bargaining easier.

Hills and Schleicher criticize the transactional approach because it does not work very well, especially in big cities. They see that the NIMBYs ("Not in my backyard" opponents to development) have recently gained the upper hand in large cities—they have always ruled in the suburbs—and distorted the development and redevelopment process. Hills and Schleicher's chief concern is that the regulatory negotiation process lacks what economists call "time consistency," which is the ability to hold fast to public policy commitments over time. For instance, New York City planners might want to place some low-income housing on the Upper West Side and assure the residents who oppose it that other neighborhoods will, in the future, have to take their fair share, too. But the Upper West Siders know that there is no way for the city to actually commit itself to scattering undesired projects around, and they resist accepting the unlovely development for fear that they will end up being the "sucker" in a real-life prisoner's dilemma game.

This is a real problem. It is especially acute where, as Hills and Schleicher insightfully point out, political parties are weak and thus cannot make plausible commitments to behave consistently over time. (It is even more acute when anonymous voters get to approve individual projects, as is often the case in smaller communities.)

Hills and Schleicher suggest that the city's master plan could serve as the commitment document. Master plans are not currently taken seriously because they are not legally enforceable in most jurisdictions. It is the current zoning map that counts, not the hypothetical changes that a master plan might envision. Hills and Schleicher argue that the master plan should be taken seriously not because planners know best, but because it can resolve the time consistency problem. They argue that allowing the developer–regulator bargaining would dissolve the credibility of their version of the master plan and thrust cities back to the current, unsatisfactory situation. You cannot have a commitment to a long-term plan and at the same time allow exceptions to be negotiated for every project.

More rent seeking / Hills and Schleicher are aware that cities change over time. The ideal plan for New York in the 1950s would emphasize finance, shipping, and railroads, while the ideal plan for the 2020s might emphasize research, culture, and high-density housing nearby. They know that master plans have to change; they approvingly call them "impermanent constitutions." Accordingly, the mayor would direct the planning staff to update plans periodically.

But that's where the problem begins. The retail-level rent seeking that occurs during the current project-by-project process would be replaced by wholesale rent seeking when the citywide plans need revision. Once plans become important, they will become central to political maneuvering by whole neighborhoods and industries. This will make the current plan last a lot longer as the political demands are sorted out. The original plan won't be "impermanent" after all. With the obsolete plan still in force, incremental changes that move in more efficient directions will be forgone.

Again, a New York City example: As manufacturing and shipping moved out of the city in the 1970s, obsolete buildings called "lofts" became attractive for what we now call the "creative class" of artists and entrepreneurs to live and work in. The original zoning was obsolete, but city officials were reluctant to give up on their former plans that called for blue-collar industry and ocean shipping to be based in lower Manhattan and Brooklyn. Instead, the incremental process of rezoning (and sometimes illegal occupation) gradually allowed the new users to take over. Once they were established, the city began to recognize the interlopers as assets and adjusted their plans and zoning accordingly. The point, which urban activist Jane Jacobs often made, is that the bottom-up dynamics of city prosperity are nearly impossible to see before they happen.

The faults of the incremental rezoning process are many, but they can be mitigated. In my current book, *Zoning Rules!* (Lincoln Institute, 2015), I analyze the NIMBY problem as originating in the top-heavy assets of homeowners, whose value cannot be insured or easily diversified. One way to deal with this would be to reduce the federal tax subsidies that cause so many people to be overinvested in housing. While the homebuilding industry would lose some demand from a more tax-neutral housing policy, it would gain from having less resistance by homeowners to new projects. The inevitable negotiation process of urban land use policy could proceed without quite as much drama if homeowners didn't have such a big stake in the outcome.

In the meantime, the cure for the commitment problems that Hills and Schleicher prescribe—making the city's master plan into a constitution-like commitment—seems likely to suppress the benefits of decentralized innovation as well as ad hoc negotiation. The conceit that city planners can foresee and implement necessary changes may not be fatal, but it is still a conceit.

