

5 Federal Housing Subsidies: Who Benefits and Why?

A JULY 6, 1990, ARTICLE appeared in the *New York Times* (“Expanding the Choices in Million Dollar Homes”) that described the Pinnacle, a cluster of new homes priced from \$975,000 to \$1.3 million, in Purchase, New York, in the heart of Westchester County’s wealth belt.

The *Times* did not describe the Pinnacle as a “subsidized” housing project, but in its glowing description of the project, the paper unwittingly revealed how taxpayers underwrite the cost of luxury housing.

Subsidy #1: “The project is on a 23-acre site,” the *Times* noted, “across the street from the 236-acre Silver Lake Preserve, a county-owned nature preserve.”

Subsidy #2: Then, gushed the *Times*, “The project is only a few minutes’ drive from the White Plains train station, and is within earshot of Interstate 684.” (While the noise of the nearby freeway might detract somewhat from the pride of owning a million-dollar home, the convenient access to a major highway makes up for it.)

Subsidy #3: Likewise, the taxpayer-subsidized Metro North commuter rail lines add significantly to the value of the Pinnacle.

The *Times* did not mention another lucrative tax subsidy—one that is available to homeowners. Pinnacle homebuyers would get huge tax breaks on both mortgage interest *and* property taxes. On a million-dollar home—with a 10 percent down payment, a mortgage at 10 percent interest (the prevailing rate at the time) and an estimated \$15,000 a year in property taxes—the lucky homeowner could expect an income tax

savings (in effect, a federal subsidy) of \$35,000 in the first year alone.

Most Americans think that federal housing assistance is a poor people’s program. In fact, relatively few low-income Americans receive federal housing subsidies. In contrast, about three-fourths of wealthy Americans—many living in very large homes—get housing subsidies from Washington in the form of tax breaks. These tax breaks subsidize many households who can afford to buy homes without it. Our policymakers and opinion leaders, however, focus more attention on federal aid to the poor. These programs—such as public housing and rent subsidies—are much more visible than the hidden tax subsidies to the affluent. For example, a Lexis/Nexis search of major daily newspapers for 1999 found 4,822 articles that mentioned “public housing”; 164 references to “Section 8”; and a scant 37 stories with a combination of “mortgage interest” and “deduction.”

As a result of housing’s weak constituency, Congress has not put low-income housing programs high on its priority list. Despite slight increases in the late 1990s, federal funding for low-income housing has declined dramatically since the late 1970s. And during the 1990s, some members of Congress even proposed eliminating the U.S. Department of Housing and Urban Development (HUD) altogether. Meanwhile, few politicians, journalists or other opinion-makers worry about getting wealthy mansion-dwellers off government “welfare.”

This chapter first examines the magnitude of federal housing subsidies, focusing on the disparity in the size of tax expenditures for

homeowners compared with housing subsidies directed toward low-income households. To understand why these major disparities exist, the chapter provides a historical exploration into the many battles over housing assistance for the poor. An apparent paradox is then presented: Why has the Low-Income Housing Tax Credit fared much better, in terms of marshaling support, than virtually any other federal housing program targeted to low-income people? Given the size and inequity of the homeowners' deductions, it is not surprising that there have been a number of attempts over the years to reduce or remove it altogether. The following section presents an overview of these efforts and the ways in which the real estate industry has harnessed its substantial power and effectively organized to protect its "sacred cow."

THE MAGNITUDE OF FEDERAL HOUSING SUBSIDIES

In 2000, the federal government spent some \$148.9 billion (in 2001 dollars) for various housing subsidies, as detailed in Table 5.1.¹ Americans typically associate the phrase "housing subsidy" with the poor. They think of public housing projects, homeless shelters or perhaps

rent vouchers, most of which are administered by HUD. But the largest housing subsidies are much more invisible. These are subsidies that come through the tax code in the form of tax breaks or tax expenditures.²

There are basically two kinds of housing subsidies—direct expenditures (administered by government agencies) and indirect expenditures—"tax expenditures" (which are incorporated in the federal tax code). As Table 5.7 reveals, in combination, various tax expenditures for housing comprise the largest tax expenditures in terms of revenue loss to the federal government. These tax subsidies for housing go either to homeowners or to investors. The table also shows that tax expenditures account for over \$118 billion—over three-fourths (79.2 percent) of the federal government's housing subsidies. Put another way, tax expenditures cost almost four times as much as direct housing subsidies. The Treasury Department—not HUD—is the largest government housing subsidy agency. Moreover, as the data in Table 5.2 show, the gap between direct housing subsidies and tax expenditures has been widening since 1976.³

