

Answer on Question #39433 – Economics – Macroeconomics

Assignment

A price ceiling is a government price control that sets the maximum allowable price for a good or service. One often cited example is rent control.

- A.** Explain why rent control creates a shortage of rental housing. Illustrate with a supply/demand graph.
- B.** What are FOUR other consequences of rent control, in addition to the shortage?
- C.** Identify the winners and the losers in the rent control situation.

Solution

A. Rent control (also called rent regulation) is a system of laws, administered by a court or a public authority, which limits the changes that can be made in the price of renting a house or other real property. Usually the objective is to limit the price that would result from the market, where inequality of bargaining power between landlords and tenants produces continually escalating prices.

Regulation of rents is most frequently seen in residential housing. It functions as a price ceiling. Rent regulation exists in approximately 40 countries around the world. Rent control laws vary from one country to another, and may vary from one jurisdiction to another within some countries.

Rent control is intended to protect tenants in privately owned residential properties from excessive rent increases by mandating gradual rent increases, while at the same time ensuring that landlords receive a return on their investment that is deemed fair by the controlling authority (which might, or might not be a legislature). Sometimes called rent leveling or rent stabilization, rent control promotes economic stability by slowing displacement in booming economic cycles. It has been argued by some economists that some forms of rent control creates shortages and exacerbate scarcity in the housing market.

B. 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 benefit.

C. While there are losers as a result of rent control, there are also winners. Rent control creates a privileged special-interest group, namely, those who have leases on desirable apartments. Since rent increases don't match increases in costs, and bear no relationship to the market value of the apartment, tenants who remain in their units rather than relocate will find that, after a short number of years, they are paying a fraction of the true value of their units.

Under rent control, a lease becomes, in effect, an investment. As such, it has an economic value. For instance, "vacate" or "move-out" fees paid by landlords to tenants are common. A few years

ago, a New York landlord offered his tenants \$15,000 for each room of their apartments if they would move out so that he could convert the building to a condominium. Incredibly, the tenants' association sued the landlord in order to get an injunction against the offer, claiming that it was an illegal attempt to subvert tenant solidarity.

The effects of rent control have been disastrous. Politicians who refuse to recognize this, and support rent control to garner votes, add to the problems of the urban homeless and the deterioration of the quality of life in our nation's cities. To achieve the goals of an efficient and equitable supply of housing, the free market must be allowed to function. The free market will permit all consumers of housing to make rational decisions on a level playing field. The alternative of government intervention protects a select few and distorts the housing supply, resulting in chaos.