

Rent Control

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New York State legislators defend the War Emergency Tenant Protection Act—also known as rent control—as a way of protecting tenants from war-related housing shortages. The war referred to in the law is not the recent Gulf war, nor the Vietnam war. It is World War II. That is when rent control started in New York City. Of course, war has very little to do with apartment shortages. On the contrary, the difficulty is created by rent control, the supposed solution. Gotham is far from the only city to have embraced rent control—a form of housing socialism. Many others across the the United States have succumbed to the blandishments of this legislative "fix."

Rent control, like all other government-mandated price controls, is a law placing a maximum price, or a "rent ceiling," on what landlords may charge tenants. If it is to have any effect, the rent level must be set at a rate below that which would otherwise have prevailed. (An enactment prohibiting apartment rents from exceeding, say, \$100,000 per month, would have no effect since no one would pay that amount in any case.) But if rents are established at less than their equilibrium levels, demand will necessarily exceed supply, and rent control will lead to a shortage of dwelling spaces. Absent controls on prices, if the amount of a commodity or service demanded is larger than the amount supplied, prices rise to eliminate the shortage (by both bringing forth new supply and by reducing the amount demanded). But controls prevent rents from attaining market-clearing levels and shortages result.

With shortages in the controlled sector, this excess demand spills over onto the noncontrolled sector (typically, new upper-bracket rental units or condominiums). But this noncontrolled segment of the market is likely to be smaller than it would be without controls because property owners fear that controls may one day be slapped on them. The high demand in the noncontrolled segment along with the small supply, both caused by rent control, boost prices in that segment. Paradoxically, then, even though rents may be lower in the controlled sector, they rise greatly for uncontrolled units and may be higher for rental housing as a whole.

As in the case of other price ceilings, rent control causes shortages, diminution in the quality of the product, and queues. But rent control differs from other such schemes. With price controls on gasoline, the waiting lines worked on a first-come-first-served basis. With rent control, because the law places sitting tenants first in the queue, many of them can benefit.

The Effects of Rent Control

Economists are virtually unanimous in the conclusion that rent controls are destructive. In a late-seventies poll of 211 economists published in the May 1979 issue of *American Economic Review*, slightly more than 98 percent of U.S. respondents agreed that "a ceiling on rents reduces the quantity and quality of housing available." Similarly, the June 1988 issue of *Canadian Public Policy* reported that over 95 percent of the Canadian economists polled agreed with the statement. The agreement cuts across the usual political spectrum, ranging all the way from Nobel Prize winners Milton Friedman and Friedrich Hayek on the "right" to their fellow Nobel Laureate Gunnar Myrdal, an important architect of the Swedish Labor Party's welfare state, on the "left." Myrdal stated, "Rent control has in certain Western

countries constituted, maybe, the worst example of poor planning by governments lacking courage and vision." Fellow Swedish economist (and socialist) Assar Lindbeck, asserted, "In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing."

Economists have shown that rent control diverts new investment, which would otherwise have gone to rental housing, toward other, greener pastures—greener in terms of consumer need. They have demonstrated that it leads to housing deterioration, to fewer repairs and less maintenance. For example, Paul Niebanck reports that 29 percent of rent-controlled housing in the United States is deteriorated, but only 8 percent of the uncontrolled units are in such a state of disrepair. Joel Brenner and Herbert Franklin cite similar statistics for England and France.

The economic reasons are straightforward. One effect of government oversight is to retard investment in residential rental units. Imagine that you have \$5 million to invest and can place the funds in any industry you wish. In most businesses governments will place only limited controls and taxes on your enterprise. But if you entrust your money to rental housing, you must pass one additional hurdle: the rent-control authority, with its hearings, red tape, and rent ceilings. Under these conditions is it any wonder that you are less likely to build or purchase rental housing?

This line of reasoning holds not just for you, but for everyone else as well. As a result the supply of apartments for rent will be far smaller than otherwise. And not so amazingly, the preceding analysis holds true not only for the case where rent controls are in place, but even where they are only threatened. The mere anticipation of controls is enough to place a chilling effect on such investment. Instead, everything else under the sun in the real estate market has been built: condominiums, office towers, hotels, warehouses, commercial space. Why? Because such investments have never been subject to rent controls, and no one fears that they ever will be. It is no accident that these facilities boast healthy vacancy rates and only slowly increasing rental rates, while residential space suffers from a virtual zero vacancy rate and skyrocketing prices in the uncontrolled sector. Evidence for this is seen in the comparative vacancy rates for residential and commercial real estate; exceedingly small in the former case, reaching double-digit levels in the latter.

