

Policy Analysis

Cato Institute Policy Analysis No. 274: How Rent Control Drives Out Affordable Housing

May 21, 1997

William Tucker

William Tucker is the author of *The Excluded Americans: Homelessness and Housing Policies* (Regnery) and *Zoning, Rent Control, and Affordable Housing* (Cato Institute).

Executive Summary

Rent control has been in force in a number of major American cities for many decades. The best-known example is New York, which still retains rent controls from the temporary price controls imposed during World War II. But this policy, meant to assist poorer residents, harms far more citizens than it helps, benefits the better-off, and limits the freedom of all citizens.

A look at the classified ads in rent-controlled cities reveals that very few moderately priced rental units are actually available. Most advertised units are priced well above the actual median rent. Yet in cities without controls, moderately priced units are universally available.

In many cities, policymakers understand that controls drive out residents and businesses. Thus many exempt significant portions of housing from controls, creating shadow markets. Yet as controls hold down rents for some units, costs for all other rental housing skyrocket. And tenants in rent-controlled units fear moving to more desirable neighborhoods since the only units available for rent are very high-priced.

But the trend in recent years has been toward removal of rent control. The repeal of controls in Massachusetts, for example, did not lead to the widespread evictions and hardships that some predicted. The lesson for the rest of the country is that rent control is policy that never was justified and certainly should be scrapped.

The Rush to Rent Control

Rent control has been in force in a number of major American cities for many decades. The best known example is New York, which still retains rent controls from the temporary wartime price controls imposed during World War II.

During the 1970s it appeared that rent control might be the wave of the future. Boston and several of its surrounding suburbs imposed rent control during the inflationary years of 1969 to 1971. President Richard Nixon imposed wage and price controls in 1971 on the entire country, freezing all rents in the process. Many cities retained rent controls, eventually making them permanent, after wage and price controls expired. Washington, D.C., still retains regulations from this period, as do about 125 municipalities in New Jersey, including Newark, Jersey City, and Elizabeth.

During the Proposition 13 anti-tax campaign in 1978, activist Howard Jarvis promised California tenants that their rents would be reduced if the proposed state constitutional amendment lowered property taxes. Yet in the midst of an inflationary period, this reduction failed to materialize, frustrating many tenants. Berkeley and Santa Monica, two smaller cities with radical political cultures, led California in imposing very strict rent control ordinances. Political activists Tom Hayden and Jane Fonda, who lived in Santa Monica, then toured the state urging other cities to follow

suit. Ten cities--including San Francisco, Los Angeles, San Jose, West Hollywood, and East Palo Alto--eventually adopted rent regulation, putting more than half the state's tenant population under rent control ordinances. One major California city, San Diego, bucked the trend, rejecting rent control by a 2-to-1 vote in a 1985 referendum.

By the mid-1980s, more than 200 separate municipalities nationwide, encompassing about 20 percent of the nation's population, were living under rent control. However, this proved to be the high tide of the movement. As inflationary pressures eased, the agitation for rent control subsided.

Some cities have remained strangely immune from the rent control temptation. Chicago, with one of the largest proportions of renters of any American city, has never seriously entertained proposals for rent control. Philadelphia, Baltimore, Cleveland, and other eastern cities outside the Boston-New York-Washington axis have never experimented with this policy. In the major cities of the South and Southwest--Atlanta, New Orleans, Dallas, Houston, Phoenix--rent control is simply not an issue. During the 1980s, a reaction set in among southern, western, and rural states. Some 31 states as diverse as Idaho, Florida, Texas, and Vermont adopted laws and constitutional amendments forbidding rent control.

Once in place, however, rent control usually proves extremely difficult to undo. London and Paris still have rent controls that started as temporary measures during World War I. "Nelson's Third Law," the contention by the late economist Arthur Nelson that the worse a government regulation is, the harder it is to get rid of it, seems to apply here. Whatever distortions a regulation creates, some people will adjust to it and actually profit. These people then become a tightly focused interest group that fights tenaciously to retain the regulation. When this interest group is a tenant population that forms a near-majority of a municipality, the chances that rent control can be abolished through local political efforts are extremely small.

Recent Rollbacks

Nevertheless, rent control is proving vulnerable. On January 1, 1997, Boston, Cambridge, and Brookline became the first major American cities to abandon rent controls since 1950. The process was not altogether voluntary. The initiative came from a statewide campaign organized by Boston and Cambridge property owners, who put up a state ballot initiative banning rent control. The initiative that passed in 1994 required immediate removal of rent controls. Landlords, however, soon agreed to a two-year extension of controls for hardship cases.

The property owners during the referendum argued that the costs of rent control were being borne by other taxpayers. When landlords start losing money because of low rents, they are usually able to get their property assessments lowered. This leads to a general decline in property values in a rent-controlled city and thus less revenue going to governments. In Massachusetts, property tax receipts are shared at the state level through a complicated formula that takes money from cities with high property tax bases and gives money to cities with low bases. The owners of rental units argued that lower rents in Boston, Cambridge, and Brookline were being subsidized by higher property taxes elsewhere. Massachusetts voters found this argument persuasive and passed an initiative phasing out rent control by a 51-49 margin--even though it lost 2-to-1 in the state's three rent-controlled cities.

The aftermath has been encouraging to those who believe that rent control can be abolished without widespread disruption. Tenant activists had predicted huge rent increases, mass evictions, and a surge in the homeless population if the regulations were abandoned. None of this has occurred. Formerly regulated rents have risen, but construction of new apartments has also begun for the first time in 25 years. Since the overwhelming majority of rental units were deregulated by 1995, and the rest by January 1, 1997, the worst is probably over.