William A. Fischel
Professor of Economics and
Hardy Professor of Legal Studies
Dartmouth College

Neighborhood Collectives Instead of Central Planners

I am pleased to see the *Regulation* article by Roderick Hills Jr. and David Schleicher ("Can 'Planning' Deregulate Land Use? Fall 2015), including a critique of the proposals made in the 1970s by William Fischel and myself that the large American zoning inefficiencies be resolved by allowing the sale of zoning changes.

Hills and Schleicher are concerned with evolving land use patterns in central city areas, partly reflecting the growing demand for residential development and revitalization in many such areas. As they point out, the rigidities of land use transition, combined with rising economic pressure for change, have led to rapidly escalating housing prices in many leading American cities—in some cases to the exclusion of all but the best-off members of American society. I agree that remedial steps are greatly needed.

Rights holders? / In my early 30s, I brashly proposed in *Zoning and Property Rights* (MIT Press, 1977) the creation of a "New System of Metropolitan Land Tenure." As has been common throughout the very long history of land tenure, I argued that zoning was a major new tenure development again grounded in legitimating myths and fictions. Zoning in actuality was not a form of public land regulation, but a disguised new form of collective property right otherwise analogous to more conventional private property rights. The key missing element, however, was the ability to sell the collective right in the manner of a traditional property right. As a result, changes in the use of zoning rights had to be achieved by some other means that would typically be less organized and less efficient than the usual exchanges of use rights—individual or collective—in the marketplace.

If zoning rights were to be legally saleable, this raised a key question: who would hold the rights and potentially receive the revenues from their sale? This issue is now raised by the Hills and Schleicher article. I proposed in 1977 two very different answers according to whether the land at present was developed or undeveloped.

If the land already contained housing or other development, I radically proposed assigning the zoning rights to the collectivity of the owners of property in each neighborhood. An existing neighborhood under this proposal would thus take on much of the character of a private homeowners association. At present, homeowners associations have the right to terminate the association in exchange for a developer payment, thus selling their collective rights. This has seldom happened, partly because the actual process of homeowners association termination at present faces large practical difficulties. I have since proposed new ways of significantly reducing those transactional difficulties.

In the much different circumstance of undeveloped land, my first choice in 1977 was to abolish the zoning altogether, possibly by a series of court rulings that this form of zoning was an unconstitutional taking of longstanding private rights to benefit from the new development of individually owned land. Recognizing the inertial, political, and other large hurdles to such a radical change in zoning, however, I also proposed a second-best solution: the zoning rights to undeveloped land within a given local governing jurisdiction could be sold by the existing residents for the wider benefit of the full jurisdiction. I questioned then the overall equity of such sales, but the legalized sale of zoning rights by a municipality or other local government could do much to resolve the growing land efficiency and equity problems in American undeveloped suburban land.

To some extent, the evolving patterns of management and control of undeveloped land in the United States have actually moved in these directions. In the outer

suburbs, new housing development today is largely occurring in private homeowners associations (and condominiums). Developers also typically pay for the zoning rights in various indirect ways—although explicit legal cash sale remains unacceptable to the courts.

In existing neighborhoods, however, the trends have been less promising. In big cities, as Hills and Schleicher describe, it is the citywide government, not the immediate neighborhood property owners, that holds and sells the local zoning rights. This is problematic because the "not in my backyard" opposition to new development is typically localized and thus the most negatively affected parties usually are not adequately compensated by the citywide revenues from the zoning sale.

To address this problem, I proposed in 1977 that new laws be enacted to allow—on the vote of a high-enough neighborhood supermajority—the transfer of the zoning rights (including the ability to sell the rights) to a new collectivity of the immediate neighborhood property owners. Rather than attempting to plan future land uses, as Hills and Schleicher propose, the principal task of citywide planners would be to design an appropriate set of neighborhood boundaries within which such a decentralized approach could be implemented. Little movement has occurred thus far in this direction, but I would repeat the same recommendation today.

