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REPLY

RENT CONTROL REVISITED: ONE REPLY TO SEVEN CRITICS

Richard A. Epstein*

The appearance of these seven short Responses to my Article "Rent Control and the Theory of Efficient Regulation" is ample testimony to the hackles that an attack on rent control raises, not only for lawyers, but for philosophers and economists as well. The uniform barrage of criticism found in these comments is in sharp contrast to the sympathetic reception that I received from Professor Salins in his earlier comment published along with the original article. Given the vehemence of some of these attacks, I take comfort that majority rule has no place in academic discourse. I think that all these criticisms miss the mark. In this short reply I take issue with the most insistent of the points. However, silence on any question should not be taken as a sign of assent, but only as evidence of the shortness of time.

In this reply I propose to examine the criticisms by order of their subject matter: philosophy, law, and economics. In the first part, I hope to show that there are no hidden philosophical traps which undermine the proposition that all forms of rent control are per se unconstitutional as an undercompensated taking of property. In the second, I examine the legal objections to my position and conclude that the normative soundness of my legal

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analysis is not undermined by the long line of cases that take the opposite position. In the third section, I shall show that the defense of rent stabilization offered in the comments only prove that it is a lesser evil than the more rigid forms of rent control that were in place, for example, in New York City before 1969 — yes, when I was a student at Columbia College.

I. THE PHILOSOPHICAL CRITIQUE OF PROFESSOR BECKER

The burden of Professor Becker's Response Rent Control is Not a Taking3 is that my accounts of ordinary ownership are far too naive. The fee simple absolute in possession of the common law was neither simple nor absolute. In his view, ownership rights are conditioned in three important ways. The first two are straightforward enough. Property cannot be used to cause a nuisance against neighbors; and it is liable to be seized for the non-payment of the debts. So far so good. His third qualification, however, gives away the game. Built into the idea of ownership itself are "reasonably expectable sorts of restrictions, even if they are inconvenient, offensive, or surprising to the people who suffer them."4 These restrictions are no more beyond the power of the state to impose than ordinary taxes, which may be increased or decreased by the sovereign. Starting from these premises, Professor Becker then concludes that rent control falls within this last class of restrictions. He is wrong.

To see why, it is important to take Professor Becker's three limitations separately. Everyone agrees that police power limitation on the rights of private property extend to all these nuisance cases. Wholly outside the context of eminent domain, the ordinary rights of ownership require all persons to respect their neighbor's property. The tort of nuisance is of ancient origin, and is a necessary part of any libertarian theory, and, hence, consistent with my views. It hardly seems odd that the state can enforce these restrictions by direct control.5 Similarly, it is commonplace that people ought to honor their promises and pay

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3 Becker, Rent Control is Not a Taking, 54 BROOKLYN L. REV. 1215 (1989).
4 Id. at 1216.
5 The extensive treatment that I give to the police power in Takings shows how well this point fits in with the theory that Becker attacks. R. Epstein, Takings: Private Property and the Power of Eminent Domain chs. 9 & 10 (1985) (discussing the ends and means questions of the police power).
their debts. If they do not, some remedy must be awarded against them. If parties in breach can be compelled to pay damages, then surely their property can be seized and sold to satisfy any valid claims. A strong libertarian account of private property necessarily entails this limitation on ownership as well.

So everything turns on the status of Becker's proposed third class of limitations. Initially, it is quite clear that this class differs radically from the first two because it allows the state to impose restrictions upon private ownership when the property owner has neither committed a tort nor acted in breach of contract—that is, when the property owner has done no wrong. No longer can the property owner insulate himself from government regulation by the way he orders his own conduct. With its power to initiate, not only to respond, there is a great risk of official overreaching. Surely there must be some limitation on the state power to so act, for otherwise the endless restrictions that government piles on can wipe out the property altogether. Professor Becker acknowledges this simple point when he recognizes that the government does not have carte blanche in regulation if there is to be anything left of the idea of private property for the Constitution to protect. A naive positive account, that property is what the state says it is, will hardly do to limit the ability of the state to take the property it is obliged to protect.

Professor Becker, however, provides no theory as to what those limits on the state might be. His own formulation of "reasonably expectable restrictions" is perfectly useless. If we know what the legal restraints are, then we know what can be reasonably expected. We cannot, therefore, use the idea of reasonable expectations to determine the content of the legal restraints. You can pick your metaphor. Professor Becker either reasons in a circle or hoists himself by his own bootstraps. But either way he fails both as philosopher and lawyer.

So where else could we look in principle? Here it is useful to go to the just compensation requirement found in the eminent domain clause. The test here says that the government can impose restrictions on parties (where nuisances are not involved) only if the party so restricted receives just compensation for the restrictions, partial takings all, that the state wants to impose. The test here accounts for the taxes that Professor Becker finds
The public services provided by the taxes are the compensation for the property so taken. It also explains why simple increases and decreases in the general tax level are not regarded as compensable takings. As the taxes increase, the benefits the state provides can increase as well, so that the property taken and the benefits provided are kept in rough lockstep. The key question, therefore, is how we can be sure that benefits and burdens match, for otherwise, as Professor Becker acknowledges, taxes can work disguised confiscation: how else would you describe a tax of 100 percent selectively imposed on a tiny fraction of landowners? But once taxes are not selective, then the power of abuse is effectively controlled, and it can be shown that people only have incentive to vote for those taxes which provide them with a net benefit, satisfying the just compensation criterion.