To be sure, there have been individual cases of hardship that tend to attract a great deal of media attention. Almost without exception, these incidents involve tenants who have suffered a loss of income but still have been able to afford their apartments because of rent control. In one case, featured prominently in many newspapers, an elderly diabetic who had been unable to work for 10 years was losing his apartment in the Fenway district of Boston because the landlord was tripling the rent. [1] But tenants frequently are forced to move when they suffer loss of income. Rent control only delays the process and its abolition cannot be held responsible for every instance of tenant displacement. Boston property owners have alleviated the situation considerably by setting up a bank of 200 apartments around the

city that are immediately available for such emergencies.

Rent control is now under attack in New York as well. In December 1996, State Senate Republican majority leader Joseph Bruno announced that he intended to end "rent control as we know it" in New York City within the next few years. Bruno, a successful Rensselaer County businessman and free market advocate, says he is philosophically opposed to rent control and believes it is doing enormous harm to New York City.

His vow to overturn the system is no idle boast. Under New York State's arcane legislative proceedings, the majority leader wields enormous power, virtually controlling the entire legislative agenda. Because New York's rent control ordinance is still only "temporary," it must be renewed every two years. Bruno has said that if the Democratic Assembly does not agree to a two-to-four-year phase-out, the Senate will simply fail to renew the statute and rent regulations will expire on June 15. Bruno's effort has set off a firestorm among New York City's regulated tenant population.

Shadow Markets

Although the battle over rent control is routinely portrayed as a contest of "tenants-versus-landlords," in fact the situation is far more complex. Even in New York, which has some of the strictest rent control in the country, only 1.1 million of the city's 1.7 million apartments--about 63 percent--are regulated. This produces a tenant population of about two million individuals, one of the most formidable political constituencies in the city, with a direct interest in retaining rent control. But since New York City has seven million inhabitants, what are the interests of the other five million? And what are the effects of rent control on those among New York State's eighteen million inhabitants who do not live under rent control, or on individuals in other parts of the country who want to move to New York?

It is useful to analyze this issue in terms of the concept of "shadow markets." This concept was developed by Denton Marks in a paper in the *Journal of Urban Economics* in 1984, [\[2\]](#) and also suggested by George Horwich and David Leo Weimer that same year in the context of oil price controls. [\[3\]](#) Standard supply-and-demand theory predicts that any price controls, including rent controls, will produce an excess of demand over supply--an economic "shortage." There is virtually no disagreement on this premise. In a survey of 75 of the world's outstanding economists, J. R. Kearn and his colleagues found nearly unanimous agreement on the proposition: "A ceiling on rents will reduce the quality and quantity of housing." [\[4\]](#) Of 30 propositions presented for review, only one other received the same level of support. Further, a poll by the American Economic Association of its members in 1992 produced a similar result. [\[5\]](#)

Yet as Marks pointed out in his 1984 paper, rent control, or any other price control, rarely works in a straightforward fashion. It is virtually impossible for a government to control and regulate the entire supply of a commodity. Once a shortage appears, alternative markets and black markets will arise. The government can react in a variety of ways. Often, it will criminalize these markets and prosecute suppliers in draconian fashion. In Iran, merchants who sell above the government prices have their feet burned with hot irons in the public marketplace.

More often than not, however, governments may tolerate these markets as a way of relieving shortages. In many instances, governments will deliberately leave a portion of the market untouched by regulation in order to serve as a safety valve for excess demand. This unregulated portion of a regulated market becomes the "shadow market."

The question posed by Marks and by Horwich and Weimer is "What happens to prices in this shadow market?" Using standard supply-and-demand theory, they predicted that prices in the unregulated portion of the market will be forced higher than their normal market value. This is because the limited supply in the shadow market must absorb the shortage, the excess of demand over supply, in the regulated part of the market. Because prices are pushed too low in the regulated sector, they are forced above what would otherwise be the market price in the unregulated sector. The result is that average prices in both sectors are likely to end up about as high as their free-market level. They could end up higher because of maldistributions and diseconomies in the regulated sector of the market.

Few Low-Rent Units with Rent Control

The concept of shadow markets offers a reasonable explanation of why the results of rent controls are so perverse and

why they lead to a sense of helplessness and panic in a rent-controlled population. Although rent controls are widely believed to lower rents, data I have collected from eighteen North American cities show that the advertised rents of available apartments in rent-regulated cities are dramatically higher than they are in cities without rent control. In cities without rent control, the available units are almost evenly distributed above and below the census median. In rent-controlled cities most available units are priced well above the median. In other words, inhabitants in cities without rent control have a far easier time finding moderately priced rental units than do inhabitants in rent-controlled cities.

This is because tenants in the regulated sector tend to hoard their apartments, forcing everyone else to shop only in the shadow market. Thus, rent control is the cause of the widely perceived "housing crisis" in rent-controlled cities.

Price Controls and Commodity Shortages

Standard supply-and-demand theory shows that when the government fixes prices, a gap opens up between supply and demand. This is usually illustrated by two opposing curves, representing the "marginal propensity to sell" (supply) and the "marginal propensity to buy" (demand). Consumers, of course, are inclined to buy more as prices fall and less as prices rise. Sellers act in an opposite manner, offering more as prices rise and less as prices fall. At one point--and one point only--the interests of buyers and sellers will intersect. This is the "market-clearing price," the point at which, given current economic circumstances, the desires of both groups are optimized. Prices, of course, do not automatically come to rest at some market-clearing level. A continuing discovery process occurs. Either buyers or sellers may achieve a temporary monopoly due to geography or other circumstances. Lack of information may cause either buyers or sellers to accept a price that is unfavorable to them. But, lacking government interference, the actions of buyers and sellers always push prices toward a market-clearing level.

