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The perils of regulation and the theory of interventionism – an application to the Berlin rent freeze

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Abstract

This paper studies the Berlin rent freeze introduced in 2020 and repealed in 2021. While the so-called Berliner Mietendeckel did lower rents in the regulated segment as intended, it was accompanied by several undesirable consequences, inter alia, less housing offered on the market. I take a dynamic, market process-based approach – relying on Kirzner’s ‘perils of regulation’, and the theory of interventionism – in order to produce a comprehensive overview of the costs of the rent freeze which shall help inform a balanced judgment of the policy measure. Most significantly, the rent freeze impacted the discovery process: it stifled the systemic capacity to discover profit opportunities, and it created superfluous profit opportunities. While the types of these and similar costs can be described, the costs themselves are unknowable. Still, a comprehensive evaluation demands taking these costs into account. I conclude that the Berlin experience shows two things: Firstly, the aptness of a dynamic, market process-based approach to understand such phenomena, including explaining the rent freeze as part of a dynamic interventionist process. And second the superiority of the market process, the power of free entry, and the severity of knowledge problems for policy-makers.

Keywords Interventions · Interventionism · Dynamics of the mixed economy · Price control · Rent policy

JEL: L50 General · P51 Comparative Analysis of Economic Systems · R38 Government Policy

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1 Introduction

Germany is a mixed economy. Interventions into the market process are prominent and seem to have become more prominent in the last couple of years. The so-called Berliner Mietendeckel, a rent control by now repealed by the Federal Constitutional Court, thus expressed a general sentiment: that governments can and should improve upon the workings of “the market”.

The Mietendeckel was a rent freeze designed to regulate parts of the Berlin housing market. It was implemented to alleviate the sturdy situation for many Berlin tenants who were, and perhaps still are, dissatisfied with the height of their rent. In reference to a basis year, the Mietendeckel forbade rents that exceeded a certain level and thus sought to keep prices down. The empirical findings show that while rent prices in the regulated segment sunk, the quantity supplied decreased significantly.

But the effects of the Mietendeckel go beyond the prices of the regulated segment and the quantity supplied. The Mietendeckel can be well-understood with the aid of, and illustrates, Israel Kirzner’s “perils of regulation” (2018 [1979]) and more generally the tenets of the theory of interventionism.¹ These two frameworks derive from market process theory – a dynamic understanding of the economy which emphasises entrepreneurial action and knowledge problems in a dynamic, complex environment. They draw attention to consequences of interventions which are ascertainable only in the abstract.

I pursue two objectives with this paper: First, capturing fully the costs of the Berliner Mietendeckel – this will not be possible in the literal sense, for we cannot know what we missed out on; but in the abstract a description of the different *types* of costs of the measure might be possible. The framework of perils of regulation together with the theory of interventionism allows such a comprehensive assessment of the Mietendeckel, with emphasis on the dynamic processes. Second, deriving some lessons from the Berliner Mietendeckel, especially with regards to the frameworks used to assess it.

I begin by briefly introducing the Mietendeckel which was a standard rent control measure that led to both lower prices in the regulated segment and less housing offered on the market, and higher prices in the unregulated segment (which includes the rent market in the vicinity of Berlin). I then rehash Kirzner’s perils of regulation framework and apply it to the Mietendeckel. Two effects are most important: the stifling of the discovery process, and the triggering of a superfluous discovery process which includes attempts for regulatory capture but also the circumvention of the rent freeze via rather ingenious measures. When regulation is undertaken for reasons of justice, as in the case of the Mietendeckel, the Kirznerian analysis is not fully applicable, however. I then add some insights from the theory of interventionism which emphasises more distant and long-term effects of interventions. This includes interventionist dynamics triggered by the Mietendeckel, including its repeal, a dis-intervention, but also interpreting the Mietendeckel as the result of previous progres-

¹ The theory of interventionism received its modern statement by Ikeda (2003 [1997], 2004). Or, to follow Ikeda (2016), the critique of interventionism, since the system as such is incoherent and cannot properly be thought to have a theory.

sive interventionist dynamics. I conclude by observing first that the experiences of the Mietendeckel show the usefulness of Kirzner's perils of regulation and the framework of the theory of interventionism to understand real-world phenomena. And second that the experiences of the Berliner Mietendeckel demonstrate the superiority of the market process, the power of free entry, and the seriousness of knowledge problems for policy-makers.

2 The Berliner Mietendeckel: lower rents and less housing

As the capital of Germany and a city renowned for its lifestyle, Berlin's population grew a lot in recent years. Rents followed suit. This situation dissatisfied larger parts of the Berlin population and was a call to action for politicians. The Berlin senate answered with the Berliner Mietendeckel which "is a rental cap, not only including a rental stop for 5 years, but also forcing landlords to lower rents if they exceed the reference rents which are based on the rent tables of 2013" (Sagner & Voigtländer, 2022, 2). The rent control applied only in Berlin, and there only to a segment of the rent market: apartments which could be occupied only on the 1st of January of 2014 or later were exempt. The law became effective in February 2020. But in March 2021 the disputed measure was repealed by the German Federal Constitutional Court, the Bundesverfassungsgericht.

