



INDEPENDENT CONSUMER AND COMPETITION COMMISSION

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Presentation Topic: Price Control on Rental Properties

Summary:

The ICCC implements government policy. It is for the Government to decide whether prices for housing rentals should be controlled or left to the free market determination. However there are arguments both for and against the practice of price control on rental housing.

At this juncture, I want to make it clear that I am not going to recommend that Rental properties be price controlled. I will however, be briefly outlining how the whole regulatory framework work and highlight forms of price control and economic regulation which the ICCC is empowered to operate under, under the ICCC Act of 2002 and Prices Regulation Act.

The Government has considered and declared certain goods and services in Papua New Guinea for price regulation purposes. The ICCC is currently reviewing a number of those declarations to determine whether price regulation is still required and if so in what form should it be applied. The ICCC's primary objective is to enhance the welfare of Papua New Guineans by facilitating and promoting competition and fair trading, to contribute to the economic efficiency of the economy as a whole.

Introduction

1. The ICCC

The ICCC was established in 2002 as part of the Government's structural adjustment program. The Commission replaced the previous Consumer Affairs Council and the Price Controller functions of the Department of

Treasury. It is responsible for the control and monitoring of the prices of declared goods and services such as tinned fish, rice, flour, corn beef, soap, sugar, tea, milk, margarine, poultry and fuel. It is also responsible for the prevention of anti-competitive behaviour such as price fixing and price collusion by industries, and administers the Regulatory Contracts established with State owned Entities (SOEs) in PNG Power, PNG Post, Telikom PNG and MVIL to set price and service standard requirements by these public monopolies.

2. The Current Price Regulation Arrangements

The Minister responsible (the Minister for Finance and Treasury) declares goods and services for price control purposes. This decision is often based on a view that the supplier of the goods or services concerned holds a monopoly or a substantial supply position in the market. Thus the price regulation declaration is a means of preventing the supplier from using that market position to extract monopoly based prices from consumers. Note here that the 'consumers' are not only individuals but include businesses and government agencies.

Price Regulation Mechanisms currently used by ICCC

a) Price Control

Price Control relates to the determination of the final price that a supplier or manufacturer can charge for the regulated goods or services under the Prices Regulation Act. The suppliers/producers can apply to the Commission for adjustments to the controlled price using a number of tests detailed in the relevant legislation. The Commission, for example, considers both the interests of consumers and those of the produces/suppliers. Such application must reflect the efficient cost of producing the regulated good/service and an appropriate rate of return on investment in the production/supply of the declared good/service. Price control is usually applied at the retail price level, where the retail and wholesale mark-ups are determined

to be applied to the price of the production/supply of the declared good/service.

b) Price Monitoring

Amendments made to the legislation in 2002, allowed the Commission adopt less intrusive form of price regulation. Rather than the supplier/producer notifying the Commission to have price changes approved in advance the Commission allow them the changes but through monitoring, the Commission screens the movements ensuring that set/agreed boundaries are not breached. Suppliers/producers are “summoned” to explain any breaches. If the explanation(s) are not satisfactory then the Commission seek through the Minister to have the good/service declared for price control purposes.

c) Regulated Price Paths

A number of public utilities have been designated ‘regulated entities’ for purposes of the ICCC Act. The regulated entities activities are guided by a Regulatory Contract which specifies the form of price control and the price adjustment mechanism that is used. Prices under this arrangement are usually adjusted on an annual basis against a formula incorporating movement in the general level of inflation (CPI) plus or minus some adjustment factor. This is known as incentive regulation and is usually expressed in the form $CPI (+/- X)$. This establishes certainty on the part of the entities and assist them in their future business and investment planning. This mechanism is reviewed after 5 years. This is particularly advantages for regulated entities providing services.

3. Regulatory Principles Applied by the ICCC

The use of price regulation is an option that the Commission will use when it is apparent that competition in the market place is either not present or is in some way unable to ensure that prices and services are provided at competitive rates. The amendments to the Prices

Regulation Act make this process clear when it sets out the steps that the Commission must take when reviewing the need for continued regulation of some previously declared goods or services.

The Commission must have regard to the existence of competition in the market and whether the market is operating efficiently. Thus, the Commission considers issues such as the existence of other suppliers in the market, the potential for new entry into (and free exit from) the market, the potential for countervailing power to be exercised by consumers, the potential availability of substitute products, and access to imported supply.

The Commission will seek to find ways of removing restrictions on the operation of the market as a preference to the imposition of price regulation. For example, the Commission would prefer to see no barriers to import competition, although it is recognised that Government's may form a view that there is some net benefit from the imposition of say tariff barriers in certain circumstances. The fundamental premise behind the competition reform program that has been introduced into PNG and that lies behind the enactment of the ICCA Act and associated legislation is that the overall efficiency and therefore competitiveness of the PNG economy is enhanced by the removal of restrictions on competition. Adoption of price regulation therefore is a second best option when the market has clearly failed to replicate the conditions of free competition.

The Commission also considers the issue of service standards as a relevant factor when considering price reviews for declared and regulated industries. The regulatory contract for those industries concerned provides a degree of certainty as to the way in which maximum prices and service standards are to be set and the price path that will apply over a period of time.

The imposition of price regulation therefore requires careful consideration lest its application creates greater costs than benefits to the efficient operation of the economy.

4. Rental Price Control on Rented Properties

a) What is it?

