The Housing Industry Never Recovered From the Great Recession Thanks To Corrupt Politicians

A decade of depression in construction led to a concentrated, sclerotic industry.

BY RYAN COOPER

In labor economics, there's a concept called hysteresis. It means that severe economic downturns have lingering effects that go beyond the immediate pain. For example, high unemployment can cause people to lose skills, and cause employers to be more selective in who they hire. When the labor market comes back, those workers scarred by the initial shock don't benefit, and the unemployment rate overall can stay stubbornly higher.

The housing market has been subject to a form of hysteresis. It's an underappreciated but important challenge to the crisis of undersupply and rising costs for shelter.

If you read the *Prospect*, you probably know something about the great housing bubble collapse. The rise of securitization spiked global demand for mortgages, which lenders satisfied with more exotic (and even illegal) terms for borrowers. The bubble was unsustainable; homeowners were missing their *first* mortgage payment, which is impossible without something going deeply wrong with the market. The interconnection of these fraudulent bets meant that defaults on mortgages cascaded through the financial system and triggered a devastating collapse that hobbled the rest of the economy in what is now known as the Great Recession of 2008.

More from Ryan Cooper

The crash badly hurt a variety of sectors, but it simply devastated the home construction industry, given that the crisis was directly centered there. The biggest thing is that, with a glut of foreclosures on the market and prices falling fast, America simply stopped building homes. New private home starts plummeted by almost 80 percent to the lowest level since 1959, the earliest year available in census data—and a year when the U.S. population was half what it is today—and stayed there for two years.

Across the entire housing supply chain, from the construction material manufacturers to wholesalers to building supply dealers to homebuilders, people were thrown out of work by the millions, and businesses went bust by the tens of thousands. Private construction employment fell from 7.7 million in April 2006 to a low of 5.4 million in January 2011—a loss of 2.3 million jobs, the worst of any industry in percentage terms. The number of construction firms peaked at 896,000 in the third quarter of 2007, and bottomed out at 738,000—a figure that was not reached until the first quarter of 2013.

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The industry recovered extremely slowly. A grinding increase in home starts began in 2011, but even the previous record *low* was not reached until 2012, six years after building levels started to fall in 2006. A decade after the recession started, the industry was still depressed, and as a result a major housing shortage built up. Both the number of construction firms and construction laborers did not match their previous peak until 2022.

That shortage set the stage for an enormous spike in home prices and rents during and after the pandemic, as millions of Americans with savings and pandemic relief checks looked to buy or upgrade their home offices. The median home price soared from $317,100 in 2020 to $442,600 in 2022; median rent climbed from just under $1,600 to over $2,000.

Yet even with the enticement of greater profits from selling homes, there was no building boom to make up lost ground. At the peak of the spike in 2022, the rate of new home starts was only at about the historical average—and only for a few months, as starts have fallen again thanks to the Federal Reserve raising interest rates.

Here's a major reason why housing hasn't come back: As industry collapsed and then very gradually recovered, it saw significant consolidation at all levels, and hence became sclerotic and unresponsive. High housing demand produced high profits rather than more homes.

THE FIGURES ABOVE OBSCURE THE FACT that disproportionately, smaller firms went belly-up after 2008. Larger companies tend to have the cash reserves, market power, and access to credit that make it easier to survive in hard times. There were also psychological scars—hysteresis—created by the Great Recession. The businesses that

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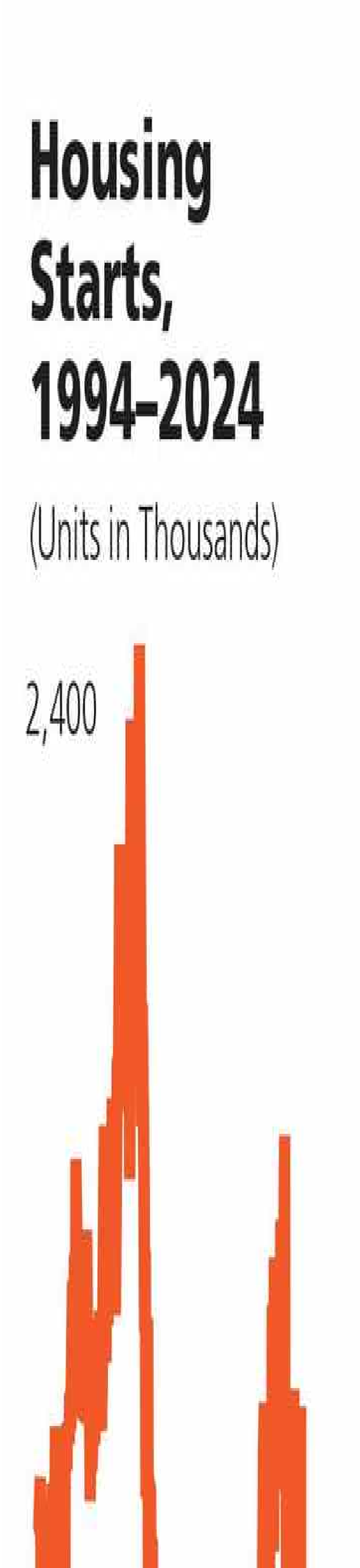

managed to survive tended to be cautious; they didn't attempt ambitious growth targets or keep around a lot of inventory whose storage costs eat into margins. It's a chicken-or-egg scenario: Did homebuilders fail to build because they were worried about creating another bubble, or because everyone was so tapped out from the last bubble collapse that demand was low?