In the short period when it was in force, the effects of the Mietendeckel already came to the fore. Three main, rather short-term effects were observed and emphasised in the literature. Firstly, rent prices in the regulated segment dropped, at least the advertised ones that were accessible. While all studies observe price drops, the different numbers vary. Sagner and Voigtländer (2022, 11), for example, arrive at a price change of -10.3% . This was the intended consequence of the measure and in this sense the policy was successful. Only those apartments that were covered by the rent freeze experienced such a price drop.

Secondly, the introduction of the rent freeze was accompanied by a strong decrease of the overall number of rent dwellings offered. Sagner and Voigtländer (2022, 11) estimate a decrease of -51.8% . Hahn et al. (2022, 33–35) also find a decrease by more than half. They stress that exceptionally many apartments were converted into owner-occupied objects and that fewer new dwellings were built. Arlia et al. (2022, 53) even estimate that the number of advertised rental dwellings was 70% lower in Q4 of 2021 than in Q4 of 2017 and find that the purchase prices of objects in the regulated segment suffered (54). Sagner and Voigtländer (2022, 60–62) apply a caveat. They note that landlords relied more often on private networks to find tenants; this would mean that the figures found by Arlia et al. (2022) overestimate the decrease in available housing, since they examine online rental ads. Another connected effect was that many investors expressed reduced willingness to invest (Sagner & Voigtländer, 2022, 58–60). All these effects were not intended.

Thirdly, again not intended, there were unexpected developments in areas which were not regulated by the Mietendeckel. Rents in the unregulated segment in Berlin increased stronger than would be expected without the rent freeze (Arlia et al. 2022, 52). Rents in the neighbouring city Potsdam (as well as other places) saw a

higher-than-expected increase (Hahn et al., 2022, 22–24). And, possibly, both in the regulated and the unregulated segment more residential properties were sold than would be expected without a rent freeze (Arlia et al. 2022, 54). However, Sagner and Voigtländer (2022, 11–12) do not find such an effect for the dwellings affected by the Mietendeckel. The empirical findings here are inconclusive.

3 Market process theory and a comprehensive view of the costs of the Mietendeckel

The strength of market process theory, which undergirds Kirzner's and Ikeda's frameworks that I want to apply, is that it highlights dynamic processes in complex contexts. According to it, "seeking efficiency", i.e., the maximisation of known factors of production in light of given ends is only one part of acting. What forms the other part is "identifying the relevant ends-means framework" (Kirzner 1973, 27) – what is needed is the discovery of both ends and means in a world of sheer uncertainty and error. Considering the discovery process is crucial for studying the Mietendeckel, since the supply of housing, including technologies and optimal production processes, is not given: new ways of living or building can be discovered by competing entrepreneurs. For a comprehensive evaluation, the effects of the Mietendeckel on this competitive entrepreneurial discovery process need to be examined. This focus on the dynamic processes is what characterises and sets apart market process theory from neoclassical theory: "the essence of competition is precisely that dynamic rivalry which the neoclassical equilibrium notion of competition is at great pains to exclude" (Kirzner, 1997, 68). Because its strength is the analysis of this dynamic process and the effect of regulating it, market process theory is particularly useful for studying rent control.

Market process theory describes that in the market process the discovery of means and ends comes about by alert entrepreneurs overcoming sheer ignorance in order to discover profit opportunities: "the systematic forces generated by spontaneous market activity consists [sic!] of entrepreneurial discoveries – stimulated by the anticipated gain to be won, that gain being created by those very situations of sheer ignorance which we claim to be present at all times" (Kirzner, 2017, 858). While profiting from their alertness, entrepreneurs help to coordinate the economy: "the process of winning these profits is at the same time a process of correcting market ignorance" Kirzner (2013 [1973], 53). By making profits, entrepreneurs drive the economy towards an ever-shifting equilibrium. Prices are essential signals for this discovery procedure. But they are not parametric²: they are no givens that tell entrepreneurs what to do. They are aids for the entrepreneurs to better assess the state of the market which are formed by the competitive actions of entrepreneurs and cannot be formed else. "It is primarily the rivalrous competition among separate owners of factors of production, trying [...] to employ them in what they believe to be the most profitable avenues for investment, which generates information-laden prices" (Lavoie 2016 [1985], 75).

² Sautet (2015) works out the differences between viewing prices as parametric, i.e., as givens, and as factors which are formed by entrepreneurs. See also Kirzner (1988).

So, entrepreneurs “are not and could not be price takers [...] the focus of the activity is on disagreeing with certain market prices” (Lavoie 2016 [1985], 83–84). While influenced by prices, entrepreneurs influence prices. And their influencing prices fills these prices with the dispersed and often tacit knowledge that is necessary for prices to function as useful signals in the market process (Hayek 1945). Signals which make it possible for alert entrepreneurs to discover opportunities for profits.

The “perils of regulation”, as developed by Israel Kirzner (2018 [1979]), are that regulation inhibits and influences just this discovery process. This supplements the deadweight loss which occurs when a government sets a price in such a way that it cannot ‘clear the market’ – an efficiency loss where we do not employ known resources in such a manner as best to satisfy consumers. In the case of the Mietendeckel the deadweight loss is the heavy decrease in the quantity supplied which means that some people who would voluntarily have agreed on an exchange – marking it as mutually beneficial – are prevented from doing so. The perils of regulation cover this but also go beyond by emphasising the prevention of discovery and the alteration of the profit opportunities, making this framework particularly fruitful for this scrutiny. “The perils associated with government regulation of the economy [...] arise out of the impact that regulation can be expected to have on the discovery process” (Kirzner 2018 [1979], 431). These are aspects which portray important but ultimately unknowable costs of the Berlin rent freeze. Kirzner (2018 [1979]) arrives at four different perils that I will recapitulate and apply to the Berlin rent freeze.

