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**HOMELESS**

**By**

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**JOHN M. QUIGLEY**

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by

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## Homeless\*

By

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Berkeley

Almost everyone my age remembers his first encounter with a homeless beggar on an American street. It happened well after we were adults, with "real jobs" (or, in some cases, research assistantships). Should you simply offer charity? Or was such an offer a bribe?

Those cursed with training in economics may have speculated whether the effect of the payment on the number of homeless beggars would exceed the effect of the payment on the (backward bending) labor supply of the specific beggar encountered. Could payment make them go away? Or would we encourage more of them?

In the past couple of decades, of course, the encounter with the visibly homeless has become so commonplace that we all have our reaction strategies firmly in place, so that the encounter requires little thought and no emotion. It was not always this way.

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\*Making Room: The Economics of Homelessness, by Brendan O'Flaherty. Cambridge, MA; Harvard University Press, 1996. Pp. xi, 349. ISBN 0-674-54342-4.

I remember the "old homeless" (before they were at all visible) from very early childhood. My mother would save old clothes, kitchen implements, curtains, whatever, in a corner of our suburban basement. Twice a year we would put the boxes into the car and drive into the City, to Chrystie Street just off the Bowery. My role was to help lift the boxes up the steps to the tenement. Attendance at this ritual was not optional, although I could not possibly have been much help.

The homeless old men in the shelter smelled mostly of stale tobacco, but the building smelled intensely of Ivory soap (the same kind we had for the bath). The ritual always concluded with a gift of tea for the house, followed by a cup of tea with all the adult caregivers (some of whom were as locally famous anarchists and pacifists as Ammon Hennacy was. My mother was a premature leftie).

My strongest memory of these forays into the Bowery was, however, the exotic smell of lunch at the Chinese restaurant where we would stop before driving back to the suburbs.

The notion of helping the homeless was, in this time and place, something you did, or at least identified with, in some active way. The alternative of simply writing a check was inadequate; putting it on the Visa card was not an option.

I used to wonder what my mother's reaction to the homeless street beggar would have been if she had lived to see the

phenomenon. The occasion for a corporal work of mercy? Perhaps, but I'm not so sure.

But I have not wondered about this for a long time. There are now so many "new homeless" street beggars that it is quite easy not to think about them at all.

Brendan O'Flaherty has written an important book to explain the rise of the "new homelessness" -- a book filled with numbers, graphs, and estimates -- but one which is also respectful of the humanity being counted and sorted and of the individuals whose behavior is the object of study. It is an original and wide-ranging account, written with grace and subtlety. It should be read carefully by any social scientist interested in poverty, housing, or urban policy.

It is also a model of how theoretical knowledge -- in this case, microeconomic theory -- can illuminate complicated and messy issues in human behavior. *Making Room* is a tour de force worthy of study by anyone with an interest in applied microeconomic theory. The author claims "just as much as exchange rates or corporate capital structure or investment tax credits, homelessness has to be taken seriously." This can be interpreted as a plea that soft subjects be subjected to the same standards of evidence, using rigorous analytical models and careful consideration of causality, as hard subjects (such as the investment tax credit) are. Homelessness is surely a soft subject, as becomes clear in considering its very definition.

Chapter Two presents a lucid discussion of the various definitions of homelessness, considered a housing market phenomenon in Britain but a social status, like "graduate student," in the United States. (Those old men in my memories were adequately housed, but certainly homeless.) Confusion in usage has led to many subsequent confusions.

The current "official" definition, devised a decade ago, combines elements of traditional British and American usage: where one slept last night determines whether one is homeless today, but the sleeping places that designate a person as homeless are places where only vagrants sleep. So the number of homeless in the US is defined officially as the number of people sleeping on the streets plus the number of people sleeping in shelters ("a number just about as confusing as the sum of people vaccinated and people with smallpox," remarks the author).

O'Flaherty indicates why liberals might think homelessness is bad enough to do something about: externalities, important and trivial; capabilities and "functionings" as pointed out by Sen (1992); a general reminder of extreme poverty and deprivation. Finally, the author advances the possibility that helping the homeless is good for those who help (that, surely, is the motivation for dragging small children off to help carry boxes upstairs in alien neighborhoods).

O'Flaherty's book includes an extended historical description of the rise of the homeless and daytime street

people, concentrating on New York, Newark, Chicago, and a few other cities. The historical analysis is fascinating, though hard to summarize. It certainly documents the steep rise in the homeless, under various definitions, during the past two decades.