These figures do not include the direct housing subsidies provided by the U.S. Department of Defense for military members and their

TABLE 5.1 Federal Housing Subsidies, 2000
(2001 \$, in billions)

Direct Housing Subsidies	
U.S. Department of Housing and Urban Development	\$30.82
U.S. Department of Agriculture	0.04
Subtotal	30.86
Indirect Housing Subsidies (Tax Expenditures)	
<i>Homeowner Subsidies</i>	
Deductibility of mortgage interest on owner-occupied residences	61.55
Deductibility of property tax on owner-occupied residences	22.61
Exclusion of capital gains on house sales	18.93
<i>Investor Subsidies</i>	
Exclusion of interest on state and local government bonds for owner-occupied housing	0.80
Exclusion of interest on state and local government bonds for rental housing	0.16
Depreciation of rental housing in excess of alternative depreciation system	4.84
Low income housing tax credits	3.28
Deferral of income from post-1987 installment sales	1.03
Exemption from passive loss rules for \$25,000 of rental loss	4.82
Subtotal	118.02
TOTAL	148.88

Source: Office of Management and Budget, Budget of the United States.

TABLE 5.2 Federal Housing Subsidies by Program Category, 1976–2000
(2001 \$, in millions)

Year	Homeowner Subsidies	Investor Subsidies	LIHTC	HUD	USDA	Total
1976	\$27,509	\$1,898	—	\$18,522	\$6,742	\$54,671
1977	23,846	1,422	—	13,328	7,870	46,466
1978	32,483	1,170	—	16,237	8,786	58,676
1979	41,548	998	—	17,972	6,672	67,190
1980	48,644	2,936	—	22,629	7,148	81,357
1981	55,894	3,385	—	24,711	7,039	91,029
1982	57,036	2,234	—	24,230	6,788	90,288
1983	49,861	5,981	—	24,261	5,757	85,860
1984	53,097	5,047	—	24,746	5,312	88,202
1985	55,365	4,916	—	41,649	5,932	107,862
1986	61,502	8,759	—	19,955	4,754	94,970
1987	70,300	5,646	\$42	21,161	1,202	98,351
1988	68,899	6,491	219	24,923	5,019	105,551
1989	78,279	12,832	375	24,961	4,838	121,285
1990	79,861	14,871	146	24,620	3,903	123,401
1991	82,148	14,015	989	27,066	4,037	128,255
1992	86,257	12,795	1,332	28,432	2,814	131,630
1993	92,548	12,543	1,795	28,640	1,791	137,317
1994	91,875	10,868	2,189	28,771	1,804	135,507
1995	92,058	10,275	2,516	31,699	2,343	138,891
1996	90,652	9,402	2,838	27,016	1,465	131,373
1997	97,107	9,699	2,462	29,055	1,175	139,498
1998	99,033	9,632	3,293	31,464	464	143,886
1999	100,068	11,534	2,935	33,429	330	148,296
2000	103,094	11,663	3,278	30,828	39	148,902
TOTAL	\$1,738,964	\$191,012	\$24,409	\$640,305	\$104,024	\$2,698,714

families who live on and off military bases. In FY2001, the Department of Defense spent more than \$10 billion in housing subsidy (U.S. GAO 1996, 2001).⁴ These figures also do not include the proportion of social welfare subsidies—such as Temporary Assistance to Needy Families (TANF), cash assistance (formerly Aid to Families with Dependent Children) and the Earned Income Tax Credit—that families spend on housing.⁵

Whether the federal government uses direct expenditures or tax breaks to subsidize housing is not important on its own terms. But the reality is that most of the direct subsidy programs go to low- and moderate-income people, while most of the tax subsidies go to middle- and upper-class people.

Homeowner Tax Expenditures

By far, the largest federal housing subsidies are the tax breaks for homeowners, totaling \$103.1

billion in 2000 (in 2001 dollars).⁶ These include the deductions on mortgage interest payments (\$61.5 billion),⁷ deductions on property tax payments (\$22.6 billion) and the deferral of capital gains on home sales (\$18.9 billion).⁸ About 31.8 million homeowners received at least one of these deductions. As Tables 5.3 and 5.4 reveal, these tax breaks are quite regressive. The highest-income taxpayers with the largest houses and biggest mortgages get a disproportionate share of these federal tax expenditures. Over one-half (59 percent) of the mortgage interest deduction subsidy goes to the richest 10.2 percent of taxpayers, those with incomes over \$100,000.⁹ The 2.2 percent of taxpayers with incomes over \$200,000 received 22.4 percent of the entire amount.