At the same time, the building industry consolidated significantly. The 100 largest homebuilders now account for half the market, up from about a third 20 years ago—which actually understates things because housing markets are highly local. D.R. Horton, the largest homebuilder in the country, boasts to investors that it is now the largest player in three of the top five housing markets in the country. Thanks to this market power, in 2023 it made over three times the nominal profit it made in 2005, despite delivering about half as many houses. As Matthew Stoller points out, these big firms have evolved into de facto financial middlemen, using their size and credit access to buy up the choicest land, planning projects slowly, and then farming out the actual work to subcontractors. Less work, more profits—a nice gig, if you can get it.

"The whole market is more consolidated every year," said Stinson Dean, who runs a lumber trading company. "The mills are consolidated. Lumber yards, massive consolidation. And the homebuilders, same thing." The rise of big-box hardware stores like Home Depot has helped drive this, as suppliers merge to gain their own market power, as well as private equity firms buying up companies and cutting inventories to increase profits. Johns Hopkins University business professor Luis Quintero recently published a paper examining concentration in the homebuilding industry. He found that 60 percent of American housing markets are “highly concentrated” today, a major increase since 2000. His statistical analysis finds that this has led to fewer homes being built, fewer homes in the production pipeline, and therefore greater price volatility, as housing dollars chase fewer units. All told, he estimates that these effects of market concentration have cut the value of housing production by $106 billion annually.

America was clubbed over the head with the problems created by these developments in 2021. Most construction and supply firms assumed that the pandemic was going to lead to another housing collapse, and therefore cut their already thin inventories to the bone. But as noted above, the opposite happened, with huge demand for homes and remodeling. High demand met tight supply in a systematically concentrated and low-capacity industry, and so prices went through the roof, as it were.

Lumber prices in particular went crazy in mid-2021, with wholesale prices more than doubling before collapsing a few months later. Consumers were agog at hardware stores, with an ordinary sheet of plywood sometimes going for over a hundred dollars.

In a well-organized market, 2021 and 2022 should have seen a giant home construction boom. With tons of money to be made, existing firms should have expanded operations, and new entrants should have flooded into the market and set to work making money. But thanks in part to industry consolidation, most of that demand instead went into brief price spikes and enormous incumbent profits. That same home price inflation helped prompt the Federal Reserve to raise interest rates, which choked off housing demand by raising financing costs long before the shortage could be fixed.

Another reason for the housing shortage, of course, is the extreme difficulty of getting permits in many high-demand cities—the NIMBY (not in my backyard) problem. Historically, the entire state of California has routinely built fewer housing units than Tokyo, which has a third the population and 0.5 percent as much land, and not coincidentally, relatively cheap rents. Conversely, the few hot American cities like Austin, Texas, that have managed to build have seen declining rents and prices. Hence the YIMBY (yes in my backyard) movement that argues for streamlined permitting rules.

However, the YIMBY argument doesn’t contradict the anti-monopoly argument here. Indeed, a highly concentrated construction sector tends to benefit from a NIMBY regime. A monopolist sitting on the choicest land can enjoy large and easy profits by dribbling out new homes into an artificially hot market, and those profits mean they can afford to develop the political connections necessary to navigate the arcane and often corrupt permitting bureaucracy. A huge building boom might theoretically mean even more profits, but at the cost of risky and painful competition. It follows that if we restore competition, some of the political heft behind NIMBYism might dissolve.

WHAT IS TO BE DONE? ONE SOLUTION is traditional antitrust. The Federal Trade Commission could issue fair competition rules, and the Department of Justice could file lawsuits to break up companies to ensure that that, say, no builder has more than a 10 percent share in any housing market. Obviously, Donald Trump's agencies aren't likely to do this, but they should then be blamed for making housing more expensive. Quintero further suggests removing a 2009 tax break whereby builders can write prior losses off their tax bill, because it benefits larger companies more.

Another important strategy would be to ensure steady high demand for housing construction over time. A major reason why industries of all kinds consolidated in the 2010s was systematically weak demand caused by the recession. When business is slack, smaller firms struggle more than larger ones, which are simultaneously incentivized to buy up their competitors to obtain a protective moat of market power rather than expanding existing operations.

When the market is hot, however, the dynamic is reversed. Smaller firms or startups can seek market share confident that if they succeed, they will make lots of money. Monopolists that have gotten fat and lazy will tend to lose out over time. Swimming over that market power moat, however, takes years—much longer than the short, moderate construction boom we saw in 2021-2022. We need sustained pressure for a decade to really bake in new market dynamics.

Economists have proposed various "automatic stabilizers" that would kick into action in case of recession, but one way to do this for homebuilding specifically would be social housing. Elsewhere, I have made this case—the idea that the government should build and own a substantial portion of the national housing stock. Cities, for instance, could build housing projects in high-demand neighborhoods on land they already own, and set aside some units for low-income residents. That would both provide units to the whole market simultaneously, and also allow for the market-rate units to subsidize the affordable ones, so no external funding would be needed, enabling the construction of many more units in turn.

This would weaken the impact of the Federal Reserve's dampening effect on investment when it raises interest rates in a hot economy, something that makes it nearly impossible to catch up on a housing supply shortage. Done properly, a national social-housing program would provide a substantial anti-concentration effect. The ideal time to build would be during a recession, or when the private market is slack, both because labor and materials are cheaper, and because it would stabilize the whole economy in general and the construction industry in particular. Prolonged home construction depressions would be ended forever.

On the other hand, it would be very important for a social-housing agency to have access to a competent, competitive construction industry. Many cities will naturally choose to hire private contractors to build their projects, and if they are getting ripped off by a monopolist, that means fewer units.

Homeownership has long been an American aspiration, and indeed today most Americans own their home. But if we want that to be broadly accessible for coming generations, we will need to restore vigorous competition to the homebuilding industry.