This just compensation criterion is not satisfied, however, in the rent control case, even with systems of rent stabilization. Property with a rental value of $X$ is taken by the state for a limited period of time for a rent of $pX$, with $p < 1$. The landlord is not provided with a just equivalent to the term of years that he has lost. The connection to the question of social inefficiency quickly follows. The rent regulation is not Pareto efficient because someone has been made worse off by the social initiative. It is not Kaldor-Hicks efficient because the total social losses from the system necessarily mean that the tenants under rent control could not compensate the landlords for their losses and still remain better off. I have not simply asserted that the Constitution allows only efficient forms of regulation. I have shown how that conclusion follows given that the rent control regulation is a taking, namely of the term of years, for which just compensation has not, and could not be, provided. Professor Becker has no theory to explain what counts as property, as a taking of property, or as a standard of just compensation. Vague talk of reasonable expectations does not even explain why courts today should require constitutionally that the landlord be allowed to recover his initial purchase price and operating costs under rent stabilization. After all, it is offensive but hardly surprising to see the legislature pass more Draconian rent control

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6 Becker, supra note 3, at 1216-17.
7 For greater elaboration, see R. Epstein, supra note 5, ch. 14.
systems. Professor Becker's amorphous tests cannot even account for the limited protection that landlords receive under current law.

Professor Becker wants his reader to believe that his rich, multilayer account of property is a sign of intellectual strength and philosophical sophistication. But it is neither. In effect Professor Becker occupies that happy, carefree land in which it is possible to reach and justify any conclusion simply by changing the weights that he attaches to the endless array of moral or social factors that are said to be always relevant, but never decisive, to the idea of property. To make the point formally, the decision whether compensation is owing is a yes/no decision, for which there must be some yes/no decision function. But that is not possible to structure under Professor Becker's approach. In essence, if there is some decision threshold, $T$, he tells us that we cross that threshold if $aX + bY > T$, where $X$ is (say) efficiency and $Y$ is community justice. Equations of that sort are tractable if we know in advance the weight of $a$ and $b$, but that is exactly the information that Professor Becker's ecumenical approach denies us. His formula, therefore, admits any answer in any particular case, even where there are but two relevant variables. Matters do not get better when there are three or more. Professor Becker has tempted us with at least two criteria, perhaps more. But he has provided us with none.

II. THE LAWYERS

Turning to the lawyers, W. Dennis Keating's Response offers a set of far less abstract criticisms of my position. At times he is quite content to assert that my view must be wrong because it has been rejected by every court, state and federal, that has examined the question. Alas, he has offered us an accurate description of the current consensus of the law, which I have never disputed. But the burden of my argument was normative, not descriptive. In light of the overwhelming case law on his side, one might think that he could easily offer some good reasons why the present universal position is also the sound one. But he makes no argument that carries any independent social

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weight. He is correct to note that the police power must be read into the Constitution, but nowhere explains why the protection of private property simultaneously has to be read out of it. He rests on the familiar distinction between "the legitimate exercise of the police power and a regulatory taking," but like countless numbers of frustrated scholars before him, he gives no clue on how to draw it. Rather he concludes that indeed he agrees with me that "rent control should be subject to the democratic process," but misunderstands the importance of my remark. The democratic process is prey to special interest domination when the power to enact a law is divorced from the responsibility for its consequences. I suggested that the democratic process could work only if the state were required to pay landlords the difference between contract and market if they chose to regulate the rental price of the units, confident that no electoral majority would be prepared to put its money where its mouth was. Mr. Keating seems to think that any electoral majority is good enough, even if the voters who benefit are local, while the landlords and prospective tenants who bear the costs are out-of-town. As I pointed out in my earlier piece, rent control is not simply a price control scheme that preserves the landlord's right to select his own tenant subject to an external price constraint. It is a system of enforced occupation that allows the voters who pass the legislation to reap its benefit.

If his brief legal analysis is impoverished, his economic analysis is more so. Keating at one point claims competition in real estate markets is nonexistent but fails to note that the rigidity of prices is a product of the rent control (or stabilization) legislation that he defends and I deplore. If the prices could move freely, then we should quickly see the forms of competition found even in Chicago, where in slack times tenants often get substantial concessions, including a free month's rent or special repairs. But prices will not move if legislation keeps them consistently below market. All competition requires is many buyers and many sellers in a market of free entry. Housing rental markets easily satisfy that definition.