3.1 The undiscovered discovery process

The market process has a tendency toward the correction of errors, toward equilibrium – after all, Paris does get fed. The incentivising private property, the guiding prices, the luring of profit, and the discipline of losses ensure this tendency.³ Now, a tendency is no assurance. But generally the market process can be expected to produce decent coordination in a reasonable period of time. Implementing the Mietendeckel means to assume that the market process will not bring about the desired improvements itself – and the discovery process remains undiscovered. But this assumption may well be flawed. Or, the market might have been at its optimum already.

In the case of the Berliner Mietendeckel the motivation for intervention comes from a quite fundamental dissatisfaction with the perceived state of ‘social justice’. The regulation is not so much intended as an efficiency-enhancing measure but as a means for ensuring justice in the form of low rents for tenants.⁴ This makes it unlikely that the market process could have brought about results satisfying to the policy-makers, albeit they may very well have been efficient given the wealth and income of citizens and their wants.

It still remains significant that the market was disallowed to work for solutions. In light of the undesirable side-effects of the Mietendeckel, a free market might overall

³ Boettke stresses these aspects. Confer, for example, Boettke (2018, 209).

⁴ The distinction is not clear-cut. But contrast it with the hypothetical example of antitrust measures against large housing enterprises in order to prevent monopoly pricing on the housing market which would be perceived to be undesirable from an efficiency standpoint.

have been preferable. Because of the regulation it is strictly unknowable what the market process would have brought about.

3.2 The unsimulated discovery process

When policy-makers set a price ceiling, they need to decide on a specific price, or rather a specific way to determine the price. Their challenge is to set the price correctly or at least to learn and adjust the price. But there is no systemic logic which would make a systemic tendency towards more accurate prices possible. Policy-makers have no pecuniary profits as incentive which would alert them to pure profit opportunities, and they rarely feel losses. This is not only about minimising costs/adopting known efficiencies. It is about the discovery of opportunities for profit of which the policy-maker is completely unaware. “No systematic process seems at work through which regulators might come to discover what they have not known” (Kirzner 2018 [1979], 435). In addition, there is no selection process which sifts out better and worse policy-makers such that those who are apt regulators win out.⁵ And, to expand Kirzner’s analysis, there is no free entry for entrepreneurs who have a good idea for good regulation. Barriers to entry are a necessary element of bureaucracy.

The Mietendeckel is designed mainly to ensure lower rents for tenants. It is motivated not by a quest for efficiency, but by a quest for social or distributive justice.⁶ In this sense, it is misplaced to judge the Mietendeckel from the point of the adequacy of the determined prices in terms of efficiency. The policy-makers either do not understand them as signals or carriers of information that inform economic decisions and alert entrepreneurs to profit opportunities and instead see them from a vantage point of justice. They understand price mainly as the question how much the tenant and how much the landlord benefits – with the intention to see to it that tenants benefit more. Or they at least judge the estimated benefits from focusing on justice to be higher than the estimated costs.⁷ There is thus no intention to adjust prices in the sense which Kirzner describes, for prices are understood in a fundamentally different way. Still, it is a cost of the intervention that the prices are less accurate than they would otherwise be. This cost comes to the fore with the stifled discovery process.

3.3 The stifled discovery process

Regulation “may discourage, hamper, and even completely stifle the discovery process of the unregulated market” (Kirzner 2018 [1979], 436). And this stifling of the discovery process is perhaps the most important peril of regulation. Kirzner begins his explanation by emphasising that regulation creates discoordination. This comes quite naturally in the case of the Mietendeckel, for the government wants to block

⁵ The market process contains such a selection procedure, see Alchian (1950).

⁶ It reads: “The Gesetz zur Mietenbegrenzung im Wohnungswesen in Berlin (MietenWoG Bln – „Mietendeckel“) was created in order to protect tenants from the developments in the tight Berlin housing market. [...] Tenants need an efficacious protection against displacement“ (Senatsverwaltung für Stadtentwicklung und Wohnen n.d.).

⁷ I thank an anonymous reviewer for this point.

profitable exchange. The rent freeze blocks mutually beneficial, because voluntary, exchange between two parties. This is intended by the regulation.⁸ The unintended consequence of this is that the number of dwellings offered for rent dwindles, and fewer houses are built. The above-quoted findings in the empirical literature indicate that this happened.

But next to causing discoordination, the measures also “*bar the discovery* of pure profit opportunities” (Kirzner 2018 [1979], 436; his emphasis). The introduction of regulation means erecting barriers to entry. But once there are barriers to entry, some are excluded from the discovery process or certain ways to profit are prohibited. Entrepreneurs, e.g., innovative new start-ups, simply are not allowed to put forth their discoveries or act on their conjectures – this decreases the alertness of entrepreneurs for profit opportunities. In addition, regulation changes prices, both directly and indirectly, and prevents their free adjustment in the hands of the entrepreneurs. As such, the prices will not be formed by (the best possible) use of the dispersed knowledge in society – this is the unsimulated discovery process. They will be quite poor prices not adequately conveying knowledge to entrepreneurs. So, the poverty of prices arises because less of the dispersed knowledge is allowed to be put into their formation. Since entrepreneurs receive poorer signals, they have less support in discovering profit opportunities. And even if they had the aptitude to discover profit opportunities, regulation might hinder them from seizing on them; this means they have fewer incentives to be alert. Regulation stifles the discovery process overall and thus decreases not only the quantity supplied at the controlled prices, but also the supply of housing in general. Demonstrating this is the strength of Kirzner’s framework and market process theory in general. Kirzner (2018 [1979], 437) writes:

A price ceiling does not merely block the upper reaches of a given supply curve. Such a ceiling also may inhibit the discovery of wholly unsuspected sources of supply (which in the absence of the ceiling would have tended to shift the entire supply curve to the right) or of as yet wholly unknown new products (tending to create supply curves for wholly new graphs).

