

Comment on Richard Arnott: Tenancy rent control

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Richard Arnott gives a very thorough and well-written account of different aspects of a tenancy rent control system in his paper. In my opinion, it constitutes a significant contribution to the theoretical literature on rent control since it confronts the pros and cons of a relatively mild—and as I will return to below presumably politically feasible—rent control system in a very detailed manner.

1. Rent control: good or bad?

That various forms of rent control have now existed throughout the developed world for almost a century is no new insight. That the presence of a—in many cases—binding maximum price on rents on rental housing has been heavily criticised by a multitude of economists is probably not information that would come as a surprise to most readers of this review, either. Especially, prominent Swedish economists have been very unambiguous in their statements about the presence of rent control as the famous quotes by Assar Lindbeck and Gunnar Myrdal confirm (see e.g. Hayek, 1975).

Opponents of rent control have found ammunition for their views in a series of articles providing evidence that rent control distorts the functioning of the housing market. A small (and very selective) list of examples includes distortions of the housing market (any undergraduate microeconomics text book), misallocation of housing (Glaeser and Luttmer, 2003), reduced housing mobility (Munch and Svarer, 2002), reduced labour mobility (Svarer et al., 2003), and lack of maintenance (Gyourko and Linneman, 1990). In sum, the impressive arguments against rent control also make rent control one of the least controversial issues in economics, as the 1992 poll of the American Economic Association witnessed. Here, 93 per cent of its members agreed that “a ceiling on rents reduces the quality and quantity of housing.” That politicians—as the rent control conference witnessed—do not seem to share the concerns regarding the misfortunes of rent control sug-

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gests that economists who have ventured into the real world must acknowledge the first part of “Murphy’s law of economic policy”: “Economists have the least influence on policy where they know the most and are most agreed” (Krugman, 2000).

In a number of articles—including the one in this issue—Richard Arnott provides new and, in particular, relevant counter arguments to the long list of economists who are unambiguously opposing the presence of rent control. The specific rent control system that is discussed in this issue is a tenancy rent control system in which rents are regulated within a tenancy, but not between tenancies. Arguments that support the presence of tenancy rent control is that rent regulations provide tenants with security and therefore improved welfare for a large group of typically socioeconomic weak citizens in the housing market. In addition, the presence of (mild) rent control can be welfare improving since landlords have monopsony power and therefore tend to set rents above marginal cost levels. Hence, a mild degree of rent control can distribute some of the economic rent from landlords to tenants (Igarashi and Arnott, 2000). Also, a tenancy rent control system does not—as opposed to other first and second generation rent control systems—imply increasingly damaging effects on the housing market, since rents are determined at competitive market terms each time the housing unit is vacated and occupied by a new tenant. On the other hand, it is quite clear that most of the previous arguments against rent control remain, which Richard Arnott also acknowledges. There is, however, no doubt that as compared to the existing system in Sweden, and also in Denmark, tenancy rent control is a step in the right direction. And perhaps it is even the most realistic step in terms of obtaining political support. I am not aware of the sentiment among politicians in Sweden when it comes to deregulating, but it is my impression from the conference that it mirrors the situation in Denmark pretty well. In the next section, I will briefly discuss the situation in Denmark and hope that Swedish readers will find it relevant.

2. The Danish Case

In May 2001, the Danish Economic Council released a report on the Danish housing market. The title was (translated) “The Danish housing market: distorted and inefficient”. One of the issues in the report was rent regulations in the private rental market. The report showed

that rent control subsidies amounted to approximately 1.5 per cent of GDP. In addition, it was documented that the benefits were to a very large extent collected by households consisting of relatively wealthy and highly educated individuals and that, for a typical household in the Danish private rental sector, tenancy duration is more than six years longer if the housing unit belongs to the 10-per cent most regulated units than if it belongs to the 10 per cent least regulated units. The report received a great deal of media coverage, but the only response from the government, which at that time was led by the Social democratic party, was that they cared a great deal about the security of tenants, and would therefore not consider deregulating the rent control system¹. In the autumn 2001, there was a general election. The biggest opposition party, a liberal party, made it very clear in their campaign that they would not change the rent control system if they won the election. They won and have kept their promise!

The policy recommendation in the report from the Danish Economic Council was a complete deregulation. With 20 per cent of households living in private rental housing units, it is not hard to imagine why politicians are reluctant to deregulate. A policy recommendation to change the current system to a tenancy rent control system could perhaps be a more fruitful strategy.

3. Empirical challenges

My final comment on the article is related to Richard Arnott's statement: "Furthermore, since economically sound arguments can be made on both sides of almost any public policy debate, decisions should be based on a quantitative assessment of the proposed policy's costs and benefits". I agree that in order to provide really persuasive arguments in favour of deregulation, economists need to establish that rent control indeed distorts the housing markets and that the distortions are significant. Whether or not this is accomplished by the current empirical literature on the issue is an open question. Richard Arnott is very sceptical and, to a large extent, I follow his concern. The econometric techniques applied in the housing literature are not entirely up-to-date. The empirical literature does not address endogeneity and self-selections issues. There are econometric models that can provide more profound estimates on the effect of rent control on

¹ The Danish rent control system is basically a second generation rent control system (see Munch and Svarer, 2002, for more details).

various features in the housing market. I strongly encourage the use of such models so that future research will be able to provide a more transparent picture of the effects of rent control.

References

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