9 Id. at 1223.
10 Id. at 1230.
11 Epstein, supra note 1, at 757.
12 See Keating, supra note 8, at 1226.
Keating’s confusion also misfires in his analysis of vacancy decontrol. He notes that it does not work well because it “encourages landlords to harass tenants into vacating the apartment so it can be rerented at market rents.” This argument does not demonstrate the necessity of rent control, but only that it is not possible to run a well-functioning two-tier market, with some deregulated and some regulated units. The thesis of my Article was not that landlords were saints and tenants were sinners. Quite the opposite, it was that the power of self-interest works its magic on both sides of the rental market. The existence of a two-tier market is an incurable lure to the landlord to take steps, fair or foul, to decontrol the unit, just as it is for the tenant to use any number of shameless stratagems to trap the landlord for technical violations of the statutes or to contrive to pass the unit secretly on to family and friends. My charge is that rent control undermines incentives for decent behavior on both sides of the market. Mr. Keating seems to think that the distorted problems of mobility should be tolerated to end the harassment. But a thoroughgoing system of deregulation eliminates both problems simultaneously. Why choose between them?

Finally, Mr. Keating notes that many problems of obtaining affordable housing preceded rent control and exist independently of it. He is clearly correct. Outmoded building codes in Chicago, for example, add thousands of unnecessary dollars to the construction of new homes and apartments. Zoning restrictions prevent the development of cheap housing in desirable neighborhoods. What is needed is a set of constitutional rules that attack these vicious practices as well. We should never succumb to the temptation to use one mindless system of local regulation to justify another system, equally mindless. Rent control is not a response, let alone a just response, to the housing shortage; it is one of its important causes. Mr. Keating’s short piece is little more than a vivid reminder of the intellectual poverty of the current arguments in favor of rent control.

Mr. Kenneth Baar’s Response follows down the path set by Mr. Keating’s. Essentially he develops two points. The first is that there is no solid evidence that the rent control laws, which

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15 Id. at 1227.
typically contain an exemption for new construction, slow the construction of new rental housing. His second point (also made by Mr. Keating) is that the repeal or invalidation of the rent control laws will not return us to some competitive utopia given the extensive restrictions on entry that are posed by restrictive zoning ordinances and building codes. In making these points, Mr. Baar has conceded the force of most of the practical and constitutional arguments that I have made against all forms of rent control statutes. He does not attempt to show in any way how the rent control laws would, or could, improve matters in a first-best world. All of the distortions and inequities that the rent control laws create with respect to the stock of existing housing are left unexamined and undefended. The destructive behaviors that these statutes invite from both landlord and tenant are either tolerated or ignored, and no account is taken of the administrative costs and fractional strife engendered by any system of rent control. Likewise on the constitutional front, he does not address the question of whether rent control is an unjustified and uncompensated taking of the landlord's reversion.

Even if Mr. Baar's two-point attack had its maximum intended impact, we should still be better off without rent control laws than with them. And we should still strike them down on constitutional grounds. But even on his own chosen grounds, he should find no solace. Mr. Baar misunderstands the social significance of both his arguments.

On the question of new construction, Mr. Baar offers no theory to explain either of two key points. First, why do the rent control statutes contain an exception for new construction? Second, what is the relationship between that exemption and the predicted levels of new rental construction?

To begin with the first point, there are good self-interested reasons why local rent control statutes often exempt new construction. The local political interests implicitly but unmistakably accept the proposition that changes in legal rules have strong effects upon investment behavior, just as ordinary economic theory insists. If the new construction were subject to the rent control rules, then quite simply it would not be built, at least if the projected regulated rental rates give a return on capital insufficient to compensate landlords for their risky ventures. But the want of new construction is not an unmixed blessing for established political interests or sitting tenants. Local governments
need to expand their rate base, and tenants in existing units are not likely to complain if new tenants shoulder a heavier portion of their local expenses through real estate taxes that are themselves tied to market value. So there should be ample political support for the exemption.

More importantly, given that the rent control laws are in place for existing housing, what should we expect the effect to be on the rate of construction for exempt housing? Mr. Baar does not address this question, and the answer is quite tricky. One key variable is the likelihood that the exemption from rent control will remain in place when today's new construction becomes tomorrow's existing stock of housing. If the political situation were such that present landlords think it likely that today's new construction will remain outside the orbit of rent control, then they are more likely to build. Not only will they receive the normal competitive rate of return, but they will benefit as well from the pent-up demand created by the inefficient deployment of existing housing under the rent control laws. Rent control commonly induces people to stay put in apartments that are larger than they need: who would leave rent controlled housing to pay more money for less space on the open market? The existing stock of housing, therefore, will not be put to its optimal use, but will instead contain too few people. That excess population is driven into the new unregulated market, where the demand increases above the levels it would reach if all rent regulations were removed from the existing stock of housing.

Important conclusions quickly follow. If there were perfect confidence that the rent control laws would not be extended to today's new housing, then we should have somewhat greater new construction given rent control than there is without it. The situation only changes incrementally if there is some positive probability that today's new housing will be subject to future rent restrictions. If that probability is low, and if the anticipated restrictions are relatively modest, then the short-term gain available to new construction may be sufficient to offset the long-term losses that the landlord will suffer when regulation does come.