Kirzner’s remark shows that beyond the deadweight loss caused by the Mietendeckel, the rent control also decreased the likelihood that entrepreneurs will be alert and able to discover unknown opportunities for profit. For instance, a clever entrepreneur might have invented a new and cheaper form of constructing and renovating houses which would have increased supply in general. But due to the decreased incentives and guidance for discovery, the discovery did not come about. What is so crucial here is that we can never know what we missed out on. We can never calculate what would have been invented or discovered had it not been for the regulation.⁹ We cannot assess these costs of the regulation but only abstractly describe the type.

⁸ Presumably, the officials suppose that these exchanges, though voluntary, are not beneficial for the tenants. But values are individual and subjective. And actions inevitably come with costs. That men voluntarily agree to do something to gain something else marks it as *ex ante* beneficial. See Puster and Winter (2018).

⁹ Perhaps the best way to get a grip on this intuition is to think of innovations which revolutionised a sector. Then consider that governments might have forbidden these kinds of things. For example, govern-

Ikeda, working in Kirzner's spirit, examines the mixed economy and adds two important factors. He writes that when the state expands, this pushes towards "the breakdown of the institutions of the market (property rights, the price system, norms of reciprocity)", and this breakdown then "undermines the error-correction capacity of the market process" (2004, 37). So, not only is the price system weakened but so are firstly property rights and secondly social norms – which are crucial for exchange and thus for prices to emerge. This means that the price system is also weakened indirectly – again costs which are impossible to determine. Incidentally, there is some empirical illustration for these effects: More than half of the landlords pronounced they were less willing to invest in their housing portfolio after the Mietendeckel (Sagner & Voigtländer 2022, 58–60). This would portray what Ikeda calls an internal consequence of the intervention. Effects on private property rights in general are external consequences, i.e., consequences that go beyond the area of intervention (Ikeda 2003 [1997], 100–102).

3.4 The wholly superfluous discovery process

The wholly superfluous discovery process is nearly as important as the stifled discovery process. Entrepreneurs want to make profit. When governments regulate, they change how entrepreneurs can make profit, and they change which skills are crucial for entrepreneurial success. Kirzner explains: "the imposition of regulatory restraints and requirements tends to create entirely new, and not necessarily desirable opportunities for entrepreneurial discovery" (2018 [1979], 438). In other words, regulation creates a new equilibrium towards which the market process tends. This is a "regulation-induced alteration in the pattern of market discovery" (Ibid.).

Kirzner assumes that regulators do not intend to create such new opportunities. This may but need not be the case. McChesney (1987) draws attention to "rent extraction" where politicians threaten with regulation in order to receive rents. Intended or not, one of the classical results of regulation is more bribery and corruption. Those regulated will tend to dislike the regulation and thus have an incentive to secure more pleasant regulation in the future. This might lead to attempts for "regulatory capture" (Stigler, 1971). New profit opportunities need not lie in the direction of bribery and regulation. They may also take the form of discovering alternative entrepreneurial paths that often come down to circumventions of the regulation. Kirzner suggests that all these new profit opportunities are superfluous in the sense of being rather undesirable, as seen from the perspective of the intervener. Also, given the superiority of the market process, it is to be expected that the entrepreneurs will be able to innovate more ingeniously than regulators can regulate.

The Berliner Mietendeckel triggered a flurry of new, unintended opportunities for profit. While it may partly be not pure profit in Kirzner's sense, it is probably apt to mention here again that many property-owners decided to convert their dwellings into owner-occupied housing (Arlia et al. 2022, 54) or to sell them. They may not have discovered unknown profit opportunities but rather adjusted to the new situation

ments might have forbidden motorised ways of transportation in order to protect horse carriage drivers. Maybe we would not have cars now, if such a regulation had come into being and had been successful.

where renting an apartment was less attractive and property rights less secure. The decision of many searching tenants to look to Potsdam or other cities in the vicinity of Berlin is similar – where rents then increased.

One of the most striking manifestations of the wholly superfluous discovery process in Berlin was the company mbly. Mbly emerged in the wake of the Mietendeckel and invented an ingenious method to circumvent the regulation.¹⁰ The business model was to make possible higher earnings for landlords by buying their furniture and leasing it out to the tenants, while paying a monthly rate to the landlords, as described by Cheung (1974, 63) as a possible avenue for landlords. The price for the furniture was not covered by the Mietendeckel and thus a rent closer to the natural market price was possible. Of course, mbly profited as well, not only the landlords. This example is striking. It shows firstly that, as Kirzner prognosed, regulation creates new profit opportunities. Secondly, that the market process, with free entry, prices, and a selection process, is vastly superior to the governmental process. The mbly founders discovered a profit opportunity of which the regulators were not aware. And thirdly that regulators lack knowledge to implement effective and efficient regulation; they need to remedy their poor regulations with additional regulation.

