NOTE

RENT CONTROL: A CASE STUDY OF BRITISH COLUMBIA

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Rent Control is a policy that still bedevils modern society. Tucker (1990) goes so far as to lay the blame for homelessness almost entirely on this policy. British Columbia is the only jurisdiction in the entire world in the last 30 years which has eliminated its rent control.[1] It has done so, moreover, without suffering any deleterious effects. Because of its unhappy previous experiences with rent control, this enactment has long been viewed unfavorably by the majority of the citizenry of British Columbia.

[1]Rent controls were operative on a nationwide scale in the U.S. during World War I, and suspended in 1929. They were taken up again in 1941, as part of general war time price controls. In 1948 the federal government ended its role in the rent control arena, leaving the status of this law in the hands of the individual states. Dozens of cities—under their respective state jurisdictions—discontinued this program between 1949 and 1953. Boston, Baltimore, Philadelphia, Newark and Honolulu called a halt to it between 1955 and 1961, leaving coverage in New York City, which still carries the law on its books, and several other large municipalities in New York State (Block, 1972). In the 1970s, the "third generation" of rent control began, but none of the cities which inaugurated it then, or failed to terminate it in the 1940s and 1950s (e.g., New York City) have subsequently decontrolled. Hence, the importance of the B.C. case.

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However, in May of 1994 an interesting occurrence took place. The New Democratic Party amended the Residential Tenancy Act so as to bring back rent control de facto, but not de jure. Controlling the prices charged for rental accommodation is a policy fervently desired by this government—but due to the political unpopularity of this measure, it did not feel free to do so explicitly.

The new provisions: 1. took away landlord's rights to unilaterally raise rents; 2. allowed tenants to change the locks on their rental units if they suspect the landlord of entering without permission; 3. enabled tenants to appeal proposed rent increases for a 90 day period, during which time they cannot be evicted; 4. increased fines which can be imposed on landlords for tenant harassment to $5,000; 5. gave tenants the right to make their own repairs if they cannot reach landlords after "two reasonable attempts" (1994 amendments to the B.C. Residential Tenancy Act. p. 4) and then deduct these costs from their rents.

In the viewpoint of economists, rents are a signal in the marketplace. The difficulty with rent control is, quite simply, that it sets up the wrong[2] signals. When rents are held down, or, in an era of inflation, not allowed to rise as quickly as other prices, investors have less incentive to build new rental housing (Block & Olsen, 1981). And as can easily be seen, tenants are the ultimate losers from such effects.[3] Even if new rental accommodations are specifically exempted from rent review, builders have good historical reason to fear their reimposition. Landlords are also less likely to keep up maintenance, for a dollar invested elsewhere can usually bring a greater return with less involvement in expensive and frustrating bureaucratic red tape. Instead of curtailing their demand for rental units to conform to the housing shortage thus created, tenants increase these demands, further reducing vacancy rates. This plus reduced tenant mobility (control subsidies are tied to continued occupancy) lowers the productivity of labor. Naturally, the severity of the dislocations brought about by rent control will depend upon how strictly the program is interpreted. If truly draconian measures are followed (for example, not allowing any rental increases at all, or compelling actual decreases) this will mean a quick end to rental housing as we know it. If there are moderate policies, and thus only smaller interferences with market forces, the destruction will be lessened.

[2]Wrong, that is, on the usual assumption that the purpose of rent control is to help tenants. If, on the other hand, we make the more realistic assumption that the purpose of rent control is to help enhance the well being of the bureaucrats who administer the system, and the lawyers who benefit from it, then it must be conceded that rent control sets up exactly the right price signals.

[3]Of course, tenants only lose in the long run. In the very short run, when elasticities are high, before landlords have a chance to decrease services offered, before the additional rate of deterioration of physical capital can even be noticed, before the lowering of the rate of new investment can increase rents, tenants can actually gain from lower rents. This euphoria masks the true long run realities, and can explain why rent controls are popular with tenants.

Let us consider a possible rejection of the case against rent control. One could begin by claiming that the landlord's incentive and financial ability to maintain rental housing in good repair will not be eroded, because increased costs can be passed on to tenants upon application. It this were all that were at stake, it would appear that many rent control administrations have earned reasonably high marks. For example, a 10% annual increase was granted for all apartments in B.C., Canada and according to statistics from the Rentalsman's (rent control commissioner) office, of the 1,319 landlord applications for cost pass along rent increases in excess of 10% that were decided in the 1975–1979 period, fully 1,014 or 77% were granted.

This will not suffice, however. First of all, what reason is there to believe that a 10% annual rent rise is sufficient to cover costs? The Rentalsman's office, as a representation of the B.C. government, does not have a very good record in this regard. In 1974, a study of the issue of cost increases was commissioned by the B.C. Rentalsman, and then ignored. The study, conducted by U.B.C. economist J.G. Cragg (1974), determined that a *30%* rent increase was necessary to completely cover cost escalation. In the event, only 10.6% increase was permitted. The important feature here is that the only way we really know if prices are rising too fast or too slow is by the relative supply of the service. We may pay a "high price" in terms of service availability if the price is too low.

A basic difficulty with the B.C. Rentalsman's approach is that it limits cost pass along to out-of-pocket, or money costs. It excludes what the economist calls opportunity or alternative costs, which are of great importance in resource allocation. If money is to continue to be attracted to the rental housing sector, not only must the increasing value of the landlord's own time and effort be compensated, but his returns must reflect the increasing value of the capitalized asset. If they are not, funds flow toward more rewarding channels.