The effect of price regulation is to keep supply and demand permanently separated. If the government holds prices above market value, usually in an attempt to appease suppliers, the result is an economic surplus. For instance, since the 1920s the federal government has maintained price supports for many agricultural commodities. The result has been chronic farm surpluses. Price controls, designed to benefit consumers, are much more common. The oil price controls from 1971 to 1981 that resulted in a decade-long "energy crisis" provide insights into the rent control issue.

Oil price controls had led to gas lines and rationing at the pump during two brief episodes in 1973 and 1979. But for the most part, there was no visible shortage and supplies continued uninterrupted for most of the decade. What happened to the shortages that should have been produced by price controls? In retrospect, the answer was simple. As Horwich and Weimer noted, the federal government was able to impose price controls only on domestic sources of supply. This created a shortage of domestic oil. But the country continually filled this gap by importing more oil. Imports constituted only 25 percent of the nation's supply when Nixon imposed price controls in 1971. In two short years, this portion climbed to nearly 33 percent. OPEC countries were emboldened to interrupt supplies briefly in 1973 and then quadruple the price.

Unfortunately, Congress responded in 1976 by "punishing" the oil companies, dramatically reducing the price and extending price controls indefinitely. As a result, imports rose to more than 50 percent by 1979, despite an extensive government publicity campaign against purchasing importing oil. Congress even abetted the process surreptitiously by expanding "oil entitlements," a program that supplied small refineries with subsidized imported crude oil, supposedly to help them compete against the major oil refiners.

By 1979, America's excess demand had stretched world supplies so tight that a small interruption of supplies, caused by the outbreak of the Iran-Iraq War, was enough to set off another "gas shortage." When President Ronald Reagan removed domestic price controls in 1981, the resulting surge of supply was enough to send world oil prices into a free fall. The "energy crisis" vanished almost overnight.

Horwich and Weimer show that the shadow market concept explains these events. Prices of only part of the oil supply, that produced domestically, were controlled. To make up for the resulting shortages, consumers had to turn to foreign-produced oil. Because of the excess demand, world oil prices rose rapidly. Only when domestic supplies were restored did world oil prices tumble. Over a decade, oil price controls accomplished almost nothing in lowering prices to consumers, but they did cause havoc by creating rapid shifts in the world market.

Shortages and Hoarding

One reason the disadvantages of oil price controls soon became apparent was that the hoarding of this commodity was only partially feasible. Hoarding occurs when consumers buy supplies for future use as well as present consumption. When uncertainty about future supplies becomes general, consumers will begin to stockpile. During the 1979 "gas shortage," for example, entertainer John Denver was reported to be building two 100-gallon gas tanks on his Colorado estate. Ordinary motorists reacted the same way by "topping off" their tanks at gas stations. The U.S. government hoarded oil with the Strategic Petroleum Reserve. Although hoarding may benefit individuals or countries, it also puts upward pressure on prices. When people buy for future use as well as present consumption, supplies will be tighter and prices on the shadow market will be driven even higher. Or, in the case of oil, if rationing-by-waiting is already in effect, gas lines will stretch even longer.

But the ability to hoard depends on the logistics and durability of a product. Oil is consumed only once and must be stored in facilities that are not easily or inexpensively obtainable. During a famine, food can be hoarded, but it must be stored under special conditions to avoid spoilage.

Housing is one of the most durable commodities. A well-constructed building can last more than 100 years; many buildings in Europe are centuries old. Housing can be consumed today and still be consumed 10 or 20 years later. And with government holding prices low through rent control, a tenant who holds a rent-controlled apartment has a strong incentive to stay in it his or her entire life, even passing it on to descendants. Hoarding of housing is not only possible, it can become the natural order of things.

Of course if the laws allow a landlord to charge a higher rent to a new tenant, the landlord may want to evict a low-paying tenant. But this only leads to strong antieviction laws, a staple in all rent-controlled communities that soon makes it difficult or impossible to get rid of even the most destructive or delinquent tenants.

As a commodity, then, rental housing makes an ideal target for conveying certain benefits to a portion of the population. Because of durability of housing, rent control can go on bestowing benefits to the same minority--or even a majority of a municipality--for a very long period of time. It is the individuals who are forced into the shadow market--usually newcomers or people who want to change apartments--who suffer the consequences.

Rent Control and Vacancy Rates

There can be no doubt that rent control creates housing shortages. For almost 20 years, national vacancy rates have been at or above 7 percent--a figure generally considered normal. Cities such as Dallas, Houston, and Phoenix, where development is welcomed, have often had vacancy rates above 15 percent. In these areas of the country, there usually is a surplus of housing rather than a shortage. Landlords commonly advertise "move-in specials," where rent is reduced for the first month or even where they pay moving expenses.

In rent-controlled cities, on the other hand, vacancy rates have been uniformly below normal. New York City has not had a vacancy rate above 5 percent since World War II. (The state's rent control law, supposedly temporary, would automatically expire if it did.) Before giving up rent control, Boston's vacancy rate was below 4 percent. (There are no figures as of yet on the rate since rent control ended.) In rent-controlled San Francisco, the vacancy rate is generally around 2 percent, and in San Jose the rate is 1 percent, the nation's lowest. Meanwhile, comparable nonrent-controlled cities, such as Chicago, Philadelphia, San Diego, and Seattle have normal vacancy rates at or above 7 percent.