Transactions and costs / As Ronald Coase pointed out many years ago, the party negatively affected by a nuisance has two choices: force the nuisance to cease its objectionable activities or demand adequate compensating payments. The generator of the nuisance has the obverse choice: meet the monetary demands or stop the offending activity. A metropolitan system of land tenure, including the definition of initial rights, should be chosen to minimize the information and other transaction costs of the associated land use bargaining and contracting (as well as to reflect considerations of social equity).

Hills and Schleicher make a case that their proposal for a revival of comprehensive planning (with zoning precisely following according to the plans) will in fact reduce such overall transaction costs. I am skeptical, however. The proposal depends critically on a newfound ability of expert city planners to anticipate with considerable accuracy future land use demand and supply trends—something they have never been able to do on the scale of a major city in the past. Hills and Schleicher also propose to overcome the high transaction costs of political deal making and other negotiating over any such comprehensive plan by means of an urban version of fast-track legislation in the international trade area. I find it hard to believe that any city legislature would surrender so much authority to the executive branch in a matter as critical as laying out a plan for the city's future. There is an element of utopianism here that is reminiscent of earlier expectations for urban comprehensive planning that eventually had to be abandoned, resulting in the substitution of more market-like mechanisms. It certainly seems a misnomer to describe it as a "libertarian" proposal, as they do.

Coasian ways of thinking generated a vast body of literature that has been central to the development since the 1970s of a whole new field of institutional economics. Although Fischel has been an important exception, and my *Private Neighborhoods and the Transformation of Local Government* (Urban Institute Press, 2005) is a sequel to *Zoning and Property Rights*, this field has given less attention to zoning and local land use management and control than many other areas of American public and private activity. Given that the negative economic consequences for the nation of perverse land use controls dwarf those of any other form of American regulation, it is to be hoped that the Hills and Schleicher article will work to advance the institutional discussions—both legal and economic—and the assessment of possible new collective control arrangements.

Robert H. Nelson
Professor of Environmental Policy
University of Maryland

Sarasota: A Solution to the Taxicab-Uber Wars

A few years ago, Mark Frankena told *Regulation* readers the encouraging story of how ride-for-hire communications companies Uber and Lyft pushed Nashville to liberalize its livery market ("More Economic Freedom in the Music City," Summer 2014). Thanks to political pressure from the companies and their users, the Nashville Metropolitan Council decided to do away with fare minimums (which were harming Uber's and Lyft's business models) and expand the number of permitted taxicabs in the city (liberalizing the taxi market).

We can now add an even more remarkable story of such liberalization, this time from Sarasota, Fla.

Uber began serving the Sarasota area in late 2014 and quickly became very successful. Predictably, cab companies saw their revenues decrease as a result of the new competitor. They responded by lobbying the local government to apply the same regulatory restrictions on Uber-using drivers that are applied to taxicabs, in order to "level the playing field."

