

The Market Fights Back

by Anne Emerson

A believer in free markets will tell you that, if you try to change a “market outcome,” you will have all sorts of unintended effects which will ensure that you don’t get what you set out to get. Aside from trying to explain what a “market” is in economics, here is an example:

Rents for apartments in New York City are “too high.” That means, approximately speaking, that not everyone who needs to live in New York City close to where they work, can afford an apartment there. So, the administrative authority decides to put a ceiling on rental prices. That is, they put a legal cap on the price that a landlord can charge for rent.

This seems to be a good idea. We want people to be able to afford to live near their work. But what often happens is that the “low” rent doesn’t cover the costs of caring for the apartment. Maintenance work is expensive. Repairs to floors and ceilings are expensive. Getting a plumber or a person to spray for bugs is expensive.

Landlords may stop maintaining apartments. They may charge fees over and above the stated rent. They may convert apartments into condos, for which there is no price cap, so that now there is “not enough” apartment housing. Etcetera.

The person who advocates for free markets may argue that this is worse than not trying to limit the rental price in the first place. If there are now not enough apartments at any price, we may be worse off than before.

I am not going to suggest a solution to this in the short term. I hope that “Annie’s model” can help for the long term. What I am going to do is offer some of the other challenges with “market systems.” That is, yes, this particular challenge is difficult to resolve. The market solution may be the lesser of two evils in this case.

However, there are other “free market” situations that most economists understand require a “non-market” or “adapted-market” solution. For example, if the market solution is a solution between a buyer and a seller that has an impact on others, we say that the market price does not capture the true price (or cost) of the situation. For example, a house is built that blocks a neighbor’s view of a beautiful lake. Buyer and builder may be quite happy with the price of the new home, but the neighbor is not happy at all. How will we compensate the neighbor for this permanent loss of the joy (and, probably, value) in his or her home?

Economists worry about this sort of thing. The rest of us handle it as best we can. But this is a simple example of how a “market” solution is not the whole story. Economics textbooks will probably offer different types of examples, where we are more accustomed to seeing some type of accommodation made.

For example, we believe that educated people make better citizens, so we offer free schooling to everyone, or almost everyone. This is a non-market solution. If we left the “market” for education alone, we would only offer education to those who are willing to pay enough to cover the cost of teachers and supplies. So – free markets are the ideal, but the real world does not always co-operate!