Only 22.6 percent of all 140 million taxpayers took the mortgage interest deduction, but this varies significantly with income. For example, 69.8 percent of taxpayers with incomes over \$200,000 took the mortgage interest deduction,

TABLE 5.3 Distribution of Tax Benefits for Mortgage Interest Deductions, FY 2000

Income (thousands)	Number of Returns (thousands)	All Returns (%)	Number of Returns Taking Mortgage Interest Tax Deduction (thousands)	All Returns in Income Category (%)	Value of Mortgage Interest Deductions (Millions)	Value of all Mortgage Interest Tax Deductions (%)	Average Value per Return for Those Taking Mortgage Interest Deduction
Under \$10	19,818	14.13	12	—	\$1	—	\$83
\$10–20	23,803	16.97	272	1.1	105	—	386
\$20–30	19,493	13.90	906	4.6	386	0.63	426
\$30–40	16,210	11.56	2,141	13.2	1,194	1.96	557
\$40–50	13,054	9.31	3,016	23.1	2,591	4.27	859
\$50–75	21,557	15.37	8,071	37.4	8,165	13.47	1,011
\$75–100	11,924	8.50	7,130	59.8	12,423	20.49	1,742
\$100–200	11,253	8.02	8,097	71.9	22,131	36.51	2,733
Over \$200	3,101	2.21	2,164	69.8	13,619	22.46	6,293
TOTAL	140,213		31,809	22.6	\$60,615		

Source: Calculated from data provided in “Estimates of federal tax expenditures for fiscal years 2001–2005,” Washington, DC: Joint Committee on Taxation, U.S. Congress, April 6, 2001.

TABLE 5.4 Distribution of Tax Benefits for Real Estate Property Tax Deduction, FY2000

Income (thousands)	Number of Returns (thousands)	All Returns (%)	Number of Returns Taking Real Estate Property Tax Deduction (thousands)	All Returns in Income Category (%)	Value of Real Estate Property Tax Deductions (millions)	Value of All Real Estate Property Tax Deductions (%)	Average Value per Return for Those Taking Real Estate Property Tax Deduction
Under \$10	19,818	14.13	21	0.1	\$1	—	\$42
\$10–20	23,803	16.97	298	1.2	40	0.19	134
\$20–30	19,493	13.90	930	4.8	152	0.75	163
\$30–40	16,210	11.56	2,109	13.0	426	2.10	202
\$40–50	13,054	9.31	3,107	23.8	819	4.05	263
\$50–75	21,557	15.37	8,229	38.2	2,683	13.25	326
\$75–100	11,924	8.50	7,332	61.5	3,833	18.94	522
\$100–200	11,253	8.02	8,522	75.7	6,980	31.20	819
Over \$200	3,101	2.21	2,396	77.3	5,303	26.20	2,213
TOTAL	140,213		32,944	23.5	\$20,237		

Source: Calculated from data provided in "Estimates of Federal Tax Expenditures for Fiscal Years 2001–2005," Washington, DC: Joint Committee on Taxation, U.S. Congress, April 6, 2001.

TABLE 5.5 HUD Budget Authority, 1976–2000
(2001 \$, in millions)

Fiscal Year	Budget Authority
1976	\$76,978
1977	77,065
1978	80,643
1979	60,704
1980	63,707
1981	56,829
1982	33,264
1983	25,407
1984	26,952
1985	45,533
1986	22,480
1987	20,031
1988	19,674
1989	18,197
1990	21,138
1991	32,875
1992	29,009
1993	30,103
1994	29,302
1995	21,610
1996	22,289
1997	16,984
1998	21,882
1999	26,904
2000	24,324

Source: OMB CD-ROM, Budget of the United States Government, Fiscal Year 2002, Historical Tables, Table 5.2.—Budget authority by agency: 1976–2006.

with an average benefit of \$6,293. In contrast, less than one-fourth (23.1 percent) of those in the \$40,000 to \$50,000 bracket took the deduction; those who did so saved an average of \$859 on their taxes. Among those in the \$20,000 to \$30,000 income category, only 4.6 percent took the deduction; those who did so received an average benefit of only \$426.

