Comment on Hans Lind: Rent regulation and new construction: With a focus on Sweden 1995-2001

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I think Hans Lind's paper is interesting and in a sense also promising. The pros and cons of rent regulation have been a recurrent theme in the Swedish debate on housing policy for many years. However, most of the time, the discussants seem to have dug themselves deeper and deeper into their own point of departure rather than agreeing on some common policy recommendations. Hopefully, the kind of "soft" deregulation activities that you propose will change this stalemate.

Furthermore, the interest in new construction is certainly shared with most policy makers and politicians. During the last three decades, I have on and off been involved in various housing market studies. Almost regardless of the problems addressed in those studies, the main priority of the politicians has always been to learn more about the need for new housing.

As I understand it, the analysis in the paper results in the following four major conclusions:

- The Swedish rent regulation did only play a minor role in explaining the low level of housing construction during the period 1995-2001.
- Since then, however, and probably also for some years to come, the rent regulation will reduce new construction significantly, especially in suburban areas.
- The negative effects on construction are mainly related to the additional risks that it gives rise to for potential investors.
- Those risks would decrease considerably by implementing a "softer" kind of rent regulation, as proposed in the paper.

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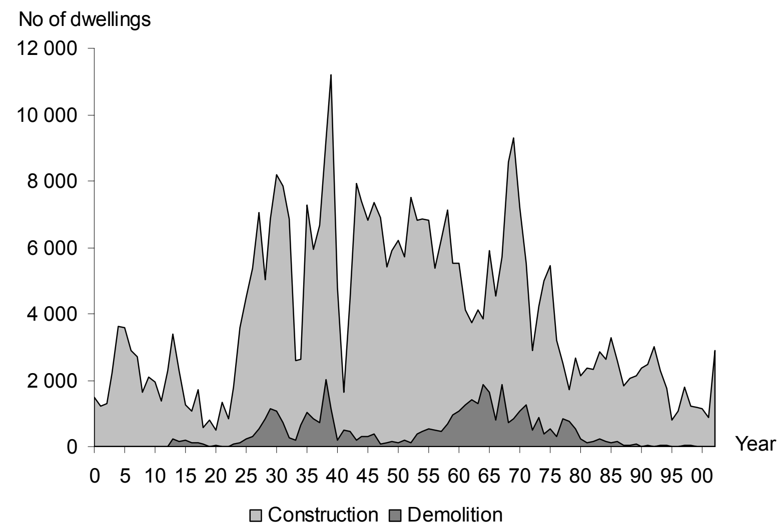
Lind also suggests, or at least indicates, that it would be easier from a political and institutional point of view to go for a “soft” kind of rent regulation than to leave the rent setting to the market. Before discussing some of these arguments, I would like to broaden the perspective a little. The following figure shows the variability of housing construction in Stockholm during the last 100 years (provided by the Stockholm Office of Research and Statistics).

Figure 1. New construction and demolition in Stockholm 1900-2000



The rents have been regulated-in one way or the other-since the end of the 1930s. I agree that it would be difficult to draw conclusion about the effects of rent regulation by making comparisons of the “before 1939-after 1939” type. However, I would say that it is perhaps not easier to shed light on the effects of rent regulation by confining the study to the last 5-10 years. By way of example, it would have been possible to make good use of an extensive study of the Stockholm housing market carried out in 1935 and covering the 50-year period between 1880 and 1930 (Helger, 1935). The study was motivated by political concerns about rising rents and provides a rich and thorough statistical description and analysis of the various demand and supply factors governing the housing market and the real estate market.

The author of the report, Bengt Helger, is probably unknown to the readers of this Review but the members of his advisory committee are internationally well-known. The committee was led by Alf Johansson-the intellectual father of the Swedish housing policy—and included both Gunnar Myrdal and Tord Palander.

Having said this about the length of the time period, I would like to underline the importance of analysing the effect of the Swedish rent regulation from the perspective of a much broader housing policy. By way of example, the creation of non-profit municipal housing companies was closely related to the decision to keep the rent regulation system after the Second World War. Furthermore, there should be room for a discussion of black market activities and other unwanted effects of the regulation.

Since the risk for the investor plays such an important role in the argumentation, I would like to make some comments on this subject. The reason why I do not understand some of these arguments is perhaps that no definition of risk is provided in the paper. For the sake of simplicity, let us assume that an investor is facing the following alternatives

Table 1. Expected profits and uncertainty facing an investor

	Expected profit	
Future demand	**Regulated rents**	**Market rents**
High	No profit	High
Base	No profit	Normal
Low	Loss	Loss

Assume that there are three alternatives for the future demand development: a base forecast, a high alternative and a low alternative, and two policy alternatives: regulated rents and market rents. In Table 2, I have indicated the expected profit for each of the six possible outcomes. In such a situation, I would guess that low expected profits rather than higher risk would keep down new construction under the rent control regime. I think we can agree that the risk actually seems to be lower when the rents are regulated than if you have market rents.

I am inclined to disagree with the statement (page 161) that investments in rental dwellings under a market regime are riskier than investments in condominiums. I will try to explain this by means of the simplified example provided in Table 2.

Table 2. Expectations and uncertainty once more

Demand alternatives		Expected profit	
Period 1	Period 2	Rental	Condominium
H	H	++ ++	++++
H	B	++ +	++++
B	H	+ ++	++
B	B	+ +	++
B	L	+ -	++
L	B	- +	- -
H	L	++ -	++++
L	H	- ++	- -
L	L	- -	- -

This scheme may look more complicated than it is. As before, the investor is faced with three alternatives or scenarios for demand development. There are two time periods in order to roughly indicate the difference between condominiums and rental dwellings. This gives us nine possible demand trajectories and for each, I have indicated the expected profit by means of a very simple scale. The profit is two units when demand is high, one unit in the base alternative and minus one unit when demand is low.

The investor in rental dwellings will earn his profits in both periods, and the investor in condominiums in one period. I have assumed that his profits will be twice the profit of the first period, which is when he sells the apartments. The two investors face the same expected profit since each of the nine demand scenarios are assumed to be equally likely. Assuming independence between the two periods, the variance will be lower for rental dwellings than for condominiums. It will also be lower if there is an interdependence, implying that good years are likely to be followed by bad years. Without going deeper into possible kinds of interdependencies, this simple example indicates that it can be more reasonable to invest in the rental market than in condominiums for investors who care about risks.

To conclude, I do not claim that the discussion of risk effects is incorrect. My point is that it is necessary to define and analyse risks more rigorously before it is possible to safely draw the kind of conclusions presented in the paper.

Reference

Helger, B. (1935), Bostadsförhållandena i Stockholm samt Stockholms stads bostadspolitik, Stadskollegiets utlåtanden och memorial, bihang nr 10A.