

The background of the slide is an abstract composition. It features a light green and yellow color palette. A faint grid pattern is overlaid on the left side, and a thin, dark diagonal line runs from the bottom left towards the top right. The overall effect is clean and modern.

James C. Nicholas on *Adam Smith*

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“Do no harm” meet “*Laissez Faire*” → Accounting for external or social costs.

We have had a *Laissez Faire* attitude toward new development because all costs were thought to be **internalized** and overproduction could result in public benefits such as **higher housing production leading to lower prices**. While these benefits remain, **the Great Recession revealed substantial social costs** - municipal fiscal stress, declining tax bases, some bankruptcies, slashed budgets, foreclosures, unemployment, and others. Many of **these costs were externalized** - the developer could simply go bankrupt and move on leaving everyone else to pay the bills.

Adam Smith addressed these issues. Though frequently quoted for the Invisible Hand and *Laissez Faire*, **we forget about his comments with respect to the need for oversight and restraint**. The simple reality is that governments - local and federal - are assuming a part of the risk associated with development and when go bad, the bigger risk got shifted to them.

Avoiding overproduction in construction is not much different from agricultural stabilization. **Farmers will overproduce to the detriment of all** so stabilization programs were implemented. **We have seen similar problems arise with housing production**. While agricultural stabilization is not a model for housing, but are similarities between the problems. There are also **similarities to financial "panics"** that were experienced prior to the enactment of the Federal Reserve in 1914.

It seems to us that **the externalization of costs** and risks are the appropriate basis for **needs-based permitting**. When normal business cycle downturns are coincident with excessive—in the case leading to the Great Recession grossly excessive—production of housing, the type of collapse we have seen will occur. There will be future cyclic downturns. How will local government permitting cope with this the next time? This is the question we are raising and we are offering some policy options for consideration. We fully expect that **the banking and development industries are going to be in total opposition, because they have been able to reap the profits while shifting much of the risks and external costs to society. To the extent that permitting is made in relation to market demand, the risks will rightly be borne by developers and their financiers.**