The wholly superfluous discovery process also leads to other ways in which companies try to make profit. Companies can gain a lot from lobbying, and maybe even need to engage in these activities to remain competitive. The large German housing company Deutsche Wohnen SE is a characteristic example. In light of the Mietendeckel and further activity of the Berlin administration, Deutsche Wohnen (2022, 81; my translation) explained:

It thus cannot be excluded that there will be further regulatory changes. Therefore, the Deutsche Wohnen continuously monitors the implementation laws, collaborates in real estate boards, and employs legal possibilities for codetermination.

What they call employing legal possibilities for codetermination translates to lobbying.¹¹ It is a wholly superfluous expense. And this behaviour is just what Kirzner's theory predicts.

More examples for the wholly superfluous discovery process were the Schattenmiete (shadow rent) and indemnity payments. Schattenmiete denotes the concept to agree on two different rents. A first one which is the market price rent (the Schattenmiete), a second one which is the coerced, official rent. Landlords and tenants agreed to switch to the Schattenmiete if the Mietendeckel is repealed, and perhaps also that tenants pay back the difference. Second, there sprung up indemnity payments. In Germany, they are legally invalid (see the Gesetz zur Regelung der Wohnungsvermittlung § 4a). But this may not have stopped landlords to circumvent the Mietendeckel

¹⁰ Those interested can find more information on their homepage, see <https://mbly.de/>.

¹¹ Like Vonovia, the other big German company in the housing sector, Deutsche Wohnen is registered in the (newly formed) *Lobby-Register*. Vonovia writes: "To anticipate potential changes in the legal framework early, Vonovia engages in active dialogue with politicians and stakeholders. Additionally, Vonovia engages in associations, and regularly monitors the legislative processes as well as the current jurisdiction" (2021, 131; my translation).

via this makeshift. Again, the measures of entrepreneurs were ingenious ways to make profit, superior to the regulators, and wholly superfluous discoveries as well as wholly superfluous expenses. Think, for example, of the costs which landlords had to incur in order to clarify the legal terms and set up contracts that covered the Schattenmiete. Still, though superfluous, they may have prevented a more severe break-down of the market given the regulation.

What Kirzner's analysis of the wholly superfluous discovery process entails are also the opportunity costs of changing the sought-after equilibrium. The government administrators, the lawyers supporting the landlords, companies' employees who track government plans and lobby – they all could have engaged in genuinely productive activities. What was lost cannot be known. But the costs must be considered when judging the Mietendeckel and regulations more generally.

3.5 Applying some additional insights from Ikeda's analysis of the dynamics of the mixed economy

Ikeda built on, inter alia, Kirzner's market process theory and his theory of the perils of regulation to develop a full-fledged theory of the dynamics of the mixed economy. In this theory Ikeda draws attention to the impact of interventions on property rights and social norms as well as on endogenous ideological change. Ikeda's framework is helpful because it emphasises the dynamic interplay between interventions and ideology, and the long-term effects of interventions. This is particularly beneficial in the case of the Mietendeckel since this policy-measure can thus be seen as part of a greater interventionist dynamic.

Interventions not only distort prices but also erode property rights and social norms which in turn impacts prices that emerge from exchange that rests on these property rights and norms – I already touched upon this. This erosion can go beyond the Berlin housing market. That a government interfered heavily with private property rights was noticed both by owners of real estate and by people more generally. The precise impact is presumably impossible to identify. But it seems likely that the willingness of investors to buy real estate in order to rent it out decreased, which would be, in Ikeda's words, an internal consequence. And perhaps this is true for investments more generally. And thus the external consequences in the form of the impact on investments more generally – on the whole *Wirtschaftsstandort* Germany – may be most pernicious.

Endogenous, and not exogenous, ideological change may be Hayek's (2006 [1944]) central contribution to the theory of interventionism. He explained that “[t]he important point is that the political ideals of a people and its attitude towards authority are as much the effect as the cause of the political institutions under which it lives” (1967 [1956], 224). Clearly our ideals, our ideology influences what we will do, i.e., whether and which interventions we will undertake. But Hayek emphasises that what we do, e.g., intervening, also influences our ideology. An intervention can shift the ideology of the people towards (more) interventionism. Ikeda (2004, 38) names three ideological drivers. Firstly, the dynamic trade-off thesis. The thesis holds that increasing the security for some increases the insecurity for the others. The Mietendeckel is interesting from this perspective since while benefiting and securing the position

of the current tenants, it caused several landlords larger troubles – 4% had to default on their credits. Curiously, landlords did not receive any government aid while those tenants who could not pay back the higher rent after the dissolution of the Mietendeckel received such aids (Senatsverwaltung für Stadtentwicklung und Wohnen 2021). The general insecurity landlords perceived goes beyond that. To this comes secondly the meaningful rationale thesis. Pursuing a spurious rationale turns this rationale into something meaningful. Justice applies to action only. In a market economy income and wealth emerge from an impersonal process. Nobody determines who receives this or that remuneration for her work; the result is not an outcome of an action and thus justice is inapplicable. But once the government intervenes, the resultant order is to the degree of intervening the result of an action. And this means justice is applicable. When the Mietendeckel threatens the income and wealth of some for the benefit of others, justice becomes a meaningful category. Especially those who suffer from the intervention will be more likely to demand government action on their behalf. And thirdly, the gradual acceptance thesis: intervening will simply lead to higher acceptance of intervening.