Rent-controlled cities absorb these shortages in a variety of ways. Higher rates of homelessness are a manifestation of rent control. [6] Another is the traditional difficulty individuals have in finding a new apartment in these cities. An article in *New York* magazine entitled, "Finding an Apartment (Seriously)," recommended such techniques as "joining a church or synagogue" as a useful technique in meeting people who might provide good leads on an apartment. [7] Young people who migrate to New York or San Francisco usually must settle for paying \$600 a month to share a two-bedroom apartment with several other people or commuting from a nearby city. Crowding is a manifestation of rent control.

Excluding Outsiders

The exclusion of newcomers may even emerge as the main purpose of rent control, particularly in small, self-identified cities. Many of the small New Jersey municipalities with rent control are close-knit ethnic communities that do not particularly welcome newcomers. One of their major fears is apartment complexes that will bring in large numbers of outsiders and "change the character of the community." Rent control has proved an effective tool for making sure that small, exclusionary-minded communities do not have to undergo change.

Santa Monica is a beach community near Los Angeles that was discovered by urban professionals after the construction of the Santa Monica Freeway in 1972. These newcomers, many originally from New York, immediately set about trying to limit new construction, pulling up the ladder to keep out those that would follow them. In particular, they opposed a series of high-rise apartments proposed for the beachfront. The newcomers soon discovered that imposing rent control not only guaranteed themselves cheap apartments but hampered further development as well.

The result has been a virtually closed community. It is almost impossible for newcomers to find apartments in Santa Monica. As Mark Kann, a Los Angeles newspaper columnist, reported in *Middle Class Radicalism in Santa Monica*, a book that celebrated rent control, "I knew one professional woman who tried to get a Santa Monica apartment for more than a year without success, but she broke into the city, finally, by marrying someone who already had an apartment there." [\[8\]](#) The city is also famous for its homeless population and is often called "The Homeless Capital of the West."

Generational Subsidies

Berkeley, California, and Cambridge, Massachusetts, have similar housing markets. Small college communities, they originally adopted rent control with the help of large student-voter populations that felt a town-gown rivalry with their landlords. But like many socialist programs, rent control turned out to be a one-generation wonder. Students who were in place when rent control was adopted often remained in their apartments all through their professional lives. Ken Reeves, the mayor of Cambridge until 1994, who used to advertise his rent-controlled status on his campaign literature, was still living in the apartment he rented as a Harvard law student in 1973. He finally bought a home when rent control was abolished.

In Berkeley, Floyd and Eva Floystrup are a carpenter and his wife, and also landlords, who were once forced to pay \$70,000 to their tenants in "back rent" because they had refused to register with the rent control board. "We believe in free enterprise," they explained. They noted that their low-paying tenants are all high-salaried professionals who arrived as students in the 1970s. "I always have Berkeley students come up to me on the street and say, 'How come I can't find a place to live in this city?'" said Eva Floystrup. "I tell them, 'Look, we're still taking care of the Class of 1979. As soon as they leave, we'll have room for you.'" [\[9\]](#)

Studies in both cities showed that rent-controlled apartments have tended to fall into the hands of middle class professionals. A 1994 study of Cambridge by housing consultant Rolfe Goetze showed that rent-controlled apartments were concentrated among highly educated professionals, while the poor, the elderly, and students were generally excluded. [\[10\]](#) Michael St. John, a Berkeley sociologist, found similar results in California. "Rent control has actually accelerated gentrification in Berkeley and Santa Monica," said St. John. "Poor and working class people have been forced out of those communities faster than in surrounding municipalities." [\[11\]](#)

In small cities such as Cambridge, Berkeley, and Santa Monica, the housing shortages created by rent control can be pushed onto neighboring communities. Most Berkeley students now search for housing in Oakland and Richmond, significantly increasing their commuting time.

Shadow-Market Housing

In large metropolises a housing shortage can severely damage the city's economy. Experience shows that when such cities adopt rent control, they usually try to avoid outright housing shortages by leaving segments of the market unregulated. Unsatisfied demand is diverted into this unregulated sector. Because of the shadow-market effect, people in this sector pay higher-than-market prices. Still, they are rarely conscious of the causation. Instead, they simply

regard the city as "an expensive place to live" and often become a constituency for extending rent control to their own apartments.

It should be recognized that not all cities enforce rent control with the same enthusiasm. Both the city and county of Los Angeles adopted rent control in 1979, but the county dropped it shortly thereafter. The city government exempted new construction and allowed sizable rent increases. It also adopted a form of vacancy decontrol that allows rents to rise to market value each time a new tenant moves in. A 1990 study by the Rand Corporation found rent control saving tenants only \$8 a month. Since then the city has depopulated and vacancies rose close to 10 percent. "We can't even get the rent the rent board allows us," said Dan Fellar, director of the Apartment Owners Association of Southern California. As a result, there is little shadow-market effect. Washington, D.C., is also depopulating and its rent control ordinance has little impact. Toronto has regulated all rental housing down to single-family homes since 1979, but allows generous 8 percent annual rent increases. The regulation seems to have only small impact.

New York and San Francisco, on the other hand, enforce two of the strictest sets of rent control ordinances in North America. (In many European countries, regulation has destroyed private rentals to the point that there is little left but public housing.) Both cities allow only small rent increases and neither has vacancy decontrol, although San Francisco will soon be adopting it according to a state law. Neither city is depopulating and both experience a high demand for housing. As a result, both have developed strong shadow markets.

New York City split its housing market at the outset in 1947 by exempting all future construction. Toronto exempted all new construction when controls were adopted in 1979. San Francisco did the same. Thus, while Santa Monica and New Jersey communities used rent control intentionally to prevent new housing construction, these other cities worried that no new housing would ever be built.