We should expect, therefore, the rate of new construction to be a function of both the present exemption and the lurking restrictions. The two effects work in opposite directions. The former promises a supercompetitive return, while the latter threat-
ens a subcompetitive return. If the former effect dominates, then we should expect to see more new housing than in a competitive market. If the latter effect dominates, we should expect to see less. There is no reason to believe that these two effects will have the same weight in all local settings, for the constellation of political forces varies widely across municipal governments. We should, therefore, expect to find exactly the type of scattered and inconclusive empirical results that Mr. Baar reports in his paper. In some cases there is much new construction, in others there is less.

To make this empirical point count as an argument in favor of rent control law, however, it is crucial to show the linkage between the rate of new construction and the overall efficiency of the housing market. That step Mr. Baar is unable to take. The fatal flaw in his argument is that he cannot identify the optimal level of new construction. But if what is said is correct, the inequities and the distortions within the regulated market intrude in the unregulated market as well. If new construction is booming, it may well represent a significant social overinvestment in unnecessary new construction. People would not have to make wasteful investments in new housing if the existing housing were better deployed. If new construction is slack, then the opposite point now becomes plausible. The threat of further regulation has dulled the incentives to construct new housing. It is thus a singular feature of the rent control laws that they are consistent with both forms of misallocation — too little and too much — in the new construction market.

To make matters worse, it is often very difficult to find the proper baseline against which under- or overinvestment should be measured. One standard practice in the studies referred to by Mr. Baar is to compare the rate of new construction in neighboring communities, some of which have rent control ordinances and others which do not. However, that experiment is dogged with the obvious difficulty that in today's environment the threat of rent control is present even in communities that have no statute on the books. Hence, it is quite possible that the risk of future regulation is greater in a community with no rent control ordinance than in one with an existing rent control ordi-

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18 See generally id. at 1232-34 & nn. 5-15; 1236-37.
19 Id. at 1232-33.
nance that is coupled with an exemption for new housing. Therefore, one strong reason to ban rent control at a constitutional level is to remove the uncertainty that otherwise will depress real estate values systematically, even in communities without rent control. The inconclusive empirical findings on new construction are no source of relief to Mr. Baar. They are perfectly consistent with the mischievous operation of the rent control laws.

Mr. Baar’s second point fares no better than his first. His argument, which echoes Mr. Keating’s, is that the repeal or invalidation of the rent control laws will not return us to a competitive utopia. The existence of strict zoning requirements and onerous building codes are two major obstacles that remain in our path. Yet again Mr. Baar does not tell us what to make of the imperfections that remain. In an ideal world, I think that these restrictions should be subject to the same type of scrutiny that is applicable to any taking of property, including rights of development and sale. The state should have to show that the restriction redounds to the benefit of the party on whom it is imposed, or it should show that it is reasonably necessary to prevent a common-law nuisance or other tort to neighbors.\textsuperscript{17} Most zoning and building code restrictions in place today do not come within shouting distance of these tests. I should hope that Mr. Baar would join me in the effort to persuade the Supreme Court to cut back on its unfortunate decision in \textit{Euclid v. Ambler Realty Co.},\textsuperscript{18} the misguided fons et origio of the present law.

Mr. Baar has no real willingness to join in yet another hopeless crusade,\textsuperscript{19} although I detect, perhaps optimistically, that he has at least some unspoken sympathy with my position. Rather, his point is to argue that so long as \textit{Euclid} is on the books, one should be indifferent to whether rent control stays or goes. But he is mistaken on several counts. First, while \textit{Euclid} type restrictions abound, they are not everywhere. At a guess, there are some communities in which rent control poses a greater threat to markets than zoning. That is surely the case whenever the rent control laws distort the use of an existing stock of housing that has already hurdled the zoning obstacles. Zoning laws have

\textsuperscript{17} See R. Epstein, \textit{supra} note 5, chs. 9, 10 & 14.
\textsuperscript{18} 272 U.S. 365 (1926).
\textsuperscript{19} See Baar, \textit{supra} note 14, at 1238.
little effect where apartment houses and six-flats have been constructed. It follows that there are many situations in which zoning is not a factor, even though rent control may well be.

Second, Mr. Baar is wrong even in those cases in which the rent control statutes and zoning ordinances cover much the same turf. To use a homely example, suppose that one person has been hit with a hard blow to the solar plexus. It is hardly a reason to hit him over the head with a candlestick. The two sets of restrictions bind more tightly than the one because they increase the costs of doing business and restrict the alternatives that are otherwise available for both landlords and tenants. Zoning and building code restrictions are usually misguided, and their bad effects are only compounded if they are allowed to justify further unwise social legislation. Indeed, Mr. Baar’s position is the counsel of despair. Once there is a single bad piece of legislation on the books, we shouldn’t care whether other bad statutes are added to the public rolls. But the right response is to limit the damage of poor legislation, not to magnify it. Mr. Baar’s position is a recipe for turning bad legislation into worse legislation. We get far better results from a system that treats each legislative proposal on its own independent merits. If rent control is unwise and unconstitutional, it does not become wise or constitutional because zoning ordinances and building codes are still on the books.