The different facets of endogenous ideological change (but also the effects on property rights and social norms) are difficult, if not impossible, to ascertain. It may be just here, however, where the most important effects of the Mietendeckel can be found. Even if one could practically determine interventions' impact on ideologies, on property rights and norms, which seems very difficult, the costs of this still remain unascertainable. The loss of a better discovery process is unknowable. "The problem is that one cannot imagine what specific, now unknown opportunities might have been discovered in the relevant hypothetical circumstances (Kirzner 2018 [1979], 439). And at least in this sense the costs here, again, cannot be known. Still, they must be considered in an overall judgment.

Moreover, a central motif in Ikeda's analysis is "policy myopia" and the dynamics which result from this. In a confused and confusing situation, policy-makers fail to understand that their interventions are the source of disaster, of the "micro-crises and macro-crises" (Ikeda, 2004, 39). Their myopia is the reason why they insist on further interventions and do not give up on the old ones, and in light of the discovery process this should be seen as a cost. In 2021, the German Federal Supreme Court repealed the Mietendeckel for reasons of legislative competence. This "dis-intervention" (Ikeda 2003 [1997], 139) was enforced from the outside on the interveners. Nonetheless, it illustrates the knowledge problems which plague interveners. A response might be new or re-interventions which would be part of the progressive interventionist process. Franziska Giffey, Berlin's mayor, recently suggested that no household should have to pay more than 30% of their net income on rent (Giffey 2022). Instead of giving up on regulating the housing market, policy-makers seem to adhere to intervening. In a similar vein the Berlin initiative for expropriating large housing enterprises was successful: a majority of Berlin citizens voted for such nationalisations. The future will tell whether this will translate into action. But the insistence on intervening after previous interventions failed and there even had been dis-interventions is a classic manifestation of the dynamics of interventionism which can be both progressive and contractionary.

From the perspective of the theory of interventionism, the Mietendeckel is interesting also because of its past. The Berlin housing market has been inhibited in several ways before the Mietendeckel was implemented (Kholodilin, 2017). The dire situation on the Berlin housing market may well be the consequence of these earlier regulations. This suggests that the Mietendeckel is an outgrowth of earlier interventions or a progressive interventionist dynamic which led to a “micro-crisis” (Ikeda, 2004, 39), i.e., a crisis of constrained extent – different from a macro-crisis which would span the whole system – that led to the government implementing the Mietendeckel. Inter alia, Berlin implemented a law forbidding so-called misuse of housing in 2013 (Ibid., 301), and on the federal level a rental brake called Mietpreisbremse was introduced in 2015 (Ibid., 315). Kholodilin also notes that the constructing of social housing had overall decreased since the mid-1990s (2017, pp. 281–283). More social housing would have been an important contribution by the government to support the housing situation and offset damaging effects of regulation. Combined with an influx of migrants beginning around 2015 and a general higher attraction of Berlin for German citizens the regulations may have produced a sluggish market unable to adjust adequately to a significantly altered situation. And this could then have been the situation which led to a micro-crisis which propelled well-meaning policy-makers to intensify their interventions by decreeing the Mietendeckel: an expansionary interventionist dynamic.

3.6 Summary of the effects

The Mietendeckel surely benefited those Berlin inhabitants who already were tenants or who were able to find a regulated apartment as well as those who profited through higher real estate prices, like landlords in Potsdam. But its costs are legion. Many beneficial exchanges were simply outlawed – and landlords *and* tenants thus impoverished. Many landlords were damaged through lower rents and the lower value of their dwellings, some even had to default on their loans. The number of dwellings offered on the market decreased considerably. And there was a remarkable price increase of rents in the unregulated segment – both in Berlin and its vicinity.

To these costs come those that are unknowable. Prices were impoverished and lost some of their guiding qualities which made it more difficult for entrepreneurs to discern where profitable opportunities lie. And the deteriorated property rights and norms combined with uncertainty about them made it less profitable to be alert. Also, the higher propensity to intervene that can result from progressive interventionist dynamics is a cost, since interventions tend to undermine the beneficial discovery process. What the market process could have brought about – both in the employment of known and the discovery of unknown resources – is unknowable. But it is important to count this amongst the costs of the Mietendeckel, and any other regulation. The increased difficulty to detect opportunities for profits and the decreased incentives for alertness were supplemented by shifts in what brings profits. And these shifts tend to be undesirable. Entrepreneurial alertness concentrated on circumventing the Mietendeckel and on influencing political decisions as to ensure laws which please the lobbying parties more. These are all efforts which could have gone into building houses, facilitating exchange, or inventing clever, new ways of living. A cost

is also the tax-payer financed politics and bureaucracy – think of the lawyers who drew up the law or the bureaucrats who had to monitor the housing market. Tenants could have paid their rents more easily if they had to pay fewer taxes. The state-employed people could have worked in other employments.

4 Lessons from the Berliner Mietendeckel

Two things can be learned from the experiences with the Berliner Mietendeckel. Firstly, they show that Kirzner's analysis and the theory of interventionism can convincingly explain real-world phenomena. The experiences of the Mietendeckel support the validity of focusing dynamics, the market process, and action. Secondly, the experiences inform political-economic thinking: the Mietendeckel demonstrates the importance of knowledge problems; the superiority of the market process, which alone has free entry; that progressive interventionist dynamics are not inevitable; and that the invisible nature of the costs of intervention is fateful and demands much more attention than it usually receives.

