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Deductio ad absurdum. Want a government subsidy of $225,000 a year? Buy a mansion - includes related article

by Peter Dreier, John Atlas

Want a government subsidy of $225,000 a year? Buy a mansion.

When President Bush unveiled his new housing program last November at a National Association of Realtors convention, the news media focused on his plans to aid the homeless, assist public housing tenants who want to buy their apartments, and provide matching grants to cities for housing rehabilitation-an extremely modest initiative totalling about $1.2 billion per year in new federal housing funds.

Especially modest given that during the Reagan years, the homeowner tax break was the only housing subsidy that did not fall to the budget axe. Housing assistance for the poor shouldered the most severe cutbacks of any domestic programs-a 75 percent reduction from $33 billion to under $8 billion. Today, less than one-third of all low-income Americans receive any kind of housing subsidy. This is the lowest level of any major industrial nation what reporters downplayed or ignored was the president's brief comment confirming his continued support for the homeowner tax deduction-a $34 billion annual federal subsidy that primarily benefits the wealthy.

Eliminating this tax break for the rich-while preserving it for the middle-class-could provide substantial money to finance housing assistance for low-income families, reduce the deficit, or fund other needed government programs.

To achieve this progressive tax reform will require Congress to overcome powerful political and ideological obstacles. The major political obstacle to reform is the real estate lobby-particularly the national associations of realtors, homebuilders, and mortgage bankers. Their political action committees have a vast local network and deep pockets. The housing industry argues that the homeowner tax break is the linchpin of the American dream. Without it, they argue, many Americans-including many young families-could not afford to purchase a home. Few congressmen want to offend these generous campaign contributors or be labeled as anti-homeownership. In fact, 245 members of the House of Representatives last year endorsed a resolution, sponsored by

Rep. Marge Roukema on behalf of the housing industry, pledging their support for the existing homeowner tax break.

The real estate lobby, however, is engaged in ideological overkill. No one wants to repeal the entire homeowner tax deduction. But it can be reformed so that it primarily benefits poor and middle-class home buyers, while eliminating an expensive and unnecessary tax subsidy for the rich.

What's all the fuss about?

The federal tax code allows homeowners to deduct all property tax and mortgage interest from their income taxes. This will cost the federal government $34 billion in lost revenues this year alone, according to the Joint Taxation Committee. This amount is more than four times Bush's HUD budget for low-income housing.

The homeowner deduction is a government subsidy that goes primarily to the affluent. Over 78 percent of the foregone tax revenue goes to the 15.1 percent of taxpayers who earn over $50,000. One third of this subsidy goes to the 3.1 percent of taxpayers with annual incomes over $100,000. One half of all homeowners do not claim deductions at all. Tenants, of course, don't even qualify.

In other words, our nation's housing subsidies disproportionately benefit homeowners with high incomes or with more than one home. For example, Senator John D. (Jay) Rockefeller of West Virginia will receive a tax subsidy worth about $233,000 per year just on his $15.3 million Washington mansion. This amount would provide rent subsidies for about 5,000 low-income tenants-roughly the size of the homeless population in the nation's capital.

"I have no objections when the deduction goes for houses," says Rep. Sam Gibbons, senior Ways and Means Committee member. "When it goes for castles, I do."

Every president since Herbert Hoover has made home ownership a fundamental part of this nation's promise of prosperity. In the postwar period, the rate of home ownership in the U.S. rose steadily for three decades, from 44 percent in the late 1940s to 65.6 percent in 1980. Most of that increase was due to postwar federal housing programs, particularly longterm, low-interest, high leverage mortgages insured by the Federal Housing Administration or guaranteed by the Veterans' Administration. Cheap suburban land, subsidized highway construction, and rising income all contributed to the postwar boom. Only in the past decade-as housing prices skyrocketed, household incomes failed to keep pace with inflation, and federal housing programs were cut-has home ownership declined.

The homeowner tax deduction was never designed to be the costly element of housing policy that it has become. According to Marc Weiss, a Columbia University professor currently writing a book on the history of home ownership, the deduction grew almost by accident. By the time Brookings Institution economists began suggesting in the 1960s and 1970s that the homeowner deduction was inequitable and unnecessary, real estate lobbyists were already declaring it sacrosanct.

The impact of the homeowner deduction in promoting home ownership is debatable. Neither Canada nor Australia have a homeowner deduction, and the homeownership rates are roughly the same as the U.S.

If anything, the deduction has helped push housing prices artificially up, because home buyers include the value of the tax subsidy in their purchase decision. It provides upper income home buyers with a tax shelter, encouraging them to view home-owning primarily as an investment, and to buy bigger homes, and more homes, than they need. And it certainly fueled the past decade's wave of housing speculation and the conversion of affordable apartments into expensive condominiums, promoting the gentrification of many urban neighborhoods.

What to do?

Two proposals make the most sense politically and economically. Both preserve the benefits for the broad middle class. Both close tax loopholes for the wealthy. And both generate substantial tax savings.