Consider that among households with incomes under \$20,000, slightly more than half own their homes. Of those who own their homes, only 28.5 percent have mortgages. Of those who have mortgages, only 6.8 percent itemize. Among households in the \$60,000 to \$100,000 income bracket, more than 80 percent own their homes. Of those who own their homes, about 78 percent have mortgages. Of those who have mortgages, about 66 percent itemize. Among households in the \$120,000 to \$140,000 income bracket, almost 91 percent own their homes. Of those, about 82 percent have mortgages. Among this group, about 92 percent itemize.¹⁰

For many low- and middle-income taxpayers, the mortgage interest deduction offers little or no incentive to own rather than rent. For many of these taxpayers—who can only afford a modestly priced house and are in a low tax bracket—the mortgage interest deduction (on its own and in combination with other itemized deductions) is likely to be lower than the standard deduction.

These tax breaks have significant social consequences. The mortgage interest deduction artificially inflates home prices, since both owners and sellers impute the subsidy into their calculations. This is especially the case at the upper end, but it has ripple effects throughout the housing market. Since the mortgage interest deduction is proportional to the cost of housing, it encourages homebuyers to buy larger homes in outlying areas rather than more modest homes in central cities and older suburbs (Gyourko and Voith 1997; Gyourko and Sinai 2001), thus promoting suburbanization and sprawl. Moderate-income homeowners, who cannot take advantage of the deduction, are concentrated in older suburbs and central cities. The tax code provision (eliminated in 1997) that allowed homeowners to defer capital gains taxes if they purchase a more expensive home, but not a smaller one, exacerbated this tendency, encouraging the purchase of larger homes, typically in suburbs farther from the central city (Bier and Meric 1994). And so by encouraging the suburbanization of housing, the tax code contributes to the well-known costs of metropolitan sprawl—transportation gridlock, pollution, costly infrastructure and related dilemmas. In other words, the “cost” of these housing tax breaks exceeds the amount that appears in the federal budget each year. There are related “external” costs to the environment, public health and other factors that do not show up when policymakers itemize the list of tax expenditures.

EXPENDITURES FOR LOW-INCOME HOUSING

Low-income housing is supported through both direct and indirect subsidy programs. Direct subsidies are provided through the Department

TABLE 5.6 Housing Subsidy Levels of States and HUD, 1978–1996
(2001 \$, in millions)

Year	States	HUD
1978	\$531	\$65,223
1979	598	47,044
1980	667	47,179
1981	629	40,736
1982	555	21,590
1983	384	13,978
1984	361	15,374
1985	326	14,401
1986	440	12,688
1987	618	11,038
1988	981	10,207
1989	1,346	10,120
1990	1,484	11,553
1991	1,308	20,188
1992	1,190	17,211
1993	1,198	18,340
1994	1,206	17,858
1995	1,178	11,194
1996	1,349	12,225

Source: U.S. Bureau of the Census, Government Finances Report, annual reports 1978–1996; 1998 *Green Book*.

of Housing and Urban Development (HUD) and the Department of Agriculture.

Department of Housing and Urban Development

HUD spent approximately \$30.8 billion in housing subsidies in 2000. HUD-assisted housing goes almost entirely to low-income households.

As Tables 5.5 and 5.6 reveal, HUD's budget outlays (actual spending in each year) have ebbed and flowed since 1976 (in 2001 dollars), while its budget authority (the authorized amount of obligations in each year regardless of when the spending occurs—thus, an indicator of new spending commitments) declined dramatically during the 1980s and crept up again in the 1990s, though still far from the peak in the late 1970s. During the 1970s and early 1980s, HUD outlays were used both to continue previous commitments and to add new housing units to the inventory. Since then, HUD spending has disproportionately gone to extend prior commitments. In other words, in 1976, HUD's budget authority was spent primarily on expanding

the inventory of low-income housing through the production of new units, the rehabilitation of substandard units and rental assistance to needy tenants. By 2000, most of HUD's budget authority was spending on maintaining or improving the existing inventory of low-income assisted housing and renewing subsidy contracts on existing subsidized developments rather than adding to the inventory.

Budget authority declined from a peak of \$80.6 billion in 1978 to a low of \$18.2 billion in 1989 (in 2001 dollars), then up to \$32.9 billion in 1991, falling to \$17 billion in 1997, then back up to \$24.3 billion in 2000. During the 1980s, in terms of budget authority, HUD shouldered the largest cutbacks of any major federal agency. As a result, the number of new low-income housing units subsidized by HUD funds declined from 300,500 in 1978 to 23,800 in 1996 (Dolbear 1996:79).