Two important chapters present and motivate an elegant model of the operation of urban housing markets. O'Flaherty motivates the abstraction by noting that theorizing

is like drawing a subway map of Manhattan -- you leave out many important things (New Jersey, most cross-streets, topography), but by concentrating on one aspect of reality you get a tool that is very useful for some purposes (transferring from an Uptown 2 train to a Brooklyn-bound D), but not for others (driving in the Bronx or completing tax forms). You simplify so that you can concentrate on things that are important for the problem at hand (how much money people have, for instance) and not waste time and energy on things that are not (the color of houses or the problem of nuclear proliferation). (p. 96)

The model he presents synthesizes several of the unique and interrelated aspects of housing markets: on the supply side the differentiation of housing along a quality dimension; on the demand side, the effect of the entire distribution of income upon the production of new housing and the maintenance of its quality. Homelessness gets defined in relation to the lowest quality still occupied along the continuum. The richest, rational, utility maximizing, homeless person is just indifferent between "abandonment quality" housing at its market-determined rent and homelessness at zero rent.

Suppose housing is built at some given quality level and then filters down by depreciation to lower levels of quality. Suppliers make decisions about new construction (increased expenditures improve the quality of newly constructed housing, subject to diminishing returns) and maintenance (increased expenditures postpone depreciation). Suppliers face a demand curve in price and equity. The equilibrium schedule of rents for various levels of quality must satisfy a number of conditions: at every quality at which housing is available, market rents must cover operating costs (in the alternative, properties are simply abandoned); the equilibrium cost of construction at the construction-quality level must equal the present value of net rents generated as dwellings of that quality deteriorate (in the alternative, too many, or too few, dwellings are built); the price, net of operating cost, at the construction-quality level must equal the interest rate times the cost of construction (in the alternative, excess profits are possible, during the time interval before the dwelling depreciated to the level of construction-quality, by building at a slightly higher quality level); the number of dwellings constructed must be constant and equal to the number abandoned (in the alternative, the number of dwellings at any quality level will fluctuate, preventing equilibrium in prices from being achieved).

The equilibrium quality-price schedule allocates households to dwellings along the quality hierarchy, elicits new

construction at the high end of the distribution, and induces landlords to incur optimal maintenance expenditures, delaying depreciation appropriately at each level.

Importantly, the price and quality at which housing is abandoned, or demolished, are exactly the price and quality combinations at which consumers are indifferent between homelessness and the consumption of abandonment-quality housing.

The model is not wholly original with this book. The general structure of this kind of model was developed by James Sweeney (1974) who proved the existence and uniqueness of equilibrium (as well as a variety of properties of the equilibrium price vector) in models of commodity "hierarchies." The comparative dynamic aspects of the model were used in a variety of policy simulations (e.g., by James Ohls, 1975). The basic model was extended to a continuum by Ralph Braid (1981); quality upgrading was addressed in a series of papers by Richard Arnott (e.g., Richard Arnott, et al, 1983).

O'Flaherty extends the model to address homelessness, incorporating a continuum of income on the demand side, a continuum of quality on the supply side, simplifying the issue of where on the quality continuum new construction takes place, and presenting a clean comparative dynamic analysis.

The technical analysis is not presented in the book at all (but see O'Flaherty, 1995, for all the details). The verbal description in the book, however, is elegant, coherent, and (as

far as I can tell) complete. The model provides a transparent mechanism for evaluating each potential cause of the rise of homelessness identified by the author.

Much of the second half of the book consists of "rounding up the usual suspects" and examining each of them using the economic model. Some of these suspects can be dismissed easily, as in the case of the "rent control causes homelessness" slogan extolled by the right or the "inadequate construction of public housing" cause put forward on the left.

Real interest rates can hardly be the cause since homelessness rose sharply in the US (not elsewhere), while the course of real interest rates hardly varied across countries. Operating costs for real property cannot be responsible. Costs rose rapidly after the first oil crisis, but then were flat. The opportunity cost of land is too small a fraction of operating costs to matter very much (and large chunks of land in these cities still exist as vacant lots, not gentrified ex-rooming houses).

O'Flaherty presents a detailed analysis of the effects of government regulations which make the production of new low quality housing unprofitable or which increase operating costs. He investigates a variety of specific rules and regulations adopted in various cities, finding inconsistencies, inefficiencies, and some outright silliness. But not enough to affect the level of homelessness in a serious way.