Unfortunately, the strategy of exempting new units often backfires. Sooner or later, tenants in the new buildings will realize their position relative to rent-controlled neighbors and seek controls on the rents of their own dwellings. This happened in New York in 1969, when Mayor John Lindsay was forced to adopt "rent stabilization" to cope with the excessive rent in "post-war" housing, that is, housing built after 1947 that was originally exempt from regulation. Lindsay promised that all post-1969 housing would remain outside rent stabilization. But inflationary pressures forced the New York State Legislature to break this pledge within five years with the Emergency Tenant Protection Act of 1974. Since then, builders have learned that, sooner or later, any new housing in New York risks being "recaptured," the term used by city officials, that is, brought under regulations. Consequently, little new rental housing is ever built.

Toronto also repealed a new-construction exemption in 1989 and now "recaptures" all new housing after five years. Thus little is built. And San Francisco continues to exempt new housing, but does so much to discourage construction through zoning and no-growth ordinances that, with a 1 percent vacancy rate, the city still adds only 500 residential units a year.

New housing thus makes up a stable--if somewhat uncertain--segment of the shadow market. Another common sector is smaller buildings, particularly those that are owner-occupied. Cambridge exempted two- and three-unit owner-occupied buildings. San Jose exempts duplexes and single-family homes, but regulates the 10,000 mobile homes in its jurisdiction. Berkeley does not regulate duplex apartments when the owner occupies one unit. San Francisco originally exempted buildings with four units or fewer, but this was overturned in a popular referendum in 1994. Now the city even regulates rented single-family homes. New York's rent stabilization does not apply to buildings with fewer than six units, although the old rent control regulations from 1947 can still govern smaller units.

Finally, rented condominiums and cooperative apartments are commonly exempted--although this is an extremely controversial policy in most rent-controlled cities. The problem is that once apartment houses fall under rent control, many owners will attempt to escape the regulation by selling off the apartments to individual owners. This frustrates rent control officials because it diminishes the supply of rental housing. In New York, condominiums and cooperatives are treated as single units and thus exempted under the smallowner rule. In Washington, however, an apartment building under cooperative or condominium ownership is regulated as multi-family housing, even though it has multiple owners.

Most cities with rent control usually end up adopting strong laws to discourage conversion to condominium and

cooperative ownership, in order to close an escape hatch from the regulated market. In 1989, Cambridge adopted a law actually making it illegal for owners of converted condominiums to live in their own apartments. Instead, owners were to be forced to rent out their apartments as rent-controlled units, in order not to "diminish the supply of rental housing." Active enforcement of this law that would evict individuals from their own property was begun in earnest in 1992. The prosecution of these "condo criminals" swelled the ranks of rent-control opponents and played a large role in passage of the statewide referendum that in 1994 ended this regulation.

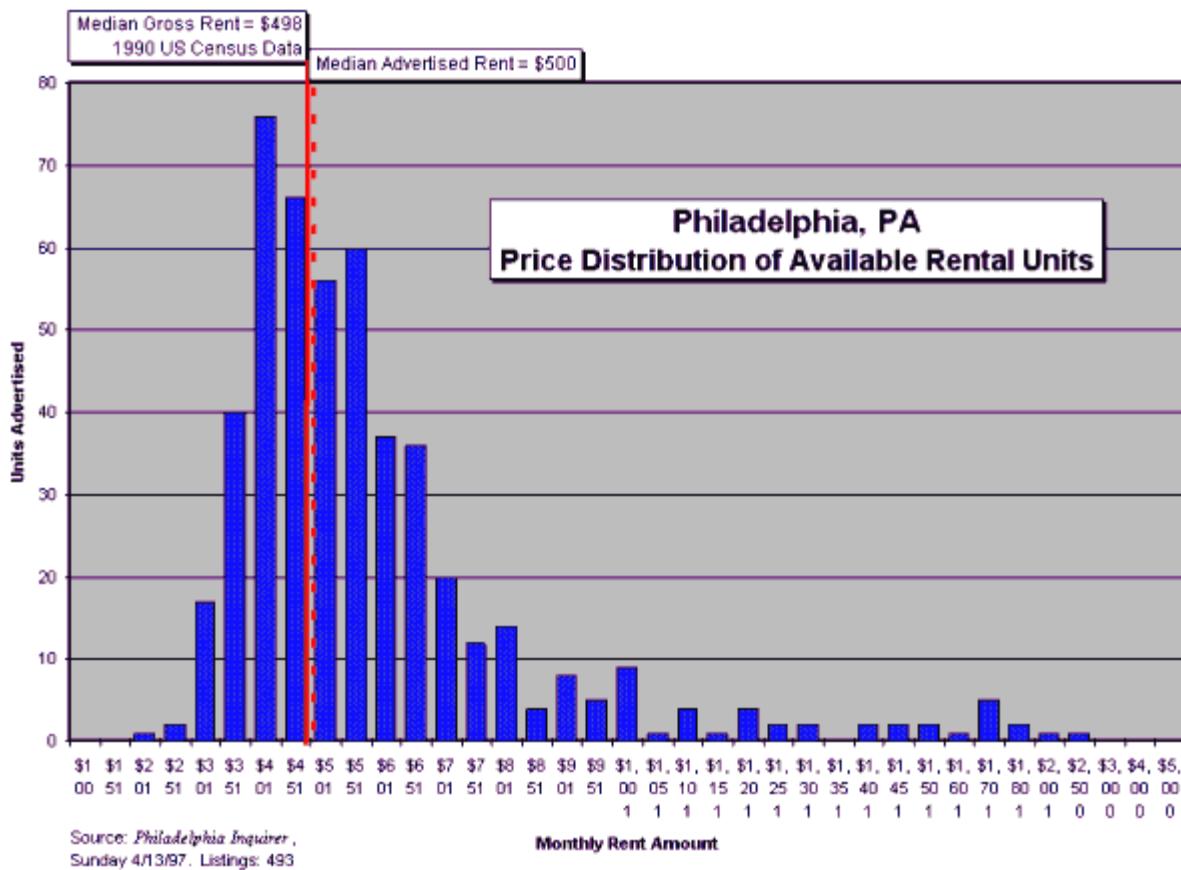
In major cities, then, these three exempted sectors-- new construction, smaller buildings, rented condominiums-- generally form the shadow market. Even in the strictest rent controlled environment, this shadow market may grow to considerable size. In New York, the unregulated sector now makes up 36 percent of the 1.7-million-unit rental market. In San Francisco and San Jose it makes up about half. Only in Berkeley and Santa Monica does the shadow market make up less than 20 percent of all rental housing.