Professor Curtis Berger’s *Home is Where the Heart Is: A Brief Reply to Professor Epstein* suggests a possible title for a bad sitcom about the perils of living in New York. But once we read past the title, his remarks are best understood as a living testament to the power of misguided forces of self-interest that work overtime to keep all forms of rent control in place. Professor Berger is a beneficiary of rent stabilization and proud of it. He notes that his situation is indeed different from mine, and so it is. The windfall I received lasted only twelve months and was probably worth in total under $1,000. Professor Berger announces that he has rent at over $1,000 per month below market, in perpetuity, which works out to a transfer of over

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21 *Id.* at 1239.

22 *Id.* *ie.* *Id.* & n.3.
$100,000 in long term capital value, even if rent stabilization does nothing to increase the gap between contract and market over the time. It is worth reciting a large amount of communitarian cant for that kind of money. And Professor Berger is equal to the challenge. Anonymity among apartment dwellers is doubtless the rule in New York, as it is in other large and impersonal cities. So neighborliness then is not the issue. Money is. There are few persons who are less entitled to generous subsidies then the fortunate professionals who have locked themselves into powerful positions under rent stabilization. Professor Berger may wax eloquent about his own connections with his apartment, and he may deplore his landlord's connection as merely "financial." But the landlord could use the money to the same ends as Professor Berger, so long as he has hospital bills to pay, children to educate, and vacations to take. The private battle is over money. But here the case for competition shows that the total social product is higher if Professor Berger loses. New entry will quickly compete away any supracompetitive returns the landlord will receive unless present landlords and tenants conspire together to pass laws that prevent new construction in "their" neighborhoods.

Professor Berger, however, is oblivious to the allocative losses of rent control. Rather he dresses up his plea to self-interest with an account of the tenant who longs for the same level of security that the homeowner receives. But while he recognizes the obvious objection — let him buy long-term ownership\textsuperscript{23} — he does not come close to answering it. So long as the market is well functioning, then persons who desire to have long-term attachments to property can buy instead of rent. But the decision to buy or rent is far more complicated than Professor Berger's inaccurate sketch of the alternatives indicates. To be sure, the owner normally builds up an equity in the property that the tenant does not. But presumably he has to pay something for this privilege; otherwise, the market would not be in equilibrium, given that homeownership would always be a better buy (at the same price) than rental property. The point missing from Berger's analysis involves the fate of that difference. Since the tenant pays less to rent, he can engage in a program of diversified

\textsuperscript{23} Id. at 1241.
saving and investment with the money left over. The tenant may have no equity, but he has a larger bank account or stock portfolio, and is probably in a stronger financial position than the homeowner, a large fraction of whose wealth is tied up in a single asset. We therefore should expect to find a sensible sorting equilibrium in which persons with short-term commitments to the neighborhood move toward renting and those with long-term desires to stay in certain areas move toward homeownership, condominiums, and cooperatives. Ordinary people can, therefore, make the right decisions with respect to how and where to live without having to battle the constant distortions brought on by any system of rent stabilization.

Professor Berger's guilty conscience requires him to recognize these nagging distortions, but he then tries to soothe it further by showing that two wrongs make a right. After all, he observes, interest payments are deductible but rent is not; and the senior citizen's lobby has procured an unprincipled exemption from taxation of $125,000 in gain as well. But Professor Berger wholly fails to explain why mistakes in the tax laws are corrected by the unrelated interference with rental housing under stabilization. One silly government subsidy does not justify another. The right response to Professor Berger's long list of misguided programs is a renewed determination to eliminate them from the law, one and all.

There are three other points by Professor Berger that deserve a brief reply. He claims that my system freezes the state into a single form of ownership known by the common law. To this there are two answers. First, why is it so bad? If voluntary transactions in rental property are superior to regulation across the board, then there is ample reason to preserve those institutions on a permanent basis, which only a constitution can do. Second, the freezing of property relationships is not absolute. In Takings, I indicate in great detail the ways in which the common-law interests in real and personal property can be changed by government regulation, regulation that works to the benefit of all concerned. In this context, rent stabilization flunks because even if the landlord is compensated for his losses, the state

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24 Id. at 1244.
25 Id. at 1242.
26 R. Epstein, supra note 5, chs. 14-18.
must finance those payments out of general revenues paid by ordinary persons who have to subsidize folks with Professor Berger's tender sensibilities. My view on this point rests on the argument, surely controversial, that all forms of redistribution (and surely redistribution to the rich) are beyond the power of the state to enact. But pass the point by and ask this question: Even if the state could work the redistribution of wealth if it pays for it out of general revenues, so that all welfare programs pass constitutional muster without question, would this program ever be enacted into law? I doubt it for the simple reason that it is not worth it. If the public does not want to pay for benefits for a select few of its members, why then should it be able to vote them into place without paying a nickel from public coffers?

