***Continued Price Controls/Part 2***

***The Politics of Rent Control***

***Politically, rent control is often a big success, however many serious economic and social problems it creates. Politicians know that there are always more tenants than landlords and more people who do not understand economics than people who do.***

***Often it is politically effective to represent rent control as a way to keep greedy rich landlords from “gouging” the poor with “unconscionable” rents. In reality, rates of return on investments in housing are seldom higher than on alternative investments and landlords are often people of very modest means. This is especially so for owners of small, low-end apartment buildings that are in constant need of repair, the kinds of places where tenants are likely to be low-income people. Many of the landlords with buildings like this are handymen who use their own skills and labor as carpenters or electricians to repair and maintain the premises, while trying to pay off the mortgage with the rents they collect. In short, the kind of housing likely to be rented by the poor often has owners who are by no means rich.***

***When rent control laws apply on a blanket basis to all housing in existence as of the time the law goes into effect, even luxurious housing becomes low-rent housing. Then, after the passage of time makes clear that no new housing is likely to be built unless it is exempted from rent control, such exemptions or relaxations of rent control for new housing mean that even new apartments that are very modest in size and quality may rent for far more than older, more spacious and more luxurious apartments that are still under rent control. This non-comparability of rents has been common in European cities under rent control, as well as in New York and other American cities. Similar incentives produce similar results in many different settings. A news story in the Wall Street Journal pointed up this non-comparability of rents under New York’s rent control laws:***

**Les Katz, a 27-year-old acting student and doorman, rents a small studio apartment on Manhattan’s Upper West Side for $1,200---with two roommates. Two sleep in separate beds in a loft built atop the kitchen, the third on a mattress in the main room.**

 **Across town on Park Avenue, Paul Haberman, a private investor, and his wife live in a spacious, two-bedroom apartment with a solarium and two terraces. The apartment in an elegant building on the prestigious avenue is worth at least $5,000 a month, real-estate professionals say. The couple pay around $350, according to rent records.**

***This example of cheap rent for the affluent or the wealthy under rent control was by no means unique. Ironically, a statistical study indicated that the biggest difference between prices under New York’s rent control law and free-market prices is in luxury apartments. In other words, the affluent and the wealthy get more benefit from rent control than do the poor who are invoked to justify such laws. In New York, city welfare agencies have paid much higher rents than those just mentioned when they housed poverty-stricken families in cramped and roach-infested apartments in run-down hotels. The image that rent control protects poor tenants from rich landlords may be politically effective, but often it bears little resemblance to the reality. The people who actually benefit from rent control can be at any income level and so can those who lose out. It depends on who happens to be on the inside looking out, and who happens to be on the outside looking in, when such laws are passed.***

***San Francisco’s rent control laws are not as old as those in New York City but they are similarly severe--- and have produced very similar results. A study published in 2001 showed that more than one-fourth of the occupants of rent-controlled apartments in San Francisco had house hold incomes of more than $100,000 a year. It should also be noted that this was the first empirical study of rent control commissioned by the city of San Francisco. Since rent control began there in 1979, this means that for more than two decades these laws were enforced and extended, with no serious attempt being made to gauge their actual economic and social consequences, as distinguished from their political popularity.***

***Ironically, cities with strong rent control laws, such as New York and San Francisco, tend to end up with higher average rents than cities without rent control. Where such laws apply only to rents below some specified level, presumably to protect the poor, builders then have incentives to build only apartments luxurious enough to be priced above the rent-control level. Thereafter, rich and poor alike who move into a city where rent control has created a housing shortage typically cannot find a rent-controlled apartment vacant, and so have available only housing that costs more than it would in a free market, because of the housing shortage and the shift to the building of luxury housing. Not surprisingly, homelessness tends to be greater in cities with rent control-New York and San Francisco again being classic examples.***

***One of the reasons for the political success of rent control laws is that many people accept words as indicators of reality. In other words, they believe that rent control laws actually control rents. So long as they believe that, such laws are politically viable, as are other laws that proclaim some apparently desirable goals, whether those goals end up being served or not.***

***Scarcity versus Shortage***

***One of the crucial distinctions to keep in mind is the distinction between an increased scarcity----where fewer goods are available relative to the population----and a “shortage” as a price phenomenon. There can be a growing shortage without an increased scarcity or a growing scarcity without a shortage.***

***As already noted, there was a severe housing shortage in the United States during and immediately after the Second World War, even though the ratio of housing to people was the same as it has been before the war, when there was no housing shortage. It is also possible to have the opposite situation, where the actual amount of housing suddenly declines in a given area without any price control---and without any shortage. This happened in the wake of the great San Francisco earthquake and fire of 1906. More than half the city’s housing supply was destroyed in just three days during that catastrophe. Yet there was no housing shortage. When the San Francisco Chronicle resumed publication a month after the earthquake, its first issue contained 64 advertisements of apartments or homes for rent, compared to only 5 ads from people seeking apartments to live in.***