Housing assistance for the poor is not an entitlement, like food stamps or Medicaid. The available funds can only serve a small fraction of those who meet eligibility criteria. In the late 1990s, about 15.8 million low-income renter households were eligible for federal housing assistance. However, only about 4 million households received HUD housing assistance. About 1.14 million households lived in units owned by local public housing authorities, 1.7 million households lived in private, government-subsidized developments owned by private or nonprofit entities and 1.2 million households received tenant-based rental certificates or vouchers that allowed them to pay for unsubsidized private rental units.¹¹ The distribution of HUD-assisted households is uneven across the country in terms of the proportion of poor families who receive any form of housing subsidies (Kingsley 1997).

That leaves almost 12 million poor households who were eligible for federal housing subsidies but did not receive them. They have to fend for themselves in the private marketplace. Among this group, HUD in 1999 identified 4.9 million households with "worst case" housing needs—those who pay more than one-half of their incomes for housing and possibly live in seriously substandard apartments as well (U.S. Dept. of Housing and Urban Development 2001).

Department of Agriculture

For many years, the Department of Agriculture provided housing subsidies in rural areas under a division called the Farmers Home Administration—now called Rural Housing Services (RHS) (see U.S. GAO 1995). In 2000, RHS spent approximately \$39 million for various housing subsidies, an all-time low; the previous year, it spent \$330 million. The Department of Agriculture's total rural housing budget fell from a peak of \$8.7 billion in 1978 (in 2001 dollars).¹² The Department's rural housing programs primarily target low- and moderate-income households. Between 1984 and 1997, the proportion of Department of Agriculture-subsidized housing targeted for low-income households ranged from 27.9 percent to 61.9 percent.¹³ The number of new housing units subsidized by the U.S. Department of Agriculture (USDA) dropped from 101,300 in 1978 to 59,900 in 1996 (Dolbear 1996; U.S. GAO 1995). It has plummeted even further since then.

TAX-EXEMPT HOUSING
REVENUE BONDS

The housing assisted by mortgage revenue bonds (MRBs) and rental housing bonds (both of which are exempt from federal taxes) goes to a mix of low-income, moderate-income and middle-income families. The investors in these bonds are primarily affluent individuals who receive federal tax breaks for their investment. In 2000, federal tax expenditures for mortgage revenue bonds and rental housing revenue bonds cost the federal government \$790 million and \$160 million, respectively—about \$950 million altogether (in 2001 dollars). This is a significant decline from the peak of \$4.79 billion in 1987 and even from the \$2.74 billion in 1997 (in 2001 dollars). MRBs can be used to purchase new or existing homes.¹⁴

Congress restricts MRB use to first-time homebuyers who meet income limits and home price limits. Borrowers can earn no more than the greater of their statewide or area median income. (Families of three or more can earn up to 115 percent of this figure.) The cost of an

MRB-financed home cannot exceed 90 percent of the average home price in the area. (In a few strictly defined disadvantaged areas, income and home price limits are higher.) Most MRB loans go to families below these program limits. In 1996, 61 percent of MRB-financed homes were in metropolitan areas. Although the breakdown of central cities and suburbs is not available, it is generally recognized that MRBs have primarily benefited suburban homebuyers.

LOW INCOME HOUSING TAX CREDIT

In the Tax Reform Act of 1986, Congress replaced existing tax incentives for construction of low-income housing (such as accelerated depreciation) with the Low Income Housing Tax Credit (LIHTC). The LIHTC provides tax breaks to investors (corporations and individuals) in developments to cover part of the cost of housing construction and rehabilitation.¹⁵ In exchange, rents are set at a level affordable to households with modest incomes. At least 20 percent of the apartments in each development must be rented to households with incomes below 50 percent of the area median; at least 40 percent of the apartments in each development must be rented to households with incomes below 60 percent of the area median income. (In most areas, this is about twice the poverty level.) Under the federal law, rents must be affordable to these target income groups for at least 15 years, after which developers can charge market rents. While the earlier projects adhered to this minimum, by 1995, the average lock-in period was 42 years (E&Y Kenneth Leventhal Real Estate Group 1997; Cummings and DiPasquale 1998).

Since 1987, the LIHTC has been the largest federal program to stimulate housing production for low-income families. From its inception through 1995, it assisted in the production of approximately 900,000 units, with the numbers growing each year as states and developers learned how to utilize the program. (Because many of these units have other federal subsidies, however, there is considerable overlap between LIHTC-assisted, HUD-assisted and USDA-assisted units.) In 2000, it cost the federal government \$3.2 billion in 2001 dollars.

The LIHTC program is not administered by any federal agency.¹⁶ Instead, Congress authorizes states (typically, state housing financing agencies) to allocate the tax credits to qualified housing development projects.¹⁷ The size of each state's tax credit allocation is determined by a formula based on population size (\$1.75 per state resident).¹⁸

WHO BENEFITS?