4.1 The applicability of 'perils of regulation' and the theory of interventionism

The first point is rather straight-forward. The Kirzernian framework predicts that the rent control leads to a depleted housing market, and this is what happened. The strengths of Kirzner's analysis come to the fore when turning to the difficult-to-detect effects. In line with the discovery process, entrepreneurs outwitted the bureaucrats and pursued superfluous profit opportunities. And in line with Kirzner's framework, many of the costs of the Mietendeckel remain unknown but can be captured abstractly. These concern mainly the discovery process which was stifled by the regulation. This stifling led to fewer profit opportunities being discovered, and thus a decrease of supply, that is, a decrease beyond the quantity supplied at the lower prices. The opportunities that would have been discovered are lost forever.

The theory of interventionism focuses on endogenous ideological change and the dynamics of the mixed economy which often concern long-term effects. Endogenous ideological change – effects on property rights, norms, and ideology – is difficult, if not impossible, to ascertain. But the experiences of the Mietendeckel make such a change plausible. For instance, tenants unable to pay back the difference between the Schattenmiete and the official rent received government support. Not so the landlords who had to default on their loans. The politicians' decision meant to distribute wealth and was an action which resulted in unjust conditions; for the damaged people, the politicians could thus be perceived to be the originators of the issue and then as the ones to solve it. Concomitantly, it increased the insecurity for a large group of people (landlords, property-owners, people wanting to move to or within Berlin) while increasing the security for another group (existent tenants, bureaucrats).¹²

¹² Locating those landlords who benefited from the regulation is more difficult. Landlords in Potsdam saw their rents (and presumably the value of their dwellings) increase. But their security may be judged differently, because they may fear similar rent controls for their dwellings.

With regards to the expansionary phase, dynamics of the mixed economy denotes the idea that interventions can lead to and necessitate for their success further interventions; whoever wants to intervene is forced to expand her intervention to cover ever more areas of the economy, as Mises sketched in his original presentation of price controls (Mises 2011 [1929]). For to the extent that the interventions leave entrepreneurs free, they will relentlessly discover new profit opportunities. Profit opportunities which, usually, are neither anticipated nor intended by the government and which negate the hopes for success of the interventions. For interventions to succeed, the options for entrepreneurial action need to be eliminated increasingly, meaning that the intervention will need to have external consequences in the end. Until the sole actor remains the government. For only then can the undesired discovery process be avoided. And the experiences in Berlin prove the aptness of this diagnosis. After the Mietendeckel, landlords decided to convert their apartments into owner-occupied property, sold their property, or circumvented the rent freeze by indemnity payments or things like the *mbly* makeshift. The unsatisfactory results of the Mietendeckel emerged largely because the entrepreneurial process continued. Think of the rent increase in Potsdam. Here, the intervention produced an undesirable result. To ensure lower rents for Potsdam inhabitants, the government would have had to extend its regulation to cover the vicinity of Berlin. And then the vicinity of the vicinity. And so on. This is the progressive interventionist dynamic: for (meaningful) success, interventions must be supplemented by further and further interventions. Until there is no more scope for the entrepreneurial discovery process. Incidentally, the theory of interventionism shows its strength also in that it offers a convincing explanation of the implementation of the Mietendeckel as a result of previous regulations of the housing market, and the repeal of the Mietendeckel as a dis-intervention. In particular, Ikeda's prediction that "[n]early all really existing systems will be in flux, cycling somewhere between the extremes of laissez-faire capitalism and complete collectivism" (2003 [1997], 217) seems corroborated. From a movement towards more economic planning with the Mietendeckel as the last of several interventions, the economy cycled into the other direction with the repeal of the Mietendeckel. And perhaps future measures, as demanded by some, will lead to a movement into the opposite direction again.

4.2 Take-aways from the rent freeze

This already blends over into the second point, i.e., the take-aways for political economy in general and the frameworks employed in particular. The first remarkable aspect is that there is no inevitability behind the progressive phase of the interventionist process. With regards to the progressive phase, the dynamics of the mixed economy describes a logic which drives a system towards more and more intervention, something which we could observe in Berlin. But this progressive dynamic is not necessary or inevitable. The tendency can be stopped. And there can be dis-interventions, what Ikeda coins the "contractionary phase of the interventionist process" (Ikeda 2003 [1997], 137). The easiest way to evade progressive dynamics is when policy-makers simply refrain from intervening and give up on the existent regulations, i.e., dis-intervene, often after micro-crises occurred. Other solutions are

of course also possible, like political change. The Berlin rent freeze was repealed by a court decision. But independent of that, the Mietendeckel provoked many critical voices, not only but especially from economists. This shows that progressive interventionist spirals can be avoided, and it shows that just this should often be the objective of economists, politicians, and policy-makers. There are dynamics in a mixed economy, but there is no inevitable progressive process leading towards comprehensive socialist planning. There can also be dis-intervention.

