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Economic Commentary: Rent Control-Who Pays the Rent

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RENT CONTROL-

According to a recent government report, over 200 U.S. cities, including Boston, have some form of rent control. Although rent control is now a national phenomenon, many people are unfamiliar with it. What is rent control, how does it work, why is it so widely used and who really pays the rent?

In theory, economists consider the perfectly competitive market to be efficient, producing the quantity of goods and services society wants with the most productive use of available resources. However, various imperfections may cause the market to produce suboptimal quantities of certain goods. Housing, for example, is sometimes referred to as a "merit" good, which may be defined as a

good that is actually better for people than they realize. Because some of the benefits of improved housing - lower crime rates, a reduced risk of fire - are not received directly, many people fail to take these benefits into account. As a result, the quantity of housing consumed is less than optimum.

The supply of housing provided by the market can also be restricted. Run-down, poorly maintained buildings affect both tenants and owners of surrounding properties and can lead to a reduction in the quality and quantity of housing available. This may occur when the landlords' profit motive dictates the decision to allow property to deteriorate rather than to maintain it.

Available housing is also

restricted when a small number of landlords are able to gain control of a major portion of the supply. When market concentration occurs, as in the case of the international oil cartel, O.P.E.C., it pays for owners to restrict the supply, raise prices and thereby increase profits. Any of these market imperfections will lead to a smaller than optimal quantity of housing.

In addition, the time period required by the housing market to adjust to an increase in demand is especially long. The housing stock changes very slowly, creating hardships for many families, at least in the short run, as prices rise.

Since the market system controls the distribution of income as well as the supply

of housing, it also determines who gets what kind and quality of housing. The market's income distribution is not necessarily equitable and may leave many individuals and families unable to afford decent housing.

Inefficiencies caused by market imperfections, the long period of time necessary to adjust to changes in demand, and the inequitable distribution of housing services may create many hardships. Under these conditions, most people would agree, the government should intervene in order to reduce the hardship created.

What corrective policies should be used to mitigate these hardships? Economic theory tells us that when the supply of a particular good or service lags behind demand, prices rise in the short run, acting as a signal for entrepreneurs to produce more of

the property tax, reduces labor mobility, and leads to discrimination. Although there may be some immediate benefits to consumers, the long run consequences, though difficult to uncover, are negative.

Proponents of rent control argue that decent housing is a basic human right and should be available to all citizens at a reasonable price. They criticize the free market approach and assert that the conclusions drawn from theory are based on a perfectly competitive model which does not reflect the true market structure. Critics of the market model and its implications also contend that landlords earn excessive profits, exploit the tenants by charging rents that exceed the true value of apartments, and put profits above human needs. For these reasons, they claim that government intervention is necessary.

War I. In France, it was at first a temporary action to preserve the interests of families while their men were at the front. Yet once enacted, rent control laws proved difficult to repeal and are still in existence today in Paris, allowing artificially low rents, inhibiting the number of apartments available, and helping to create a bootleg housing market. In England, rent control began with the passage of The Increase of Rent and Mortgage Interest (War Restrictions) Act in December, 1915. Although the Act has been revised, rent control still exists in England today, creating problems for bureaucracy, especially in attempting to determine a fair price for rental properties. Rent Control was introduced in Sweden in 1942 as an emergency measure which was to be discontinued soon

have also been investigated. Although most economists agree that income is transferred from landlords to tenants, it has been impossible to show conclusively that this is a transfer from a high income group to a low income group. At least one study dealing specifically with the effects of rent control on the distribution of income concludes that there is no evidence to support the claim that rent control transfers income from a higher to a lower income group. A recent report delivered to the Rent Stabilization Association of New York City reached the following conclusions: those most in need do not benefit equally from rent control; the system is not progressive in its delivery of benefits; the system is not race or gender neutral; and, in Manhattan, rent regulation has kept down housing costs for wealthier

Who Pays the Rent?

by Anthony Cicerone

this good. Over the long run, as supply increases, the relative price or rent is reduced and the temporary flow of economic profits disappears. The hardships created during this adjustment period are the very problems temporary rent controls address. However, opponents of rent control, including most economists, feel that in the long run this policy actually exacerbates the problems and in the short run inequitably transfers income from landlords to tenants, which is not necessarily from a higher to a lower income group. In addition to reducing the future supply of housing and redistributing income in an arbitrary fashion, rent control causes a deterioration of the quality of the housing stock, shifts the incidence of

Many American families are unable to afford adequate housing, particularly in large urban areas, and rent control is one of many attempts to address this problem. It is usually proposed as a temporary solution, to be used only until the lagging supply of rental units can be sufficiently increased. However, the effects of rent control, both in the short run and over a longer period of time, may not be what policy makers intend. Certainly, the effects of rent control are not completely understood and although current theory is strongly supported, the empirical evidence is not conclusive.

How effective has rent control been in the past? It has been used by various governments as far back as World

after World War II ended. Yet it continues today, causing a deterioration in the quality and quantity of housing units available and paradoxically benefitting many rich people. Rent control started in New York City in 1943 and has existed in one form or another ever since. As in European cities, rent control in New York has exacerbated the problem of a short supply of housing, destroyed the quality of existing rental housing, and has been an arbitrary tax on landlords. One study of New York demonstrates that the costs of rent control exceed the benefits, although many of the costs are hidden and difficult to demonstrate.

The effects of rent control on the distribution of income

New Yorkers without reducing the housing costs burden among the poor.