What is the "bottom line" concerning who benefits most from federal housing subsidies? First, federal spending for low-income housing has not kept pace with growing needs. While overall funding has grown, mainly (since the 1980s) to pay for prior commitments, new budget authority—capturing the rate of which new assisted units are added—has fallen dramatically.

Second, tax expenditures for housing, particularly those benefiting higher-income groups, far outweigh direct expenditures for housing. Measured in constant (2001) dollars, tax expenditures for homeowner subsidies and investor subsidies increased almost 300 percent between 1976 and 2000, from \$29.4 billion to \$117.6 billion. In contrast, federal funds for low-income housing—through HUD, the USDA and the Low Income Housing Tax Credit—increased only 135 percent during that period. More telling, the HUD budget authority for additional housing units declined by 68 percent, from \$76.9 billion to \$24.3 billion.

In light of the significant increase in low-income families and the widening gap between the supply of affordable rental housing and the need, these trends have exacerbated an already serious problem. Moreover, while states have increased their spending on affordable housing, they have not come close to filling the gap left by federal cutbacks, as Table 5.6 reveals.

THE ONGOING BATTLE OVER HOUSING ASSISTANCE FOR THE POOR

In contrast to federal policies that promote homeownership for the middle and upper

classes, programs to help house the poor and near-poor have been continuously vulnerable to political assault. Whereas programs to promote middle-income and upper-income homeownership have essentially been entitlements—available to all those who meet the eligibility standards—housing subsidies for the poor have always been similar to a lottery, available only to a small fraction of eligible households. The weak support for low-income housing assistance is a direct outcome of the historical struggle to promote housing for this group. To understand why these inequities persist, we need to understand the historical role that housing has played in the United States. What emerges is the clear sense that we have always had an ambivalent and sometimes hostile attitude toward providing housing assistance for the poor.

The original vision of government-subsidized housing emerged from the progressive movement in the early 1900s. Until the Great Depression, reformers who advocated a strong federal government role in housing were a lonely voice in the political wilderness. The depression—when at least one-fourth of the workforce was unemployed and many more experienced declining wages and the threat of lay-offs—convinced housing reformers and labor union organizers that the private market and private philanthropy could not solve the economic and housing problems of the poor. Some of the earlier Progressive Era housing reformers like Edith Wood, joined by a younger generation of activists like Catherine Bauer, pushed for a strong government-led response to housing problems. Along with the labor union movement, they lobbied for a public housing program, union-sponsored cooperative housing, and new communities guided by cooperative principles. The early public housing advocates, like their European counterparts, initially envisioned public housing for the middle class as well as the poor, but the real estate industry, warning about the specter of "socialism," successfully lobbied to limit public housing to the poor (Lubove 1962; Oberlander and Newbrun 1999; Wright 1981; Radford 1996; von Hoffman 1996).

The federal public housing program was created in 1937 primarily to stimulate the economy,

TABLE 5.7 Major Tax Expenditures in the Income Tax, Ranked by Revenue Loss, 2000
(\$ millions)

Rank	Provision	FY
1	Net exclusion of pension contributions and earnings: Employer plans	\$84,350
2	Exclusion of employer contributions for medical insurance premiums and medical care	77,670
3	Deductibility of mortgage interest on owner-occupied homes	55,100
4	Capital gains (except agriculture, timber, iron ore and coal) (normal tax method)	40,585
5	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	37,000
6	Accelerated depreciation of machinery and equipment (normal tax method)	35,465
7	Step-up basis of capital gains at death	27,090
8	Deductibility of charitable contributions, total	25,850
9	Exclusion of interest on public purpose bonds	20,450
10	Deductibility of state and local property tax on owner-occupied homes	19,495
11	Child credit ¹	18,725
12	Capital gains exclusion on home sales	18,540
13	Exclusion of Social Security benefits for retired workers	18,125
14	Exclusion of interest on life insurance savings	14,990
15	Net exclusion of pension contributions and earnings: Individual Retirement Accounts	11,170
16	Deferral of income from controlled foreign corporations (normal tax method)	6,200
17	Exclusion of workers' compensation benefits	5,475
18	Graduated corporation income tax rate (normal tax method)	5,360
19	Earned income tax credit ²	4,971
20	HOPE tax credit	4,855
21	Exclusion of interest on non-public purpose state and local debt	4,635
22	Workers' compensation insurance premiums	4,585
23	Net exclusion of pension contributions and earnings: Keogh plans	4,255
24	Exception from passive loss rules for \$25,000 of rental loss	4,215
25	Tax credit for corporations receiving income from doing business in the United States possessions	4,120

Source: *Analytical perspectives: Budget of the United States Government: Fiscal year 2000*, 114.