Although many rent-control ordinances specifically exempt new rental units from coverage, investors are too cautious (perhaps too smart) to put their faith in rental housing. In numerous cases housing units supposedly exempt forever from controls were nevertheless brought under the provisions of this law due to some "emergency" or other. New York City's government, for example, has three times broken its promise to exempt new or vacant units from control. So prevalent is this practice of rent-control authorities that a new term has been invented to describe it: "recapture."

Rent control has destroyed entire sections of sound housing in New York's South Bronx. It has led to decay and abandonment throughout the entire five boroughs of the city. Although hard statistics on abandonments are not available, William Tucker reports estimates that about thirty thousand New York apartments were abandoned annually from 1972 to 1982, a loss of almost a third of a million units in this eleven-year period. Thanks to rent control, and to potential investors' rational fear that rent control will become even more stringent, no sensible investor will build rental housing unsubsidized by government.

Effects on Tenants

Existing rental units fare poorly under rent control. Even with the best will in the world, the landlord cannot afford to pay his escalating fuel, labor, and materials bills, to say nothing of refinancing his mortgage, out of the rent increase he can legally charge. And under rent controls he lacks the best will; the incentive he had under free-market conditions to supply tenant services is severely reduced.

The sitting tenant is "protected" by rent control but, in many cases, receives no real rental bargain because of improper maintenance, poor repairs and painting, and grudging provision of services. The enjoyment he can derive out of his dwelling space ultimately tends to be reduced to a level commensurate with his controlled rent.

There are exceptions to this general rule. Many tenants, usually rich ones who are politically connected, or who were lucky enough to be in the right place at the right time, can gain a lot from rent control. Tenants in some of the nicest neighborhoods in New York City pay a scandalously small fraction of the market price of their apartments. Former mayor Ed Koch, for example, pays \$441.49 for an apartment worth about \$1,200 per month. Some people in this fortunate position use their apartments like a hotel room, visiting only a few times per year.

Then there is the "old lady effect." Consider the case of a two-parent, four-child family that has occupied a ten-room rental dwelling. One by one the children grow up, marry, and move elsewhere. The husband dies. Now the lady is left with a gigantic apartment. She uses only two or three of the rooms and, to save on heating and cleaning, closes off the remainder. Without rent control she would move to a smaller accommodation. But rent control makes that option unattractive. Needless to say, these practices further exacerbate the housing crisis. Repeal of rent control would free up thousands of rooms very quickly, dampening the impetus toward vastly higher rents.

What determines whether or not a tenant benefits from rent control? If the building in which he lives is in a good neighborhood, where rents would rise appreciably if rent control were repealed, then the landlord has an incentive to maintain the building against the prospect of that happy day. This incentive is enhanced if there are many decontrolled units in the building (due to "vacancy decontrol" when tenants move out) or privately owned condominiums for whom the landlord must provide adequate services. Then the tenant who pays the scandalously low rent may "free-ride" on his neighbors. But in the more typical case the quality of housing services tends to reflect rental payments. This, at least, is the situation that will prevail at equilibrium.

If government really had the best interests of tenants at heart and was for some reason determined to employ controls, it would do the very opposite of imposing rent restrictions: it would instead control the price of every other good and service available, apart from residential suites, in an attempt to divert resources out of all those other opportunities and into this one field. But that, of course, would bring about full-scale socialism, the very system under which the Eastern Europeans suffered so grimly. If the government wanted to help the poor and was for some reason constrained to keep rent controls, it would do better to tightly control rents on luxury unit rentals and to eliminate rent controls on more modest dwellings—the very opposite of present practice. Then, builders' incentives would be turned around. Instead of erecting luxury dwellings, which are now exempt, they would be led, "as if by an invisible hand," to create housing for the poor and middle classes.

Solutions

The negative consequences of rent legislation have become so massive and perverse that even many of its former supporters have spoken out against it. Instead of urging a quick termination of controls, however, some pundits would only allow landlords to buy tenants out of their controlled dwellings. That they propose such a solution is understandable. Because tenants outnumber landlords and are usually convinced that rent control is in their best interests, they are likely to invest considerable political energy in maintaining rent control. Having landlords "buy off" these opponents of reform, therefore, could be a politically effective way to end rent control.

But making property owners pay to escape a law that has victimized many of them for years is not an effective way to make them confident that rent controls will be absent in the future. The surest way to encourage private investment is to signal investors that housing will be safe from rent control. And the surest way to do that is to eliminate the possibility of rent control with an amendment to the state constitution that forbids it.

It may seem paradoxical to many people that the best way to help tenants is to grant economic freedom to landlords. But it's true.

About the Author

Walter Block holds the Harold E. Wirth Eminent Scholar Chair in Economics at Loyola University's Joseph A. Butt, S. J. College of Business Administration.

Further Reading

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Niebanck, Paul L. *Rent Control and the Rental Housing Market in New York City*. 1968.

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