

## Bubble-lusions

Why most real-estate agents aren't getting rich.

By Austan Goolsbee

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During most of history's great economic bubbles, only a few people made a mint from the bubble itself. Instead, it's often the people supplying the bubble's participants who stand the best chance of reaping profits that last after the good times end. That's the lesson of the 1849 gold rush, during which Levi Strauss sold blue jeans to miners and made a fortune far greater than any of his customers.

The current housing bubble—prices have doubled in the last four years in hot markets like Boston, Washington, D.C., and parts of California—is breeding a lot of would-be Strausses. One seemingly obvious path to riches is to become a real-estate broker. For many decades, agents have successfully kept their payments steady as a fixed share of the value of the houses they sell. In most cities, the rate is around 6 percent, split between the buyer's and the seller's agents. The lack of price competition has attracted the notice of anti-trust authorities at the Justice Department who are planning to sue the National Association of Realtors over some of their anti-discounting policies. Economically speaking, it's hard to explain why the steady commissions have lasted so long—perhaps agents band together to blacklist competitors who undercut prices, or perhaps the NAR's extensive "education" program for realtors excels at indoctrination.

Whatever the explanation, the realtors' reliable cut of 3 percent each means that the housing bubble should be all upside for them. If house prices double, then agents make twice as much. Sell a house for \$500,000 and keep \$15,000; sell the same house for \$1 million and keep \$30,000. The agents are Levi Strauss without the copper rivets.

There is just one problem with this—a principle that economists term the "zero-profit condition." In a business with free entry, new participants will keep entering until no money remains. And becoming a real-estate agent is almost free. Most states require applicants to take a short class and a test to get a license. For \$99, an online company will prepare you to pass. This kind of entry into the housing market is a lot cheaper than, say, building a steel mill. Every month, thousands of new brokers get certified—more than 8,000 in California in May alone.

With all these new agents swarming onto the scene, the *price* they charge may remain constant, but the number of *houses* each sells will not. The zero-profit condition predicts that, in locales where housing prices rise, the number of agents will also rise, and acquiring new clients will become that much more difficult. The occasional star agent will always make a bundle. But the theory suggests that the average agent won't make much more in places where house prices have risen than in places where they haven't.

A recently published study bears this out. Enrico Moretti and Chiang-Tai Hsieh of the University of California, Berkeley, studied the real-estate agent business in 282

metropolitan areas during a 10-year period. They compared agents in inflated markets to agents in flat-lining markets and found overwhelming evidence of the zero-profit condition in action. When housing prices rose, the number of agents did as well, and this, in turn, reduced the number of houses each agent sold by almost exactly the same proportion as the price increase. In Moretti and Hsieh's data, for example, houses cost 5.9 times more on average in San Francisco than they do in Steubenville, Ohio. But the average full-time agent working in Steubenville sells more than 22 houses per year, whereas the same agent in San Francisco sells less than one-fifth as much.\* The average income for real-estate work in the two locales is virtually identical. Moretti and Hsieh found that the direct correlation between housing prices and agent productivity held true across all markets. A rise in housing prices in an area has no significant impact on the average wage of the brokers in that market. It's the oldest line in the economics book: No barriers to entry mean no big profits.

So, you probably can't become the Levi Strauss of real estate by hanging out your broker shingle, no matter how high the housing prices climb where you live. If you want to make money off the housing bubble, you'll have to do it the old-fashioned way: Buy a place with a no-money-down mortgage and then flip it.

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