First, eliminate the subsidy for the most expensive homes and vacation villas by limiting mortgage interest deductions to $12,000 per single return or $20,000 per joint return, adjusted for inflation. These ceilings are higher than the deductions now taken by nearly all homeowners-in fact, they would affect less than one-half of 1 percent of all taxpayers. They would yield the federal government an additional $1.25 billion this year, according to the Joint Taxation Committee. According to a Congressional Budget Office study, it "would retain the basic incentive for homeownership, but would not subsidize the luxury component of the most expensive homes and vacation homes."

Second, phase out the deduction entirely for the rich. If the 3.9 million taxpayers with incomes over $100,000 (3.1 percent of all taxpayers), adjusted for inflation, were no longer eligible for homeowner tax breaks, the federal government would net an additional $11.6 billion a year. If the cut-off started at $200,000 (1 million taxpayers, representing 0.8 percent of all returns), new federal revenues would total $3.7 billion.

Despite dire warnings from the real estate lobby, neither proposal-singly or in combination-will have a significant impact on the homebuilding industry. The affluent will continue to buy large homes, and second homes, but the prices will reflect their real market value, rather than the artificial price that includes the government subsidy.

And that way, we could stop subsidizing the rich to live in castles, and help more Americans stay out of shelters.

THE WORST CITY GOVERNMENT

In St. Paul, Minnesota, government usually runs as clean as the water; the occasional scandal appearing in the local press usually has a dateline from Chicago. So imagine local eyebrows this winter, when a year-long Minneapolis Star Tribune investigation disclosed that veteran fire chief Steve Conroy and his staff had declined to investigate dozens of suspected arson cases while Conroy's brother Pat, a fire rehab specialist, harvested more than $1 million dollars repairing (and sometimes not repairing) the damage

Over the past 25 years, calculated the Star Tribune, 15 Conroy friends and business associates suffered an improbable 51 fires at their homes and businesses, collecting millions in losses from insurance, And firefighters frequently overlooked the obvious causes of these blazes-gasoline-soaked rags, broke or felonious owners, and other arson-for-profit indicators. "Grossly inadequate," said one outside fire investigator of the city's follow up habits, which included asking no questions when certain local businessmen suffered three, four, and even five fires in a row'

One possible explanation is that many of the firefighters attending these dubious blazes also happened to be moonlighting for St. Paul's leading insurance adjustment firm-a firm originally financed by Chief Conroy and now owned by a friend. (Two former executives in the firm have been convicted of federal arson conspiracy.) Fire victims used the helpful adjuster to estimate or, as several judges subsequently ruled, to inflate-the losses in fires at their clubs, homes, and apartment complexes. As the insurance companies paid up, contractor Pat Conroy was often called to handle the remodeling.

Not that Fire Chief Conroy was handing out insurance bonanzas only to his friends and associates. His own properties burned three times in 20 years; his brother's properties racked up eight conflagrsations-a record that suggests some people just shouldn't play with fire.

A HARD TAX ON HARD WORK

Even while the government is giving more money to the rich for their houses, it is taking more money away from working people. Recently, the Social Security payroll tax, which disproportionately hits low-income wage earners and small businessmen, was raised again. The following item is excerpted from a column Jodie T. Allen of The Washington Post wrote pointedly exposing this injustice:

Nobody seems to complain much about the payroll tax, even though it is now a far heavier burden on the average worker than the personal income tax and a far bigger drag on industry's ability to compete in foreign markets than the corporate income tax. There was no taxpayers' revolt last November when Congress and the administration, in a little-noted departure from the read my lips" rule, slipped into law an added boost to this month's payroll tax hike even though it was totally unneeded to pay for Social Security benefits.

Contrast that muted reaction with all the hoopla-the chilling denunciations of the "politics of envy"-raised last fall, when House Democrats toyed with the idea of raising marginal income tax rates on the wealthiest Americans to the same higher level already faced by families with far less income. Or the fight to cut the capital gains tax paid by investors even as the payroll tax on workers rises. If the average American doesn't mind being suckered why should policy makers care?

They should care because Congress and the president are supposed to be looking after the public interestnot figuring out how best to fool it. And the fact is that the public has been fooled into accepting the most regressive tax structure among Western nations.

"Supply-side" economics advertised tax cuts, but, in fact, the tax burden as a whole has not changed over the eighties. What has changed is that the proportion of revenue coming from progressive income taxes has declined, while the payroll tax, which reaches only the lower part of earnings and doesn't touch investment income at all, has soared by about 25 percent. As a result, as Brookings Institution economist Joseph Pechan, the longtime dean of experts, wrote shortly before his death last year, the tax system actually makes the U.S. income distribution less rather than more equal.

This, Pechman observed, is even more troubling because the distribution of income in the United States, already far more unequal than that of our leading competitors, has become substantially more so in the last 10 years. History shows that nations that allow their wealth to become concentrated in the hands of the few prosper in neither social nor economic ways.