Professor Berger also repeats the common argument that rent stabilization is fine because the current owner has purchased with knowledge that the system is in place and takes subject to its restrictions. The fact of knowledge may be true, but the legal conclusion does not follow. All Professor Berger has demonstrated is that rent stabilization now imposes large capital losses on the original owners who were forced to sell subject to a disability that never should have been imposed in the first place. At most, Professor Berger has shown that he owes over $100,000 to the former owner of his building, not his present one. Even that figleaf could be totally removed if the contract for the sale of a building had transferred to the purchaser all rights to challenge rent stabilization that were held by the predecessor in title. In any event, Berger's point is overbroad. The fact that the purchase was made with knowledge would justify any system of regulation given a transferee, even one that does not provide a reasonable rate of return on the original investment, which Professor Berger seems to think is required under the Constitution, although he never quite says why. But we could avoid all these questions of who has a legitimate grievance against state regulation if we strike it all down in the first place. Professor Berger's $100,000 windfall is ill-gotten gain, and deep-down I dare say that we both know it.

Mr. Dobkin uses an amalgam of history, economics, and philosophy to attack my conclusions, but he misses the boat on

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27 Berger, supra note 21, at 1243.
28 Id. at 1246.
all counts. His initial points are historical. He begins with a description of conditions in New York as described by Jacob Riis, and treats that as an attack on market principles. Yet he never asks two critical questions about his data. First, were there other types of housing market regulation that could account for the dislocations that he observed? And second, how great were the dislocations? This last question is not trivial. The weakness in Riis's expose is that it never asks about the conditions that the residents of the New York tenements escaped. The bet here is that life in the Polish and Russian ghettos was far worse in every way than life in the tenements, especially in the long run. After all, millions of people, including my grandparents, voted with their feet. Indeed, the ability of the New York housing system to absorb that enormous influx is itself testimony to the level of enterprise that must have taken place, with or without regulation. We should expect many short-term dislocations when there are huge increases in demand for housing. Dobkin does not tell us how rent control would solve the problem. But we do know the answer. It would have done its part to keep immigrants out of this country — to perish in the pogroms of Russia or the concentration camps of Germany.

Similarly, Dobkin misunderstands the historical record when he points to the massive stresses on the housing system that preceded rent control and, thus, could not be attributed to it. His historical point is, of course, correct, but it only shows that there can be many ills in the world, not that rent control or rent stabilization is a sound set of social policies. Thus, the dislocations of the 1930s were attributable in large measure to the large (35 percent) deflation that was introduced first by Hoover (a statist president) and maintained by Roosevelt. Any deflation is an implicit transfer of wealth from the debtor to the creditor, since debts denominated in constant dollars only get larger. The effect is systematic foreclosure as farmers and others are unable to pay their debts. But mortgage moratoria, the analogy to rent control, are hardly the answers to this problem, given that the banks themselves have obligations to their own depositors that cannot be honored if their source of funds is cut off. The only

30 Id. at 1252-53.
answer is to reinflate the currency to its former level so as to nullify the implicit transfer that the original deflation brought on. Other gimmicks only make things worse.

To describe the dislocations of the 1930s as a failure of markets is therefore wrong on two counts. First, it attributes to market forces the changes in the real value of money when that function is within the exclusive control of the federal government, which controls the money supply. Second, it cannot explain why the dislocation took place in the 1930s but not in the deflation-free 1920s since mortgage markets were unregulated in both periods.31

Dobkin's lack of understanding of the history is matched by his failure to understand what went wrong with the partial reform efforts in the New York housing market in the years since the phasing out of the old system of rent control in 1969. Rent stabilization attempts to set rentals by looking solely at historical costs, and, hence, ignores any shifts in demand for housing. The costs of operating an apartment may increase only 10 percent a year, but the market rentals may move by 50 percent if demand should surge as neighborhoods become fashionable. The accumulated difference between market movements and cost based increases can become very large, which then allows the landlord to play the type of games that Dobkin points out exist with vacancy decontrol. Dobkin would like to examine the landlord’s profits to block this abuse.32 In so doing, he shows the misguided regulatory mindset that is the source of New York’s housing problems. If entry were free, then profits would be competed down to a competitive level. Consequently, no one would have to check the books to see that costs were properly allocated or that corrections were made for unrealized appreciation in assets purchased long ago.

His lack of systematic knowledge of the behavior of markets under regulation leads him, like Keating, to misperceive the source of vicious and petty intrigue so characteristic of New York rental markets. The lag between regulated and market rents is so great that under any system of vacancy decontrol the landlord will fabricate any charge to throw the tenant on the street: that is exactly the result predicted by the economic the-

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31 See Dobkin, supra note 29, at 1253.
32 Id. at 1263.
ory that Dobkin so deplores. That form of bitter class warfare does not happen in Chicago, and it’s not because Chicago landlords are so benevolent. The explanation is not transactional, but structural. In Chicago, the gap between market and regulation does not exist, so the eviction game is not worth playing. Dobkin would be better off to direct his outrage at the system he supports than to condemn the landlords for being as selfish and as sneaky as, say, tenants.