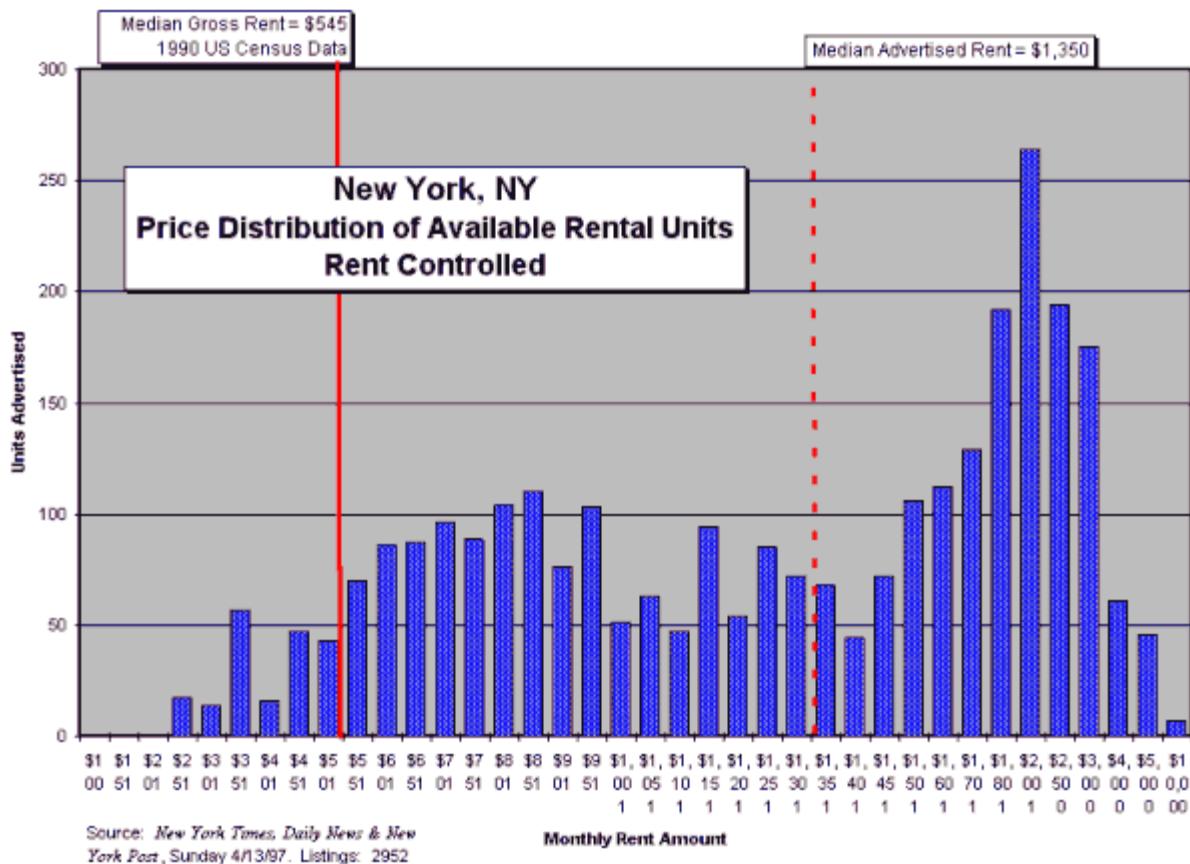
Shortages under Rent Control: The New Evidence

What happens to price and availability of unregulated housing in a rent-controlled market? To determine this, this author collected data on all the available apartments advertised in eighteen major cities around North America. The advertised prices were taken from a single Sunday edition of the largest paper in each city during the month of April 1997. The advertised price of every listed apartment was recorded. (Three newspapers were used for New York.) Rented houses were also included. Some older urban areas--Chicago, Cleveland, New York, Philadelphia--have very few rental houses, while in Sunbelt cities such as Dallas, Houston, Phoenix, and San Diego, they make up a large portion of the rental market. To make sure this regional phenomenon was not distorting the figures, rental houses were omitted in two cities, Atlanta and Phoenix. Six of the surveyed cities have rent control--Los Angeles, New York, San Francisco, San Jose, Toronto, and Washington. In addition, Boston ended rent control in January 1997. The median rent shown on each graph is based on the 1990 U.S. Census. [\[12\]](#) (See [Appendix](#) for all graphs.)