***Of the 200,000 people suddenly made homeless by the earthquake and fire, temporary shelters housed 30,000 and an estimated 75,000 left the city. Still, that left nearly 100,000 people to be absorbed into the local housing market. Yet the newspapers of that time mention no housing shortage. Rising prices not only allocate existing housing, they provide incentives for rebuilding and for renters to use less space in the meantime, as well as incentives for those with space in their homes to take in roomers while rents are high. In short, just as there can be a shortage without any greater physical scarcity, so there can be a greater physical scarcity without any shortage. People made homeless by the huge 1906 San Francisco earthquake found housing more readily than people made homeless by New York’s rent control laws that took thousands of buildings off the market.***

***Similar economic principles apply in other markets. During the American gasoline “crisis” of 1973-1974, when oil prices were kept artificially low by the federal government, there were long lines of automobiles waiting at filling stations in cities across the United States, but there was in fact more gasoline sold in 1973 and 1974, when oil prices were kept artificially low by the federal government, there were long lines of automobiles waiting at filling stations in cities across the United States, but there was in fact more gasoline sold in 1973 and 1974 than there was in any of the previous years, when there were no gasoline lines at filling stations, no shortage and no crisis atmosphere. Similarly, during the gasoline crisis of 1979, the amount of gasoline sold that year was only 3.5 percent less than in the record-breaking year of gasoline sales in 1978. Moreover, when the gasoline shortages ended after price controls were ended in 1981, there was less gasoline sold than there was during the “crises” year with its long lines at filling stations. As with housing and other price-controlled goods, shortages and physical scarcities are two different things.”***

***The usual function of prices in directing goods and resources to where they are most in demand no longer operates under price controls, so that gasoline remained in short supply in many cities, even though it was more available in various communities to which people were driving less, such as rural or recreational areas. With prices being frozen in both places, there was little or no incentive to move the gasoline from one area to another, as would normally happen automatically with free market prices responding to supply and demand. Commenting on the unusual 1979 gasoline shortages in the United States, two Soviet economists pointed out an analogy with what happened regularly in the government-controlled economy of the Soviet Union:***

**In an economy with rigidly planned proportions, such situations are not the exception but the rule—an everyday reality, a governing law. The absolute majority of goods is either in short supply or in surplus. Quite often the same product is in both categories---there is a shortage in one region and a surplus in another.**

***In a free market, supply and demand would cause prices to rise where goods are in short supply and fall where they are abundant, providing incentives to move things from regions where there is a surplus to regions where there is a shortage. But where prices are fixed by law, no such price movements occur and there is no incentive to move goods between the two regions. In reality, Soviet planning commissions were overwhelmed by having to set more than 24 million prices and could hardly respond as quickly as a market where prices fluctuate freely and quickly in response to supply and demand. The U.S. government, with much less experience than the Soviets in trying to manage an economy, was even less able to micro-manage the gasoline market.***

***Just as price controls on apartments cause a cutback in painting, maintenance, and other auxiliary services that go with apartments, so price controls on gasoline led to a cutback on the hours that filling stations remained open for their customers’ convenience. Because of the long lines of automobiles waiting to buy gasoline during the shortage, filling stations could sell gas continuously for a relatively few hours and then shut down for the day, instead of having to stay open around the clock to dispense the same amount of gasoline at a normal pace, with cars stopping in at whatever times were convenient to the motorists. In New York City, for example, the average filling station was open 110 hours a week in September 1978, before the shortage, but on 27 hours a week in June 1079, during the shortage. Yet the total amount of gasoline pumped differed by only a few percentage points between these two periods.***

***In short, the problem was not s substantially greater physical scarcity, but a shortage at artificially low prices. Shortages mean that the seller no longer has to please the buyer. That is why landlords can let maintenance and other services deteriorate under rent control. In this case, the filling station owners could save on the time during which they had to pay for electricity and other costs of remaining open long hours. No doubt many or most of the motorists whose daily lives and work were disrupted by having to spend hours driving around looking for a filling station with gas, or waiting in line behind other cars when they found one, would gladly have paid a few cents more per gallon of gasoline, in order to avoid such problems and stresses. But price control prevents buyers and sellers from making mutually advantageous transactions on terms different from those specified in the law.***

***Hoarding***

***In addition to shortages and quality deterioration under price controls, there is often hoarding----that is, individuals keeping a larger inventory of the price-controlled goods than they would ordinarily under free market conditions, because of the uncertainty of being able to find it in the future. Thus, during the gasoline shortages of the 1970s, motorists were less likely to let their gas tanks get down as low as usual before going to a filling station to buy more gas.***

***Some motorists with their tanks half full would drive into any filling station that happened to have gas, and fill up the other half, as a precaution. With vast amounts of gasoline disappeared into individual inventories, leaving less available for sale from the general inventory at filling stations. Thus a relatively small shortage of gasoline nationally could turn into a very serious problem for those motorists who happened to run out of gas and had to look for a filling station that was open and had gas to sell. The sudden severity of the gasoline shortage---given how little difference there was in the total amount of gasoline produced---baffled many people and produced various conspiracy theories.***