The maximum base rent system is also denounced by Dobkin, and rightly so. It involves at the very least a complex administrative apparatus to determine which costs should be passed on to the tenant. The calculations can never be worked out with precision. Even if they were, the system would fail for the same reason that stabilization cannot work: the base rent system is cost driven and does not take into account the shifts in rentals attributable to changes in demand. None of those problems would have existed if there had been a system of total decontrol coupled with free entry into the rental market.

Mr. Dobkin similarly does not understand the economic explanation for other practices that he deplores. He notes, for example, that Harry Helmsley and Donald Trump are currently hoarding apartments. But again he never asks why that same practice does not occur in cities without government controls of one sort or another. In an ordinary market, the landlord loses rental income when he keeps property off the market, so there must be some powerful inducement to hoard units. It may well be, for example, that Helmsley and Trump might want to sell these units but could not do so under current law without obtaining (for a hefty price) the consent of their tenants. Better to hold the property idle than to risk the inability to evict a tenant entrenched in possession by state law. If one could draft a valid lease that allowed eviction on resale, then the property could be put to interim use, and the homeless housed. But that option is foreclosed in New York where regulations, by reducing the total stock of available rental housing, hurt the very people they are said to benefit.

Dobkin also notes that rental leases are loaded with all sorts of clauses that work for the benefit of the landlord and treats

33 See id. at 1262.
that as a sign that there is no consumer freedom in a market dominated by the landlords. But again, some of the concessions that a landlord obtains are doubtless an effort to escape the system of price controls that are imposed from without. If the stated rental is below market, then tenants can offer no financial concessions since they are not allowed simply to bid up the price. The cost of the system of regulation, therefore, is to induce people to enter into inefficient agreements. But the cure is not to denounce landlords; it is to remove the restrictions that prevent rentals from rising to market levels.

Mr. Dobkin tries to lend an aura of respectability to his confused musings by relying extensively on Morris Raphael Cohen's writings of years ago. But the issue here is not whether there are limitations on private property: my position expressly takes the police power into account. The question is whether these limitations should reach the set of regulations of the sort found in New York. Here we need to leave philosophy and look more closely to see how self-interested people respond to various forms of regulation, an issue that Cohen never explored. Mr. Dobkin confesses that he is not an economist, which is evident enough, but mistakenly thinks that he knows obvious truths that economists do not understand. In so doing he proves anew that precepts without concepts are indeed blind. Dobkin is a grizzled street veteran of too many bruising battles between landlord and tenant. His lack of theory and his lack of distance means that he cannot understand that the system of regulation is the villain, even though he recognizes that every regulatory system he describes is a failure. Some people never learn.

III. The Economists

Professors Mandel and Cirace each in his own way offers a qualified defense of rent stabilization as distinguished from a fixed rent control system. Both writers recognize that the arguments I make against rent control parallel those that are found

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34 Id. at 1260.
35 Cohen, Property and Sovereignty, 8 CORNELL L.Q. 12 (1927).
in standard economics texts. But both dismiss these arguments as irrelevant, or at least indecisive, in the context of rent stabilization, which exempts certain forms of new construction from controls and which authorizes routine increases for the landlords to take into account the increased costs of maintenance of their premises.

So far so good. But the question that both Mandel and Cirace have to face is, why stop with half the loaf? The argument to keep new construction unregulated is an explicit incentive argument (and one that was understood as early as the first rent control statutes enacted during World War I, which exempted new housing). If the incentive arguments are correct with respect to new housing, why then are they incorrect with respect to the existing stock of housing, whose sound allocation also depends upon the proper price signals? Similarly, rent stabilization of existing housing differs from the traditional, rigid methods of rent control only in that its statutory increases narrow the gap between the regulated and the market rent. As this gap is narrowed, the dislocations of the regulatory system will be correspondingly reduced, which is again all to the good. Indeed, if a system of rent stabilization permits 10 percent annual increases when the rental market stays flat, then prices will quickly be set solely by the market, much as wages are set by the market when the minimum wage is $3.35 per hour and the market wage is $5.00 per hour.

In this context, however, Professors Mandel and Cirace face the same problem that they have above. If reducing the gap between market and regulated rents is a good thing, then why isn't eliminating the gap altogether the best thing? And that can be achieved by repealing rent stabilization. Closing down the apparatus also reduces the public charge of running so cumbersome and convoluted a system, so that everyone wins from the change. What then can they offer to justify a system that creates genuine misallocations of rental housing at positive social costs?

Here Professors Mandel and Cirace take different courses. For Professor Mandel the justification for social control lies in the “externalities” that can be found in unregulated housing markets. He writes:

Assume that people prefer relatively stable neighbors rather than a rapid turnover. In a competitive housing market you would not take the utility of your neighbors into account when deciding whether to
renew or vacate. Thus, without rent control the rate of turnover may be too high, so that rent control may in fact move the market toward economic efficiency.\textsuperscript{38}

The weakness in the argument lies in the arbitrary nature of his assumption and his ability to hedge his assessment with the use of the verb “may.” Initially, there is no reason to assume that people like stable neighborhoods any more than they like changing ones. It all depends upon who is moving in and who is moving out. Thus, one argument — if such an argument were needed — against rent stabilization is that people do not take into account the \textit{decline} in the utility of their neighbors when they decide to stay put. The neighbors would rather see them move than stay after their children are grown, but the false signals sent by rent stabilization keeps them wedded to places where they are not welcome (if it matters to people who might also move if rent stabilization were repealed). There is, therefore, the identical type of externality with rent stabilization as there is without it.