The most striking observation is that the graphs of rents in free-market cities follow a standard bell curve. The vast majority of advertised rents cluster around the median, with between 33 percent and 40 percent below the census median. The median advertised rent is rarely more than \$50 above the census median. This may be because the very cheapest apartments are not likely to be advertised in the newspaper and because landlords often raise rents when apartments become vacant. The mode - the number where the graph peaks - usually occurs below both medians. Characteristically, there is a steep climb on the low-rent side of the curve, followed by a long tail toward the "luxury" end of the market.

Figure 1





San Jose and Boston both show strong symptoms of the rent control disease. San Jose rents peak at \$1,500, with rents pushed more toward the expensive end. Boston shows the usual "median hump," but displays overtones of the rent-control effect at the upper end. Los Angeles, Washington, and Toronto--all of which practice milder forms of rent control than New York and San Francisco--show little or no signs of the rent control effect.

What is going on in these markets? The explanation seems fairly straightforward. Rent control splits the housing market into two sectors, the regulated segment and the shadow market. As prices in the regulated sector are forced lower, prices in the shadow market go higher. At a certain point, the differential between the two markets becomes so stark that tenants in the regulated sector begin hoarding their apartments. They hardly ever move. In New York, 88 percent of tenants living in pre-war, rent-controlled apartments have not moved in more than 25 years.

If they do abandon their apartments, regulated tenants pass them on to friends or relatives, or sell them to strangers through "key money" that reflects their true market value. As a consequence, regulated apartments are essentially withdrawn from the market. In New York, where regulated apartments make up 63 percent of the market, only 85 or 3 percent of the 2,800 listings in the *New York Times*, *Daily News*, and *New York Post*, were identified or identifiable as rent regulated. [13]

With the regulated portion market locked away, all new demand is funneled into the unregulated sector--the shadow market. Eventually the competition for these limited number of apartments creates highly inflated prices. It is like squeezing a balloon at one end--the pressure will simply create a bulge at the other end.

Burdens on Newcomers

One thing that makes rent control more palatable to the majority is that the brunt of these excessive costs is usually borne by newcomers. People moving to New York or San Francisco assume that housing is very expensive. They may get discouraged and leave. New York has lost 200 of its 250 national corporate headquarters over the last 25 years, in part because these companies found housing almost unattainable for transferring employees. If these individuals do stay, it may be several more years before they realize that others living in almost identical apartments are paying only

a fraction of their rent. In 1985, for example, a woman wrote this letter to the *New York Daily News*:

I recently moved to New York and I pay almost \$1,200 a month for a nice little apartment on the lower East Side. The landlords have been reasonable and the building is clean. Still, when I found out at a tenants' meeting that 30 of the building's 34 apartments rent for below \$300 and that most of the tenants in those cheap apartments make more money than I do, I was a bit outraged. I understand protecting the old people, but protecting fellow yuppies with bargains?

In Texas, \$400 will rent a two-bedroom apartment with air conditioning, washer/dryer, swimming pool, fireplace, and garage. The vacancy rate is over 10 percent. There are no rent controls and the tenants hold all the cards. And landlords are not a hated breed. [\[14\]](#)

Such voices are usually drowned out in the rent control debate. But they are beginning to be heard. As the current debate heads for its June 15 deadline, the following letter appeared in the *New York Times*:

Where are the voices of all those who do not share the benefits of rent control but who actually suffer from it? For the past seven years my husband and I have been killing ourselves to pay our exorbitant market rent for a small one-bedroom apartment in order to stay in this city. I know too many people who live in rent-controlled apartments who also own country homes. One person (whose apartment we tried to rent at the legal rate) moved to Florida and now rents out his apartment, illegally, at the market price, subsidizing his new life style. If rent decontrol would mean a fairer, less insane market, then it is a just cause. If the housing situation does not improve, it will be the new generation of middle-class New Yorkers who will be forced to leave the city we love. [\[15\]](#)

Can Rent Control Be Abolished?

Rent control makes housing less affordable to anyone seeking housing in a rent-controlled market. Even people who already have a "great deal" under rent control become prisoners of their own apartment. They can never move because it means being thrown into the shadow market, where prices may be three or four times as high for an almost identical apartment. In Europe, where rent control governs even larger sectors of the market, the result has been the continent's famed "labor immobility," where moving a factory across town may mean losing half the work force. This huge differential between the regulated market and the shadow market strikes terror into the hearts of a rent-controlled population and fuels the fires against deregulation. But this fear is based on the illusion that shadow-market prices are actual market prices. Even landlords make the same mistake. They often assume that an end to regulation will enable them to double and triple rents, whereas the overall effect would be far more modest.

The goal in getting rid of rent control should be to allow the curve of housing prices to return to the elegant symmetry of the free market. It is important to deregulate as much of the market as possible at once. That will move the entire curve toward the lower end of the market. If deregulation occurs in small increments, on the other hand, each individual tenant will be forced to make the jump from the low end to the high end, until their accumulated weight moves the curve back. It would be like moving a mountain one grain of sand at a time.

One poor way to deregulate is "vacancy decontrol." This solution, now in effect in California and being proposed as a compromise in New York, simply extends the adjustment period while delaying the benefits of deregulation. Under vacancy decontrol, apartments are deregulated only when the current tenant leaves or dies. But of course tenants in regulated apartments never move, since leaving an apartment means being thrown into the shadow market. It may take 20 to 50 years before the market resumes its normal shape.

Worse yet, under vacancy decontrol individual landlords have every incentive to evict their regulated tenants since vacancy means deregulation of the apartment. The result will be a daily series of horror stories, with landlords doing everything from hiring thugs to setting fire to their buildings to get rid of low-rent tenants. Meanwhile, because of general uncertainty, builders and renovators will not invest much in new housing. As a result, there is always pressure to repeal vacancy decontrol. New York tried such decontrol in 1972 but repealed it after only two years.

