

Title of the article: Shanghai imposes cap on rents for affordable housing as costs rise

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Commentary 1

This article talks about the efforts the Chinese government has put to make housing more affordable in Shanghai through government intervention in the free market. The article explains two key interventions the government implements. Firstly, the government imposed a five per cent rental cap per year on affordable houses. This means landlords can only increase the price of rent by five percent maximum each year.

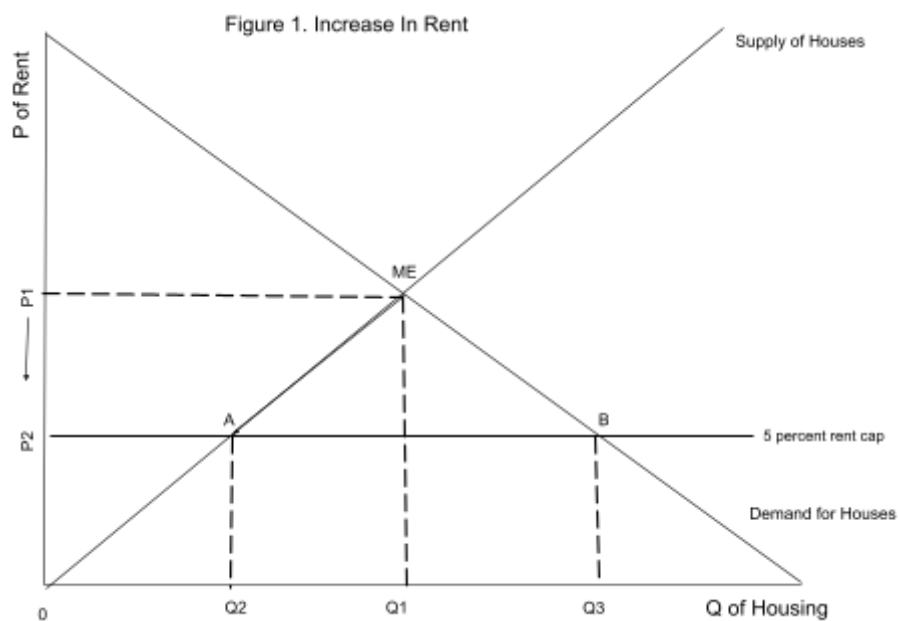
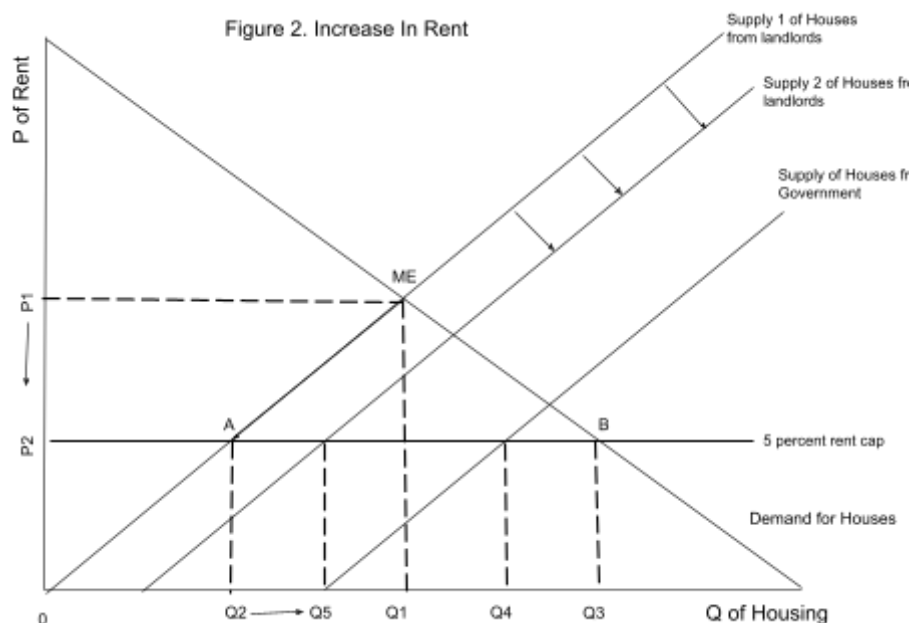


Figure 1 Shows the effects of imposing a price cap also known as the price floor on the increase in rent in Shanghai. As rent in Shanghai over the last few years has risen by more than 5 percent each year, it should be safe to assume the rent cap would be below market equilibrium. In this case, as the price of rent decreases from P1 to P2, the supply of housing will contract from Me to A while the Demand for Housing will expand from ME to B. This can be explained as the rent becomes cheaper, landlords will be less inclined to rent out their houses while more people will want to rent a house when it is cheap. The quantity of Houses supplied will drop to Q2 while Demand will be at Q3. This causes excess demand of (ME.A.B).

In a free market before government intervention, due to laissez-faire, the price of rent would stay at P_1 and quantity would stay at Q_1 , therefore achieving Market equilibrium. However, in this case, Only a few people would benefit from the rent cap (Q_2 of people) while some people who would have had housing would not be able to rent a house ($Q_3 - Q_2$ of people). This could lead to a first come first serve system when distributing the housing or worse, a parallel market could form. Landlords could make a side deal expecting a higher price in order for people to rent a house. Another issue of setting a rental cap of 5 percent per annum is landlords may rent the houses at a much higher price at the start knowing that they will not be able to increase rent higher than 5 percent. For example, they may suspect the inflationary rate may increase 7 percent each year for 5 years. In this case they would lose out if they rented out the house at the same price but could only increase rent by 5 percent so they could increase the starting rent by 10 percent of its original price. This would cause more people to be unable to afford houses in Shanghai and the government intervention would lead to market failure.



To combat this, a second government intervention is implemented. The government promises to build 470,000 affordable houses from 2021 to 2025. This would be publicly owned meaning the government would set the rent and supply it to the consumers. In this case the graph would change. As it can be seen in figure 2, Supply of government housing is supplied in large quantities even at a low price as profit is not the primary goal of the government. The Quantity supplied from the government (Q_4) means the demand for houses will decrease from Q_3 to $Q_3 - Q_4$.

This will make landlords inclined to supply housing at a lower rent, shifting the supply from S_1 to S_2 , quantity supplied will increase from Q_2 to Q_5 .

In this case, the government would be able to achieve its primary goal of making houses more affordable for young people and recent arrivals. This will greatly benefit these people, as less of their income needs to be spent on housing. This could be spent on education, healthier food or other merit goods. This can reduce government spending on health care as people are eating healthier and less likely to get ill, and can be spent on other public goods such as parks or bus stations. It would also increase people going to school as people will have more money to spend on education, which could lead to more people becoming employed or getting a higher paying job, meaning more income tax for the government. There is also no risk of brain drain or the emigration of human capital as they cannot move with the house.

However, the people who will lose out from the government intervention will be the landlords, who will earn less from rent. Despite the loss, it would not impact them as much as the gain of the lessee as there will not be a major impact in the daily lives of people who own a house. However, another concern of the government building affordable housing is that the crime rate may increase and the prices of surrounding property values may drop as well. Especially in a city like Shanghai, the wealthiest city in China, this could be a concern for the residents who are already living in Shanghai.