Secondly, the experiences of the Berliner Mietendeckel show that policy-makers suffer from a serious lack of knowledge. That policy-makers failed in the sense of understanding the law correctly and thus witnessed the repealing of their legislation by the German Federal Constitutional Court presses this home. But maybe the case of mbly best illustrates this. Here, policy-makers failed to anticipate that landlords might employ such a makeshift to circumvent the rent freeze. They did not envision this measure. That they did not pre-emptively and effectively forbid such kinds of measures shows their serious lack of knowledge when designing interventions. Not only does the lack of knowledge manifest in the mbly case. It is more generally manifested in the poor performance of the Mietendeckel from the perspective of most of the Berlin inhabitants (and especially would-be inhabitants). Good intentions do not guarantee good outcomes. For there are knowledge problems.

This blends over to the third important lesson. This is the superiority of the entrepreneurial market process to the governmental process: the market process with private property as skin in the game, free entry, prices as guides, and profit and loss as disciplinary forces versus the governmental process with little skin in the game, with barriers to entry, with lack of prices as guides and weak disciplinary forces for the participants. In particular, the importance of free entry is striking. Mbly shows that any person with a good idea can simply go ahead and provide her product on the market. Not so for bureaucrats. There may well be a fine would-be bureaucrat who knows a much superior way to regulate the housing market, for instance, by constructing new dwellings with taxpayers' money or by deregulating housing regulations. But she is not allowed to enter the governmental process as she pleases. She cannot submit her idea for best practices of regulation. This is a structural and necessary disadvantage of the governmental process: the governmental process by definition does not have free entry, since governments possess a monopoly of force in a delimited area over a specific population. People cannot freely come in and submit their best ideas how to regulate others – for regulation ultimately relies on force, or the (legitimate) use of coercion of which the government possess the monopoly. Regulators can only enter the 'market of bureaucracy' if they are actively employed to do so. This suggests that polycentric solutions are attractive. Then, policy-makers should find it easier to submit their ideas for regulation and can autonomously experiment to find best practices (Müller, 2018).

Fourthly, the maybe most important lesson for the perils of regulation and the theory of interventionism – but also for political economy in general – is that the nature of the problem makes it so difficult to draw attention to the costs of interventions and achieve a balanced judgment of any measure. This leads back to Frédéric Bastiat's (2007 [1850]) insight that it is simply much more difficult to get people to see the (ultimately unascertainable) costs of an intervention than its immediate benefits. You

see who now pays less rent for her apartment¹³; but you do neither see who did not move to Berlin because she failed to find an apartment at all nor all the entrepreneurial discoveries which only a free, unregulated market process could have produced. In the most cases, all that is knowable is that *something* is lost, and of what type these costs are. But determining the specific cost is impossible. And this may contribute to policy myopia as well.

That the costs of interventions are ultimately so hard to take into account combines with the unrelenting resilience and strength of the market process to support the popularity of interventions. The market process is theoretically very powerful. And in Berlin we saw that notwithstanding the regulations, clever entrepreneurs devised ways to coordinate actors in the market, e.g., via indemnity payments, via mbly, or via the Schattenmiete. Despite the regulations, the entrepreneurial market process, at least with some moderate success, maintained coordination on the market. Peltzman (2007) argues that this strength and resilience of the market process contributes to the popularity of regulating. Regulations are usually damaging. But *despite* the regulations, the market process works sufficiently well to ensure some coordination and some satisfaction of consumer wants. Put very roughly, entrepreneurs get the better of regulation. The resilience of the market then bolsters regulating, because regulations, while bad, do not lead to complete breakdowns of the market process. The experiences in Berlin support this view. While the situation deteriorated, it was no complete disaster. And this because of the ingenuity of entrepreneurs. So, entrepreneurs may indirectly support the popularity of regulating which then is undergirded by policy myopia into which the invisibility of costs feeds.

5 Conclusion

The Berliner Mietendeckel has benefits and costs. Many treatments of the Mietendeckel have drawn attention to several important costs. But they have seldom produced a complete list. For a complete appraisal of its costs, the dynamic market process approach helps. It shows that next to the deadweight loss of price control there are costs which are easy to overlook. The costs of the Mietendeckel consist also of that what could have been. They consist of what the discovery process could have achieved if it had not been stopped and stifled; of the beneficial profit opportunities which the entrepreneurs could have discovered; of the resources which could have been expended for productive activities. The Mietendeckel surely benefited some groups: the existent tenants in Berlin and the landlords in the vicinity of the German capital; and surely some bureaucrats, politicians, and some entrepreneurs and workers. But there are so many who were damaged by the regulation. In order to arrive at a reasonable judgment, all costs must be considered. And this a purpose of this paper: it shall inform such a comprehensive and thus fair judgment of the Mietendeckel and then also of similar measures.

¹³ However, do not forget the undiscovered discovery process. When judging the intervention, consider what the market would have achieved absent the regulation.

One benefit of the Mietendeckel is that it teaches several important lessons to political economists. The first is that market process theory and an emphasis on dynamics is vital to understand real-world market phenomena and to arrive at a reasonable judgment of any policy measure. If we want to evaluate a regulatory measure in its fullest, we must consider its dynamic impacts including the effects on the discovery process, and thus costs which remain unknowable, and also the interventionist dynamics surrounding it. Secondly, the experiences practically demonstrate that bureaucrats lack knowledge; that the governmental process is inferior to the market process, which is, *inter alia*, the case because only the market process has free entry; that policy-makers suffer from myopia and that the costs of interventions are preponderately unknowable which reinforces this myopia – and which together with the unrelenting power of the market process explains why interventions remain popular.

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