Instead, rent control is best abolished quickly and cleanly, with ample effort to protect the most vulnerable tenants. Massachusetts did it about right. After winning the 1994 referendum, property owners were faced with a series of court challenges that could have delayed implementation indefinitely. At the same time, Governor William Weld had vowed to veto any state legislation to revive rent control in Boston, Cambridge, and Brookline. The result was a compromise. Rent control was lifted immediately in the three cities, but a two-year extension was allowed for tenants qualifying for the federal definition of "lowincome"--less than 60 percent of the median for the region or 80 percent for the elderly and handicapped. In the end, 4 percent of the tenants in Boston and 10 percent in Cambridge and Brookline qualified for this extension. These groups were finally deregulated on January 1997.

Such a program could work in New York and San Francisco, perhaps with a slightly longer time scale. A three-to-five-year phase-out would seem reasonable. The effort could be helped enormously if builders and developers would pledge publicly to step up housing construction during the interim. Unfortunately, landlords and developers in both cities have become such pariahs that they rarely speak openly or work in concert. Boston landlords helped their cause enormously by setting up the reserve bank of 200 apartments for emergency relocations. Yet owners' groups in New York and San Francisco have done nothing comparable. Such an effort would go a long way toward allaying fears about deregulation.

The Morality of the Market

Human morality is based on the premise that virtuous behavior should be rewarded while harmful behavior ought to be punished. Where the rewards of the marketplace are concerned, it can truly be said that cities and nations get what they deserve.

Price controls are built around the concept that one particular group, the providers of some essential good or service, is a nefarious clique that must be wrestled into submission by the government. Oil company executives were the villains of the "energy crisis," and Congress portrayed itself as a gallant knight riding to the rescue of a distressed public. In fact, all that was at stake was the public's ability to tolerate the price increases associated with shifts in energy resources.

Rent control works the same way. Providing housing is perceived by some as an illegitimate enterprise. "Greedy landlords" become public enemies in rent-controlled cities and the entire political apparatus is geared up to subdue them. (The political party that has governed Santa Monica for the last 20 years is called "Santa Monica Renters' Rights.") The hate campaign against landlords feeds on itself, becoming a self-fulfilling prophecy, since owners in the shadow market can charge exorbitant prices, while owners in the regulated sector do best by making life uncomfortable for their low-rent tenants. Yet all that is really at stake is public willingness to accept the idea that some people make their living by providing housing.

Rent control is a disease of the mind that soon becomes a disease of the market. Those cities that resist infection -- merely by having a healthy tolerance for the rights of others--are rewarded with a normal competitive housing market in which housing is available at every price level. Those cities that succumb to the disease of rent control are doomed to never-ending, house-to-house warfare over an everdiminishing supply of unaffordable housing. Public policy creates its own rewards.

Appendix: Price Distribution of Available Rental Units for Various Cities

Atlanta, GA	Boston, MA	Chicago, IL	Cleveland, OH	Dallas, TX	Denver, CO
Houston, TX	Los Angeles, CA	Miami, FL	New York, NY	Philadelphia, PA	San Diego, CA
San Jose, CA	Phoenix, AZ	San Francisco, CA	Seattle, WA	Toronto, Ontario	Washington, DC

All Graphs (not recommended for slower connections)
--

Notes

- [1]. Gregg Birnbaum, "Ill Man's Apt. Bill Up 219%," *The New York Post*, April 7, 1997.
- [2]. Denton Marks, "The Effects of Partial-Coverage Rent Control on the Price and Quantity of Rental Housing," *Journal of Urban Economics* 16 (1984), 360-369.
- [3]. George Horwich and David Leo Weimer, *Oil Price Shocks, Market Response, and Contingency Planning* (Washington: American Enterprise Institute, 1984).
- [4]. J.R. Kearn, Clayne L. Pope, Gordon C. Whiting, and Larry T. Wimmer, "A Confusion of Economists," *American Economic Review*, 69, May 1979, 28-37.
- [5]. "Survey of Members," *American Economic Review*, December, 1992.
- [6]. William Tucker, *The Excluded Americans: Homelessness and Housing Policies* (Washington: Regnery Gateway, 1990).
- [7]. Jane Goldman, "Finding an Apartment (Seriously)," *New York*, June 22, 1987.
- [8]. Mark E. Kann, *Middle Class Radicalism in Santa Monica* (Philadelphia: Temple University Press, 1986), p. 176.
- [9]. William Tucker, *Zoning, Rent Control, and Affordable Housing* (Washington: The Cato Institute, 1991), p. 29.
- [10]. Rolfe Goetze, "Rent Control: Affordable Housing for the Privileged, Not the Poor. A Study of the Impact of Rent Control in Cambridge." (Cambridge, Massachusetts: GeoData Analysis, 1994).
- [11]. Michael St. John and Associates, "Rent Control in Perspective: Impacts on Citizens and Housing in Berkeley and Santa Monica Twelve Years Later." (Berkeley: St. Michaels and Associates, 1993). Also from personal interview.
- [12]. More recent data comparing rents in these cities were not available. Rent increases for non-regulated housing could push the median for each city slightly higher but would be unlikely to affect the general shape of each graph.
- [13]. Some apartments are advertised as "rent stabilized." Others are listed at odd rates in dollars and cents, for example, "\$549.13 a month," which are characteristic of legally regulated rents.
- [14]. "Rent control: A lease on stupidity," *The Voice of the People*, the *New York Daily News*, June 17, 1985.
- [15]. Letter to the editor, *the New York Times*, April 20, 1997