¹The figures in the table indicate the effect of the child tax credit, on receipts, not outlays. Child tax credits for individuals with three or more children may be refundable and as such are paid by the federal government. This portion of the credit is included in outlays, while the amount that offsets tax liabilities is shown as a tax expenditure.

²The figures in the table indicate the effect of the earned income credit on receipts, not outlays. Earned income credits in excess of tax liabilities may be refundable to individuals and as such are paid by the federal government. This portion of the credit is included in outlays, while the amount that offsets tax liabilities is shown as a tax expenditure.

not to address urban slums or housing affordability. From the program's inception, it was aimed at providing housing for the "submerged middle class"—those who could not find suitable housing in the private market—but not the very poor with no means to pay rent. Senator Robert Wagner of New York, principal author of the Housing Act of 1937, declared, "There are some whom we cannot expect to serve . . . those who cannot pay the rent" (Friedman 1968; Freedman 1969; Hays 1995). For years, this arrangement worked. Public housing was often the best housing available to working-class families. By 1942, 175,000 public housing apartments—most in two- to four-story buildings—had been constructed in 290 communities. During World War II, the federal government created the temporary National Housing Agency (NHA) to co-

ordinate the government's efforts to provide housing for defense workers. By 1946, another 195,000 units of permanent housing were built, primarily near war industry sites and military bases. After the war, some Democrats sought to make the NHA a permanent agency responsible for housing and urban redevelopment, but in 1946, the Republican-controlled Congress rejected the idea under pressure from the National Association of Real Estate Boards (later renamed the National Association of Realtors), which strongly opposed public housing.¹⁹ Recognizing the pent-up demand for housing and fearing competition from public housing, the real estate industry sabotaged the public housing program by pressuring Congress to limit it to the very poor. That new rule, embodied in the 1949 Housing Act, was the beginning

of the decline of public housing's political support, exacerbated by the political climate of the McCarthy era and the Cold War (Davies 1966; Friedman 1968; Radford 1996; Wright 1981; Keith 1973). Several other factors—including changing demographics, costs and design and location—diminished political support for public housing (Vale 1993). As a result, only 1.3 million units have been built in the program's history.

During the 1950s and early 1960s, Democrats in Congress—supported by big-city mayors, along with the liberal National Housing Conference, a coalition of labor unions and public housing advocates—tried unsuccessfully to create a cabinet-level agency to deal with urban problems²⁰ (Bratt and Keating 1993). After winning a landslide victory in 1964, President Johnson—with the support of civil rights groups, big-city mayors, labor unions and private developers (all key Democratic Party constituencies)—in 1965 created the Department of Housing and Urban Development. Throughout its history, HUD has been controversial, fighting an uphill battle to win political support for its mandate to help house the poor and revitalize cities.

For about a decade following the Civil Rights Movement and the ghetto uprisings of the 1960s, HUD rode the wave of public sentiment to address the problems of poverty and inner cities. Through the late 1960s and early 1970s, HUD was able to gain steady funding from Congress, thanks to the coalition of big-city mayors, sectors of the housing and banking industry, unions, civil rights groups, advocates for the poor and business leaders concerned with revitalizing central business districts through the urban renewal program. Several Presidential reports on urban problems released in 1968—including the National Advisory Commission on Civil Disorders (the Kerner Report)—all cited the condition of ghetto housing as a serious problem and recommended a major new commitment to low-income housing. These forces triggered a new round of federal housing initiatives. Congress sought different approaches than public housing—enticing private developers to build housing for the poor, providing low-income tenants with vouchers and funnel-

ing federal “block grant” funds to cities and community organizations. The Housing Act of 1968 established a housing production goal of 26 million units within ten years, with 6 million for low-income households. Congress turned to the private sector to build low-income housing. Several programs gave private developers low-interest mortgages, tax breaks and, later, rental subsidies. A low-income homeownership program (Section 235) provided low down payment, low-interest mortgages. Eventually, over 2 million units of privately owned subsidized housing were built—almost double the overall number of public housing units. By contrast, between 1968 and 1973, only 375,000 public housing apartments were added.