At the very best, therefore, it is necessary to guess which externality is stronger before Professor Mandel can begin to make out his case. My tentative view is that the externality attributable to rent stabilization is probably the stronger. Here is why. The decision that any person makes about staying or leaving depends upon the mix of private and neighborhood benefits that he gets from his housing decision. With rent stabilization there is a heavy bias to stay given the implicit subsidy from the system. Some people will enjoy a hefty subsidy and others will enjoy a lesser one. It seems likely that the population who enjoys that subsidy will grow more heterogeneous over time because there will be no second sorting as tastes continue to diverge. It follows that the neighbors will all have a greater variation in their preferences about the kind of public goods to be provided for the neighborhood. Neighborhood decisions now will become more difficult to make over time as the split in residents’ tastes widens. The absence of rent stabilization tends to insure that people will move on once they no longer have the tastes (or need or budget) to stay located in the original place. The mobility should lead to modest homogeneity, which improves the condi-

\textsuperscript{38} Mandel, \textit{supra} note 36, at 1271.
tions and style of neighborhoods. The externality problem, therefore, seems to be a little less daunting without rent stabilization than with it.

I allow that this argument is theoretical and may be wrong. But that is of little comfort to Professor Mandel, who has missed altogether the relevant externality attributable to rent stabilization. For what it is worth, I can think of no obvious theory which makes his view of neighborhood effects more plausible than mine. At best we are left with wash. His position “may” be true, but by the same token, it “may” be false. It follows that Professor Mandel has still offered us nothing to justify the allocative distortions and administrative costs that are inseparable from any system of rent stabilization.

Professor Cirace for his part stresses the smooth pattern of rent fluctuations that a system of rent stabilization can bring. He thus provides us with a figure which has three equilibrium points: E1, E2, and E3.39

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39 Cirace, supra note 38, at 1276.
In his view violent distentions in the market could move us from E1 to E2 and then back to E3. If the movement between E1 and E2 is very large, and the same can be said of the movement from E2 to E3, then the advantage of rent stabilization is that it can smooth the flow by taking us from E1 to E3. (Actually on his graph E1 = E3, which looks like a case for rigid rent controls.) The greater the moves on the first and second legs, the more powerful the case for rent stabilization.

The difficulties with his argument are twofold. First, it is highly unlikely that we would observe in a market the violent external shocks of the type he postulates. Rents in unregulated towns are generally pretty stable, and the moves that do occur in the rental markets typically are reflected in the homeownership market as well, which suggests that they are perceived to be long term.

The second point quickly follows. Professor Cirace’s graph is drawn ex post, but the decisions for rent stabilization must be made ex ante. We cannot be sure that just because we have moved from E1 to E2, that the second leg of the journey will be from E2 to E3. If that leg does not take place then the risk of rent stabilization is that it locks us in at E3 when we are far better off at a higher rent at E2. Stated more generally, we cannot make the regulation at the first leg confident of what will happen at the second leg. The movement in prices impounds all that we know about the market, and we cannot predict that markets will act like gravity: what goes up need not come down again. If rent stabilization could do wonders in some markets, it will do massive damage in others, namely those in which the demand continues to shift upward far more rapidly than the cost of running the apartment. At best, Professor Cirace has shown us that if the government knows more than the market, it can outperform the market. But when it knows less, it will do worse. We shall still have all the allocative and administrative distortions of a rent stabilization system.

Both Professors Mandel and Cirace then urge, and I agree, that rent stabilization is less obnoxious than old-fashioned New York rent control. But they have not made out anything close to an affirmative case for its adoption. The externalities identified by Professor Mandel exist as much under rent stabilization as they do in its absence, and the ability of rent stabilization to dampen market swings, as developed by Professor Cirace, de-
pends upon an assumption that government has greater knowledge of the market than a cast of thousands of private landlords and tenants. Neither of those assumptions is in my view defensible. As they fall so does any case for rent stabilization.

CONCLUSION

These short Responses to my Article Rent Control and the Theory of Efficient Regulation do nothing to soften its basic conclusion, which is that rent control and rent stabilization are per se unconstitutional takings of private property. Nor do they offer any sound social justification as to why so unfortunate a state of affairs should be allowed to continue. Again, I stress that the arguments I have made against rent control are not a brief for landlords, but a brief for a social system of competition in which the constant pressure of entry restrains landlords to a competitive rate of return while providing tenants with the quality of housing that gives them the most for their money. I confess that I still believe that this is a very modest and very desirable social program indeed. But it will be a difficult one to implement given the high level of intellectual confusion and vested special interests that stand in the path of its adoption. That much, at least, we have learned from these seven comments.