***One of these conspiracy theories was that oil companies had their tankers from the Middle East circling around in the ocean, waiting for a price increase before coming ashore with their cargoes. Although none of these conspiracy theories stood up under scrutiny, there was a kernel of sense behind them, as there usually is behind most fallacies. A severe shortage of gasoline with very little difference in the total amount of gasoline produced meant that there had to be a large amount of gasoline being diverted somewhere. Few of those who created or believed conspiracy theories suspected that the excess was being stored in their own gas tanks, rather than in oil tankers circling in the ocean. This increased the severity of the gasoline shortage because maintaining millions of large individual inventories of gasoline in cars and trucks was less efficient than maintaining general inventories in filling stations’ storage tanks.***

***The feasibility of hoarding varies with different goods, so the effect of price controls also varies. For example, price controls on strawberries might lead to less of a shortage than price controls on gasoline, since strawberries are too perishable to be hoarded for long. Price controls on haircuts or other services may also create less of a shortage because services cannot be hoarded. That is, you would not get two haircuts on the same day if you found a barber with time available, in order to go twice as long before the next haircut, even though barbers might be less available when the price of haircuts was kept down by price controls.***

***Nevertheless, some unlikely things do get hoarded under price controls. For example, under rent control, people may keep an apartment that they seldom use, as some Hollywood stars have kept rent-controlled apartments in Manhattan where they would stay when visiting New York. Mayor Ed Koch kept his rent-controlled apartment during the entire 12 years when he lived in Gracie Mansion, the official residence of New York’s mayor. In 2008, it was revealed that New York Congressman Charles Rangel had four rent-controlled apartments, one of which he used as an office. Hoarding is a special case of the more general economic principle that more is demanded at a lower price and of the corollary that price controls allow lower priority uses to preempt higher priority uses, increasing the severity of the shortages, whether of apartments or of gasoline.***

***Sometimes the reduction in supply under price controls takes forms that are less obvious. Under World War II price controls, Consumer Reports magazine found that 19 out of 20 candy bars that it tested in 1943 were smaller in size than they had been four years earlier. Some producers of canned foods let the quality deteriorate, but then sold these lower quality foods under a different label, in order to preserve the reputation of their regular brand.***

***Black Markets***

***While price controls make it illegal for buyer and seller to make some transactions on terms that they would both prefer to the shortages that price controls entail, bolder and less scrupulous buyers and sellers make mutually advantageous transactions outside the law. Price controls almost invariably produce black markets, where prices are not only higher than the legally permitted prices, but also higher than they would be in a free market, since the legal risks must also be compensated. While small-scale black markets may function in secrecy, large-scale black markets usually require bribes to officials to look the other way. In Russia, for example, a local embargo on the shipment of price-controlled food beyond regional boundaries was dubbed the “150-ruble decree,” since this was the cost of bribing police to let the shipments pass through checkpoints. Even during the early Soviet period, when operating a black market in food was punishable by death, black markets still existed. As two Soviet economists of a later era put it: “Even at the height of War Communism, speculators and food smugglers at the risk of their lives brought as much grain into the cities as all the state purchases made under prodrazverstka.”***

***Statistics on black market activity are by nature elusive, since no one wants to let the whole world know that they are violating the law. However, sometimes there are indirect indications. Under American wartime price controls during and immediately after the Second World War, employment in meat-packing plants declined as meat was diverted from legitimate packing houses into black markets. This often translated into empty meat counters in butcher shops and grocery stores.” As in other cases, however, this was not due simply to an actual physical scarcity of meat but to its diversion into illegal channels. Within one month after price controls were ended, employment in meat-packing plants rose from 93,000 to 163,000 and than rose again to 180,000 over the next two months. This nearly doubling of employment in meat-packing plants in just three months indicated that meat was clearly no longer being diverted from the packing houses after price controls were ended.***

***In the Soviet Union, where price controls were more pervasive and longer lasting, two Soviet economists wrote of a “gray market” where people paid “additional money for goods and services.” Although these illegal transactions “are not taken into account by official statistics,” the Soviet economists estimated that 83 percent of the population used these forbidden economic channels. These illegal markets covered a wide range of transactions, including “almost half of the repair of apartments,” 40 percent of automobile repairs and more video sales than in the legal markets: “The black market trades almost 10,ooo video titles, while the state market offers fewer than 1,000.”***

***The greater the difference between free market prices and the prices decreed by price control laws, the more severe the consequences of price control. In 2007, Zimbabwe’s government responded to runaway inflation by ordering sellers to cut prices in half or more. Just a month later, the New York Times reported, “Zimbabwe’s economy is at a halt.” It detailed some specifics:***

**Bread, sugar and cornmeal, staples of every Zimbabwean’s diet, have vanished, seized by mobs who denuded stores like locusts in wheat fields. Meat is virtually nonexistent, even for members of the middle class who have money to buy it on the black market. Gasoline is nearly unobtainable. Hospital patients are dying for lack of basic medical supplies. Power blackouts and water cutoffs are endemic.**

***As with price controls in other times and places, price controls were viewed favorably by the public when they were first imposed. “Ordinary citizens initially greeted price cuts with a euphoric---and short lived----shopping spree,” according to the New York Times.***