The author provides an intensive re-analysis of the various pathological explanations for the rise in homelessness -- mental illness, the availability of crack, criminals on the loose. This review and analysis is a cogent challenge to the conventional wisdom which gives pathology a central role in fostering the "new homelessness." O'Flaherty provides new estimates of the institutionalized mentally ill, showing: that deinstitutionalization of the mentally ill took place between 1960 and 1975; that during this period, mentally ill people found private housing; and that after 1975 the movement out of mental institutions was more than offset by movements of the mentally ill into nursing homes and prisons. After 1980, homelessness rose among the mentally ill, but also among the left handed and the tone deaf.

O'Flaherty's interpretation contradicts Jencks' (1994) conclusion, which relies upon two further arguments. The first is that, after 1975, mental institutions were forced to discharge large numbers of the more disturbed patients who would have remained hospitalized under pre-1975 presumptions (and who were especially susceptible to homelessness). O'Flaherty amasses solid evidence to question this "worst apples at the bottom of the barrel" argument, as well as another implying that pre-1975 discharges were justified by "science" (e.g., psychotropic drugs, community psychiatry) while post-1975 discharges were motivated merely by "budget balancing."

The discussion of substance abuse may infuriate adherents to the conventional wisdom. O'Flaherty uncovers evidence that 5-7 percent of single-shelter populations are "occasional" heroin users. So if the current population of US crack users had been airlifted in from another planet, it might have increased the single-adult homeless population by something like 5-7 percent -- a rough approximation.

But crack is an economic commodity, a cost-reducing innovation in the delivery of euphoria, and the crack-using population did not arrive by parachute. The innovation in production permitted three kinds of substitution: heroin addicts could continue their previous levels of intoxication with more disposable income to spend on housing; addicts could spend more on this form of intoxication, instead of muscatel or heroin, etc., and the same amount on housing; or they could spend more on crack and less on housing. If the first effect dominates the third, then the crack innovation would decrease homelessness. (This also requires that the net number of new addicts to intoxication induced by the innovation be not too large, a fact not stressed by the author.)

The issue turns on the price elasticity of crack cocaine. O'Flaherty's exhaustive review of the price elasticity of intoxicants (beer in Finland, cigarettes in the US, etc.) supports the conclusion that crack had a small impact upon

homelessness in the US. It could even have been an ameliorating factor.

By the process of elimination (and by the relentless presentation of interesting fragmentary bits of evidence), O'Flaherty exposes the one major change during this period which could have caused the rise in homelessness -- the substantial decline in housing demand by the middle class. This purely market-based story arises from putting together parts of the economic model described above.

Fewer middle class households means less demand for used housing (below construction-quality). Thus, prices must change; prices for lower quality dwellings must rise and prices for higher quality dwellings must fall. These changes (so that, in equilibrium, the present value of price increases offsets the present value of price decreases) mean that the price of housing slightly above abandonment-quality rises. But in equilibrium the quality at abandonment must fall (otherwise households consuming just-above-the-old-abandonment-quality would be better off by consuming lower quality housing). So the quality at abandonment falls, and the price of the lower quality housing supplied by the market increases.

Eventually, the market reaches a new equilibrium. Inexorably, the incidence of homelessness has increased -- not because there are more poor, but rather because homelessness has extended--by rational calculation--further up into the income

distribution. The model yields a variety of other comparative dynamic predictions about market behavior: the range of housing quality supplied will increase, but with fewer dwellings emitting each level of quality; rates of construction and demolition will decline; there will be an increase in dwellings providing less-than-the-old-abandonment quality; there will be a reduction in the supply of low-rent housing as well as an increase in its price.

O'Flaherty presents an impressive body of evidence, from quite disparate sources, which points to the disappearance of the middle of the income distribution from large metropolitan areas. (For some reason, he does not examine the intra-urban relocation of the middle class to the suburbs or the policies which have facilitated the hollowing out of big cities). The closest competing economic explanation for the rise of the "new homeless" is an increase in the number of poor and very poor households. The distinction between these two explanations -- more poor people or fewer middle income people -- is quite sharp. In the former case, the stock of low quality housing would increase to satisfy new demand. In the latter case, for reasons discussed above, the stock of low quality housing would ultimately decline.

The unique evidence uncovered by O'Flaherty demonstrates clearly that the low-quality housing stock just disappeared in a number of big cities. Low-quality rental housing was boarded up or burnt up; flophouses, lodging houses, and roominghouses went

out of business. The sources of the data are unusual (and the notes to his tables make fascinating reading). For example, the history of fires in Newark and the occupancy history of low-quality hotels was pieced together from hotel records kept for twenty years by a fire inspector in "two shoeboxes," supplemented by interviews with the inspector.