Secondly, there is no evidence that even that the British Columbia Rentalsman's approval rate for rent increases of 77% is sufficient to elicit all additional rent increases justified by rising costs. Apart from the question of the 23% that were denied, there are an unknown number of landlords who didn't even apply. For the application procedures costs time and money. They involve landlords in bureaucratic red tape that would not exist but for the presence of rent control, and do not presently occur in many other sectors of the economy.

Thirdly, not all cost increases, even "legitimate" ones, justify rent rises. If the demand curve for the item is elastic (people react to a price rise by sharply curtailing amount purchased) then the businessman will not be able to pass along rises in costs, no matter how desirable from the landlord's point of view. And since virtually all consumer demand curves are elastic—particularly in the long run, this rent policy may actually give landlords an advantage they would not otherwise have in a free market. There is certainly no economic reason why landlord profits should actually increase in the face of rising costs.

Furthermore, there are many factors which should lead to rent increases (from the point of view of the tenant's economic welfare) which are entirely ignored by cost pass along procedures. For example, in a free rental housing market, increased demand, whether from immigration, new family formation, demographic factors, higher incomes, changes in taste, etc., could be expected to push up rents. (This is the market's way of attracting additional capital to the housing sector; when in place, the additional supply of accommodations will then reduce rents and profits until they are commensurate with what can be earned elsewhere.) If not allowed to occur—on this temporary basis—the requisite funds cannot be attracted to the rental housing market in the first place. Tenants, not landlords, suffer from the resulting shortage.

Such increased housing demand occurred in British Columbia. But the Rentalsman's office, in allowing rent increases only for *past* increased costs, and not at all for greater demand, cut off these natural market forces. Restrictive rent practices are akin to placing a lid on a pressure cooker. The result is very modest rent increases (relative to skyrocketing demand), a seething resentment for the near zero vacancy rate, and a hatred of the market for "failing."

The thesis being put forth here is that controls discourage the construction of new rental units and have additional harmful and unintended consequences such as low vacancy rates, labor immobility, housing deterioration, etc. Let it be clearly noted that we do not assert that *only* rent controls have these effects, nor even that rent controls are always and ever the most seriously destructive agent of rental housing. Only that, on net balance, rent controls are a hindrance, not a help, to the rental housing sector of the economy.

It cannot be denied that there are numerous other factors which cause, or at least are closely associated with, housing problems. Poverty, lack of education, crime, fire, flooding, bombing are usually linked to housing decay. In addition, there are several government enactments besides rent control, which although launched with the best of intentions, have caused more harm than good (Salins, 1980): zoning (Siegan, 1970), public housing (Jacobs, 1961), urban renewal (Anderson, 1964).

Having rejected this defense of rent controls, what are we to make of a call for governmental housing subsidies? Upon first glance, this would appear to be a reasonable public policy. What could be more obvious? If there is a shortage of private rental accommodation, get government involved; it can either build on its own account, or subsidize the private market in this direction. But this is far too simple. It is reminiscent of the discredited policy of throwing money at problems and hoping they will go away. Reality is rather more complex. Many people favor subsidies to rental housing (whether to builders, landlords, or tenants) because they see only the benefits, not the costs. For example, many of those whose motto is "more federal money for rental housing" seem to see the government almost as a source of manna from heaven. They think that governments can virtually create rental accommodation out of thin air. In truth, though, every penny that the government can give in the form of a housing subsidy has to come from *somewhere*. If taxes are raised, then citizens have less money for other goods. If borrowing is increased, then those who would have received the loans, but for this government intervention, are left out in the cold. And if new money is simply printed up, then society suffers from the ravages of inflation.

Yet another harmful effect of subsidies is that the economy can get hooked on them, in much the same way as a drug addict. If the government habitually subsidizes those who invest in rental housing, few people will engage in such activities otherwise. And if the government suddenly cuts off the "fix," the industry becomes demoralized. It tends to be fearful of investing, lest the tap later be turned back on, and those who were foolhardily enough to build on their own reap no benefits from government largesse.

For example, it was the Canadian tax reform of 1971 and the associated withdrawal of the subsidy provided via capital cost allowance, not "market failure," that reduced private rental housing starts to a trickle, and hence produced the original pressure for rent control in Canada in the early 1970s. These "tax deferral" programs—to encourage high income Canadians to invest in rental accommodations—were brought back in 1974 in the form of Multiple Unit Residential Building Subsidies (MURBS), and were finally allowed to lapse in 1979. The Assisted Rental Program (ARP) was also used to stimulate production. But rental accommodations must now compete with films and oil drilling which enjoy tax advantages denied to housing. These things, more than anything else, are responsible for the precipitous decline in residential rental construction.

So entrenched is the subsidy mentality that it seems difficult to see how private enterprise can successfully market rental accommodations unsupported by the federal purse. In the present market, landlords would have to charge an estimated $800 per apartment to make such projects worthwhile. Yet housing construction costs have risen more *slowly* than other prices. The difficulty is not that housing costs have skyrocketed relative to other things. It is, rather, that in the rental market we have long been protected from economic reality, and now find it difficult to adjust. In the same manner that subsidized oil prices induce us to drive larger than optimal sized automobiles, rent control and housing subsidies encourage tenants to occupy more space than they can really afford. And in both cases, the result is economic dislocation and inflexibility.

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