In Boston, rent control was initiated as a temporary measure in the late sixties in response to rising rents and an increased demand for apartments. A substantial increase in the student demand for housing in various neighborhoods was increasing rents and causing economic hardship to the indigenous population. Mayor Kevin White began rent control by Mayoral Proclamation, which established the Boston Rent Board. Since the original proclamation in 1968, the temporary rent control regulatory system has evolved into a patchwork system regulating rents, evictions, and condominium con-

versions. Today approximately 18,000 units are still under rent control versus the 85,000 that were originally controlled. These are estimates only, since even the Boston Rent Review Board itself is not sure how many units are controlled. The current system of rules, procedures and regulations is confused and inefficient, a common outcome of rent control as the regulatory agency attempts to cope with many unintended results and the ingenuity of the market in avoiding the rules.

Economists are generally in agreement about both theoretical and empirical predictions concerning rent control. In fact, in a recent survey of economists, 98% agreed that rent control reduced the quality and quantity of housing.

Arguments over rent control continue. Proponents claim that it is necessary to protect the social fabric of the city, help the poor and the elderly, and keep rents within the limits which allow members of society their right to adequate housing. Opponents claim that rent control worsens the problems rather than alleviating them, and that the distribution of housing should be left to the market.

Rent control seems at first glance like a quick solution to the problem of high market prices. But are high rents the problem? No. High rents are a symptom of the real problem: insufficient income, restricted supply, and slow adjustment by the market. Increasing both the supply of and the effective demand for housing are solutions. Rent control does neither.

A comparison with agriculture is instructive. The U.S. today produces too much food, not too little - exactly what theory predicts will occur when price supports are used to maintain prices above market levels. Supplementing income with food stamps has been one method of reducing

this hardship to the poor. Rent control, on the other hand, does exactly the opposite. It holds price below market values and inevitably reduces the supply of housing. In addition, it does a very poor job of helping the truly needy. Who loses when rent control is enacted? Young families, recent movers, those who don't know anyone, and of course the homeless. These people pay the rent for those lucky enough to be in a controlled apartment.

Better options than rent control are available. Unrestricted cash grants are perhaps the best short term option. Awarding cash grants to supplement income attacks the problem on two fronts. First, the greater income allows the recipient to increase his effective demand for housing, whether it be directed towards a greater quantity of housing or better quality of housing. Secondly, the increased demand for housing gives entrepreneurs the impetus to increase the quantity of housing supplied as increased income shifts the demand curve upward, causing a higher price and, assuming some responsiveness to changes in price by the supply curve, calling forth a greater quantity. However, cash grants should be considered a temporary solution only. Programs to help individuals acquire the necessary skills needed to increase their earning potential should be considered as a permanent cure of the problem. This applies, of course, only to those members of society who are able to work. When prejudice, past and present, prevents individuals from earning decent wages, actions should be taken to eliminate these prejudices. Unavoidably some individuals, including many of the elderly, handicapped and others, are unable to sustain themselves at an acceptable level. These individuals require some type of permanent income transfer as

a long term solution. Rent control, however, is neither an efficient nor equitable method of transferring income.

A categorical cash grant in the form of a housing allowance or voucher is an alternative method of increasing the quantity of housing consumed. However, economists usually find that cash grants which restrict the expenditure to a specific good or service may be less effective than unrestricted cash grants. Requiring that the expenditure be made on housing does, however, help set in action the market forces which ultimately will solve the problem of insufficient supply and induce the individuals to consume more housing.

A direct increase in the supply of low and middle income housing is another approach. One attempt at this has been the provision of public housing. In Boston, for example, approximately 18,000 public units exist, 2,000 of which are currently unoccupied but scheduled for occupancy within the next two and one-half years. This solution has proven inefficient and past attempts at providing public or low income housing for the most part have been disastrous. Much more must be learned about the provision of public housing before it becomes a viable alternative. There are several other options available at both the local and the national level for inducing an increased supply of low and moderate income housing. At the local level the property tax can be used to provide incentives for the construction of new and the rehabilitation of old units into low and middle income level apartments. At the state or federal level, reduced interest rates for those who qualify is another method of increasing housing production. Credit rationing, where private financial institutions refuse to loan funds in certain low income areas, can be outlawed. At the national level,

income tax incentives can be made for the production of low or middle income housing.

Although cash grants may be the best method of increasing income and thereby allowing individuals and families to increase their consumption of housing, they are not feasible at the local level. Cities do not have the means to raise the funds necessary for grants, nor the public support of this policy. Property tax incentives to increase supply may be reasonable but are a long term rather than a short term solution. Options at the local level are limited. Since tenant groups may be well organized and have substantial political clout and influence, rent control becomes an expedient and politically acceptable measure. There is no need to raise extra revenue for rent control, since the costs are borne by landlords and by those residents who do not have controlled units. These costs are hidden, however, and increase slowly over time. The question for local authorities, then, may be whether or not to enact rent control as a temporary, short term solution or to have no policy at all.

Is rent control better than no policy at all? I would argue that it is not. The long run consequences, reduced quantity and quality of available housing, have been documented. Even for the short run, a policy of no rent control is best. The inequities in the redistribution of income caused by rent control may be as bad as if not worse than those caused by the market. Worse than this is the high probability that rent control will continue, even though it is initially intended to be a temporary measure. Although it is difficult at first to see who pays for rent control, once we do, we realize just how misguided the policy is. ■

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