The author concludes that the causal mechanism was: the income distribution changed, reducing the size of the middle class; this changed housing prices, increasing them at the low end; this increased homelessness, increasing its incidence among the very poor and also further up the income distribution; this induced homeless shelters; this caused more homelessness. Around the edges are the effects of increased tenants' rights, decriminalization, and increases in the stock of newly released ex-offenders. These conclusions are qualified and documented in this meticulously researched three hundred and fifty page volume.

The O'Flaherty book will be compared to Christopher Jencks' *The Homeless*, published two years earlier by the same academic press. Jencks, one of the country's senior social scientists, writes with grace and wit. His book is an extended essay, synthesizing, reconciling, and reinterpreting the data collected by Martha Burt (1992) and others. In contrast, O'Flaherty's tome is organized around a tight theoretical perspective which provides motivation for the relentless presentation of fragmentary empirical evidence. Indeed, the volume could have

been quite tedious -- but O'Flaherty's prose is so well-crafted that he manages to make the discussion seem conversational.

Both the Jencks and O'Flaherty volumes are compassionately, coherently, and engagingly written (with the kind of freshly written prose that comes only after four or five drafts). The books arrive at quite different conclusions about the causal mechanisms which have given rise to the familiar sight of the homeless in US cities. A reviewer for the **JEL** would squander credibility by advocating a sociological explanation over one firmly grounded in the operation of markets. But readers of the O'Flaherty book should also read Jencks brief monograph (and not merely to appreciate better the power of economic analysis).

There are some problems with O'Flaherty's book. He sets out to describe and compare homelessness in six cities, but the bulk of the analysis concentrates on New York, Newark, and to a lesser extent, Chicago. In particular, the parallelism of Hamburg with Anglo-American cities seems misplaced. The author provides little evidence about Hamburg that is not in a gazetteer. In contrast, the analysis of Newark is exhaustive.

O'Flaherty's book ends with the obligatory twenty five page chapter on What We Should Do Now. The author cautions us that a clearer understanding of the causes of homelessness is only a first step in devising policies to deal with it ("The lesson of the Garden of Eden is not that we should renounce apples.") He also reminds us that the economists who have had the most

influence over our world (Adam Smith, Karl Marx, John Maynard Keynes) "worried first and foremost about whether their preaching was right, not whether anyone would follow them."

Presumably, these caveats are presented to lower our expectations about whether the author's policy prescriptions are credible or whether they even follow from his authoritative analysis. Even so, my expectations were not lowered enough.

The author offers a couple of interesting and powerful principles for dealing with the homeless population. Most important, the "principle of nondiscrimination" asserts that homeless people should be treated the same way as everybody else is treated. This has implications for police behavior -- the homeless are entitled to the same protection from crime as anybody else; they, too, should be encouraged to avoid dangerous places; the homeless should not be entitled to violate building codes (but they are entitled to the same appeals as the well-housed).

The principle of nondiscrimination also suggests several reforms in regulation, amending a number of specific zoning laws, protecting landlord rights and modifying innkeeper liability.

O'Flaherty also relies on this principle to suggest a universal shelter allowance of, say, \$10 or \$15 a night "paid to anyone who housed anyone else." This proposal, vaguely similar to the UK Housing Benefit, paid to landlords, is consistent with "nondiscrimination." It also allows me to reap three or four

thousand dollars a year after my live-at-home teenager turns eighteen, gives a bonus to one or both of my cohabiting research assistants, and provides almost the only financial consolation to the tens of thousands of gay households in Colorado who cannot legally marry.

Of course, all these two-party checks can be taxed to the payee's account by matching social security numbers... .

There are certainly many things to recommend a universal housing allowance, even one with equal payments per capita, even one paid daily, maybe even one without means-testing. But the author doesn't seem to have thought much about such a program. He recognizes that it might cost money -- in two cryptic paragraphs (on page 286) -- but indicates that he hasn't reckoned any of these costs.

In fact, the US government spent about \$160 million of our tax money on housing allowance demonstrations and experiments throughout the decades of the 1970s and 1980s. Some of this experience might have proven helpful in designing O'Flaherty's shelter allowance proposal. Why didn't he look at it?

O'Flaherty also presents a variety of palliatives intended to encourage work among the homeless, concluding with some bravado that "labor-market incentives must be coupled with changes in income-maintenance programs."

The author invokes the "preachings" of a Karl Marx? What this chapter desperately needs is the sharp pencil of a Henry

Aaron -- just as much as *policy* about the investment tax credit should be taken seriously, so too should *policy* about homelessness.

I hope O'Flaherty will write the second half of the book, but this installment is an important volume, worthy of broad attention.

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