Rent control is a form of price ceiling that is used to control prices on rental dwellings. It can be applied to all dwellings or to particular types of dwellings. It can also be applied as a form of social welfare support and have it focused upon lower cost dwelling which are normally occupied by lower income groups.

b) How can it be applied?

Rent control can take two forms;

- Firstly, “**Control of Rents**” - the fixing of “*fair rent*” for every unit and the establishment of enforcement mechanisms such as the use of the ICCC’s field surveillance staff. Adjustments to the rents would be made on the basis of assessment of cost increases or other market indicators by the relevant government agency (for example the ICCC). This approach tends to treat all dwellings of a certain type as the same, and does not necessarily allow for differences in particular attributes such as location or possibly age of the dwelling.
- Secondly, “**specific rent-capping**” arrangement which reflects the differences between dwelling types, location and other attributes. This involve the setting of broad price ranges within which dwellings of a certain (say) size or type may be leased and allow an appeals mechanism by the lessees should they be dissatisfied with the rent being proposed for a particular dwelling. This approach encourages lessors to provide additional attributes that may be desired by lessees for (say) a higher rent.

Variations on these approaches can be used although the favoured approach tends to be the simpler standard rent cap for all dwellings of a certain size or type with little opportunity for variation to reflect particular attributes.

5. The PNG Rental Housing Market

In a free rental market where there is no control on prices, the setting of rental prices is influenced by a number of factors including: the availability of housing for rent, quality, security, convenience and the location of the accommodation. In PNG a ‘free’ market for rental essentially exists for all privately owned dwelling that are available. The price for

these rentals is determined by market forces, that is the demand for dwellings and the available supply ultimately determines the rent charged. Where there is evidence of limited supply and high demand, the rental values can increase. Effectively this acts as a clearing mechanism in the sense that those who can afford dwellings at particular rental prices will take up the leases but disadvantages lower income households who find themselves priced out of the rental market.

In PNG, there is a strong evidence that this is the current experience. It has been particularly noticeable in places like Port Moresby where there are limits on the availability of rental accommodation, and as a result prices for residential accommodation at all levels has shown strong upward movement, particularly in response to significant movements of people into the city as part of, for example, the ECP program.

This is not a new phenomenon in Port Moresby. In the 1984 report by Garnaut and Baxter on the *Hard Kina Strategy*, the authors noted similar difficulties being encountered in the Port Moresby and other major city property markets at that time as the economy strengthened and more expatriates and higher paid Papua New Guineans bid up the rental prices of the available supply of rental accommodation. Garnaut and Baxter noted also that there was a tendency for investors in residential dwellings to want to reduce their country investment risks by seeking to recover the value of their investment in the residential dwelling over a much shorter period than would be normal in other countries. The demand for rental accommodation was sufficiently strong for the owners to be able to achieve this objective.

National Housing Corporation facilitates the Government's housing market. It provides housing in three main groupings, low, medium and high covenant. Housing is available for rent from the NHC as well as for sale (after a qualifying period). The NHC rental properties are essentially price capped. The relevant Minister sets the rental price, and the NHC

collection of the rents assist fund the maintenance and upkeep of the properties and to contribute to the Corporation's investments in new houses. The policy objective for the NHC appears to be to provide sufficient housing to meet the needs of Papua New Guineans, at affordable rentals charges.

6. Effects on the NHC/PNG Housing Market of Rental Price Control

There is in effect already a form of price control applied by NHC. It is appropriate therefore to consider the effects of this form of price control in the operation of NHC and more importantly whether or not the overall objectives of the government are being met through rent control. Some of these are;

- NHC rentals as fixed do not effectively represent cost recovery on the R&M of the properties concerned.
- Therefore does not earn an appropriate rate of return on its investments in new houses.
- Consumers/lessors interest/concerns are not appropriately addressed under such arrangement,
- Funding is relatively inappropriate and prevents it from undertaking new constructions.
- Sub-leasing arrangements by current tenants (using their positions) at higher rentals thereby effectively creating a form of "black market" in the industry.

The net benefit of price control in these circumstances is not evident, but rather the evidence seems to suggest that there are other actions that possibly should be taken to correct the market failure problem rather than adopt rental caps. One of these other options may be to address the issue of direct public subsidy funding for a significant capital works program designed to address the severe shortages of residential dwellings in Port

Moresby and the gradual removal (once new dwellings become available) of the current rent cap arrangements.

7. Conclusion

The use of price control mechanisms in any circumstances should be considered only after there has been a careful consideration of the market that the price regulations are meant to control. The ICCC Act and associated legislation provides a good framework for consideration of these issues and is the basis upon which the Commission undertakes its assessment of the need for and form of price regulation in PNG.

The use of price caps in the housing rental market is fraught with difficulties. Not only is there a need to consider just what the price caps are intended to achieve and whether or not the market failure problem (if it exists) can be resolved by use of some other mechanism, but the form and operation of rent caps need to be carefully researched and administered. The evidence to date in PNG is that the price caps that have been applied to NHC rental accommodation may not have achieved their objective in terms of making accommodation affordable for Papua New Guineans, but may have had other unintended adverse implications. Therefore before embarking on any expansion or even continuation of this form of price regulation, there is a need to stand back from the problem, address the market operation issues, determine where and if market failure is occurring, and then address the possible solutions to the problem which will include a number of alternative approaches other than simply using rent controls.