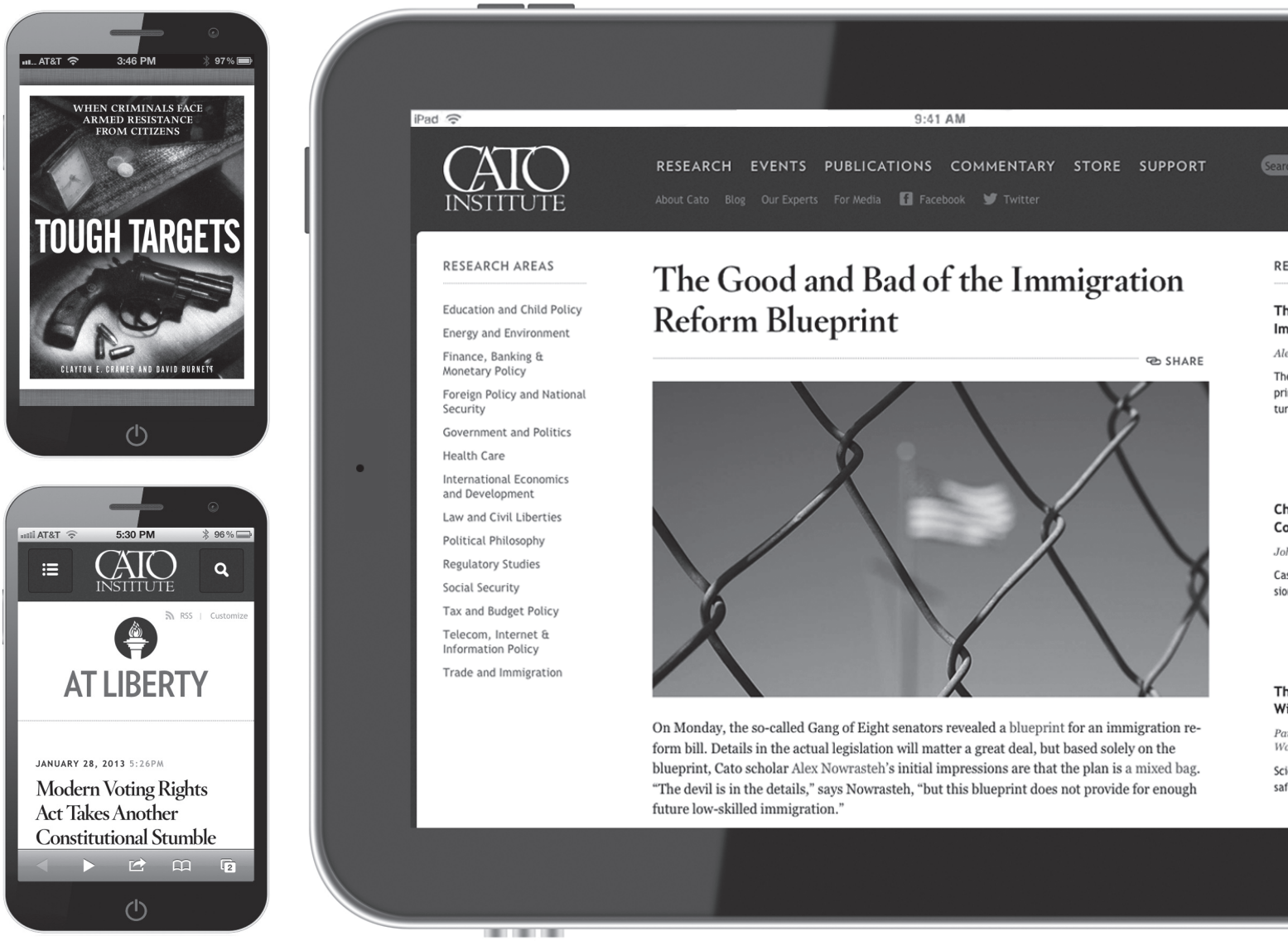
The city responded by drafting an ordinance that would impose regulations on Uber; Uber said if it passed, the firm would be forced to stop providing services to Sarasota. So far, a common story.

But after public outcry, the Sarasota City Council decided last Sept. 8th to remove all regulations on ride-for-hire services, whether taxi or Uber-using drivers. The playing field is now indeed level, and Sarasota should see a substantial increase in the ability of its residents to get around.

Paul H. Rubin
Samuel Candler Dobbs
Professor of Economics
Emory University

Cato at your Fingertips

The Cato Institute's acclaimed research on current and emerging public policy issues–and the innovative insights of its *Cato@Liberty* blog–now have a new home: Cato's newly designed, mobile-friendly website. With over 2.2 million downloads annually of its respected Policy Analysis reports, White Papers, journals, and more–and it's all free–the quality of Cato's work is now only matched by its immediate accessibility.



Visit today at Cato.org and at Cato.org/blog. | CATO INSTITUTE