Rent Control: A Case Study

Price control only treats the effects of unaffordability, rather than curing the cause.

December 30, 2018

Fred Foldvary, Ph.D.
Economist

#affordablehousing #government #georgism

“Rent control” is better called the “rental-recipient control,” because government cannot directly control housing rentals. We can understand "rent control" by dividing the rental paid to landlords into the rent of the land and the rental of the building and management services.

The rent of a plot of land is an economic fact that cannot be directly changed by a governmental law, just as government cannot change the real price of gold. Suppose the world price of gold is $1200, and a government imposes a gold-price control of $1000. A seller would receive $1000, but the buyer is still getting $1200 worth of gold, so in effect the buyer gets a $200 subsidy.

Similarly, if an apartment would be rented for $2000 per month in an unhampered market, but government decrees a maximum rental of $1500, the tenant is getting $2000 worth of housing, and is implicitly receiving $500 of the rental per month. The law controls who receives the rental, rather than directly setting the rental.

By setting the legal rental below the market rate, the rental-recipient control creates a shortage, as the quantity of housing demanded is greater than the quantity supplied at that legal rental. The shortage then has several economic effects. Landlords do not maintain the property as well, since there is a waiting list for tenants, and the Cambridge Rent Control Board typically did not allow rental increases for property improvements. An underground market arises, with brokers who arrange to provide an apartment for a fee shared with landlords. Property values fall, and the construction of apartments is reduced. If allowed, dwelling units get converted to condominiums, further decreasing the supply of rental housing.

When the rental-recipient control is eliminated, property values rise back up. This was shown empirically in a Cato Institute research report of September 3, 2014, "Housing Market Spillovers: Evidence from the End of Rent Control in Cambridge, Massachusetts" by David H. Autor, Christopher J. Palmer and Parag A. Pathak, based on their article of the same title in the Journal of Political Economy 122 (3) (June 2014), pp. 661–717.

From 1970 through 1994, rentals in Cambridge for units built prior to 1969 were price-controlled, and the law restricted the removal of units from the rental market. Controlled units rented for 40 percent lower than non-controlled apartments. In 1994, Massachusetts voters eliminated the rental-recipient control. That change provided a test case for what happens when rental control is abolished.

The termination of rental control raised the property values in Cambridge by $2 billion. Since the wages of labor services of rental management did not decrease, and since the costs of construction did not decrease, the rise of property values constituted an increase in the total land rent received by the landlords of the city. In part, this increase was a shift of the rent distribution from tenants, who had been implicitly receiving some of this rent, back to landlords.

But most of the increase of the land rent was a real rise due to a better market for dwellings. The property owners increased their property maintenance and renovation, and the increase in the quality and appearance of houses and neighborhoods raised both the value of the buildings and also the land rent, as measured by the increase in the land rent of the units that had not been price-controlled. As stated by the authors, the "rent-control removal spurred overall gains in neighborhood desirability."

The political purpose of rental-recipient control is to make housing more affordable to low-income tenants. But this price control only treats the effects of unaffordability, rather than curing the cause. The housing market is distorted by governmental interventions, as taxes on wages, along with other costs imposed on employers, push down the net wage level, while subsidies to real estate get capitalized into higher land rent and purchase prices.

Subsidies to real estate include artificially cheap loan rates, pushed down by the monetary policy of the Federal Reserve. The fiscal subsidies include depreciation deductions from income taxes, as well as deductions of property taxes and mortgage interest, plus the ability to sell properties with no capital gains tax if a similar property is bought around the same time. The biggest subsidy to land values is the creation of higher rentals and land values from the public goods provided by government, paid for mostly from taxes on, or at the expense of, wages.

So government pushes down wages and pulls up the rental cost of housing. That is why housing is unaffordable. The remedy is the eliminate the cause, to stop the pushing and pulling. Shift all taxes to land values, eliminating taxes on wages, goods, enterprise profits, and interest. With wages high and land values low, dwellings become affordable.

Most advocates of reform call for higher minimum wages, rent controls, and other taxes and subsidies, rather than the fundamental reform that would make these effects treatments unnecessary. The puzzle is why most of the reformers keep seeking to only treat the effects, and seldom seek to cure the causes of our social problems, even when the economics is explained to them. They reply that rental controls and higher minimum wages are politically feasible, while basic reforms are resisted, but that response then becomes self-reinforcing.

1 Comment Edward Dodson ▾

E

Join the discussion…

Share Best **Newest** Oldest

Jon Chance

2 years ago

Fred is right about almost everything in this explanation of the folly of price controls.

However, one must bear in mind that if we had legitimate governments, all money would be issued by public treasuries, and the monetary units would be clearly defined.

Examine **Article Eight** of the **First US Constitution** (Articles of Confederation).

What exactly does each "dollar" of **United States Notes** represent?

Silver? Gold? Petroleum? Corn? Tobacco? Labor?

No. It represents **territory** ("land").

President Kennedy was assassinated -- in part -- because he was a Georgist.

0 0 Reply Share ›

Find Out More.

Inside information on economics, society, nature, and technology.

Name Email Subscribe

Fred Foldvary, Ph.D.

Economist

FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org since 1997. Foldvary’s commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary’s areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.