During his first term (1969–1973), President Nixon and his HUD Secretary (former Michigan governor George Romney), along with a Democratic Congress, promoted a supply-side housing strategy to create a record number of new housing units built by the private sector with federal subsidies. Beginning in the mid-1970s, under President Nixon, a number of urban-oriented programs were folded into the Community Development Block Grant (CDBG) program. Grants under this program were distributed directly to cities, giving control to mayors rather than community organizations. These funds could be used for capital improvements, human services and housing. In 1974, Congress also created the Section 8 program to entice private developers to house the poor with subsidies for new construction, rehabilitation and rent supplements.

New housing starts set records in the 1970s, even if far short of the 26 million goal. Since the late 1960s, about 20,000 privately owned projects with almost 2 million units of privately owned subsidized housing were built under several federal programs.²¹ These programs have been criticized as being expensive bribes to lenders and developers. In many cases, construction and operating costs exceeded the per-unit costs of public housing. Moreover, the federal programs gave the owners of many of these developments an option to withdraw after 20 years. As this ticking time bomb began to explode in the late 1980s, Congress passed legislation allowing HUD to entice owners to keep their projects

as subsidized housing but at a huge additional cost to taxpayers²² (see Chapter 7).

During the 1980s, the ideological assault on government activism—by conservative politicians, think tanks and the media—helped to undermine support of programs for the urban poor, including housing (Edsall and Edsall 1991). When President Reagan took office in 1981, the attack on HUD intensified. The Reagan Administration sought to dismantle federal housing programs, claiming that “free and deregulated markets” could address the nation’s housing needs. It reduced the budgets for most low-income programs, but low-income housing suffered the largest cuts. As Tables 5.5 and 5.6 reveal, federal support for low-income housing—in terms of additional spending each year—has never recovered from the Reagan-era attack. Although the HUD budget increased during the Bush I and Clinton years, in real terms (adjusting for inflation) it never came close to the pre-Reagan era. In 1980, the year before the Reagan Administration took office, HUD budget authority was \$63.7 billion. By 1989, the last budget for which Reagan was responsible, it had declined to \$18.1 billion (in 2001 dollars). Although the Republican Party’s effort to decimate or dismantle HUD, or to sell off public housing projects, never came to fruition, there was widespread public sentiment that HUD was a wasteful and inefficient agency, a view exacerbated by a HUD scandal, which involved revelations of corruption and political favoritism during the Reagan Administration.

By the time that Clinton took office in 1993, HUD was one of the least popular or respected agencies of the federal government. After the Republicans won control of Congress in 1994, they escalated their attack on HUD as a symbol of the problems of activist government. House Speaker Newt Gingrich told the *Washington Post*, “You could abolish HUD tomorrow morning and improve life in most of America” (Cooper 1994). A year later, the *Post* reported that, “Politically, HUD is about as popular as smallpox” (Gugliotta 1995:A4). That year, Republican Senator Lauch Faircloth of North Carolina, chair of the HUD oversight subcommittee, filed legislation to eliminate HUD, asserting, “I think we need to put this department to rest”

(Adm’n Wins . . . 1995). The 1996 Republican platform called for the elimination of HUD. The Party’s presidential candidate that year, Bob Dole, drawing on popular but misleading stereotypes of public housing, called it “one of the last bastions of socialism in the world.” Local housing authorities, he said, have become “landlords of misery” (Gugliotta 1996:A5).

Not only conservative Republicans criticized HUD. In 1989, following the HUD scandal, the *New Republic* published an editorial entitled, “Abolish HUD.” HUD secretary Henry Cisneros admitted that he had inherited an agency “characterized by slavish loyalty to non-performing programs” (Raspberry 1995). Soon after the 1994 Congressional elections, Clinton, looking for a way to cut federal spending, proposed putting HUD on the chopping block. Cisneros, hoping to save his agency, pledged to “reinvent” it and soon produced a “blueprint” for reform that called for dramatic reduction in HUD’s mandate, including the privatization of most federally subsidized housing developments. In 1995 and 1996, Congress cut the HUD budget by more than 20 percent. After the 1996 election, Clinton asked Congress to increase HUD’s budget, mostly to fund expiring Section 8 subsidy contracts, but the GOP leadership balked at this request. In October 1996, the *New York Times Magazine* published a cover story by Jason DeParle entitled, “Slamming the Door,” claiming that “the Federal Government has essentially conceded defeat in its decades-long drive to make housing affordable to low-income Americans” and that “housing has simply evaporated as a political issue” (DeParle 1996).

How did this happen? One cannot simply blame the country’s changing mood toward the poor. After all, low-income programs such as food stamps and Medicaid, while occasionally controversial, have not shared the same fate as federal housing programs. House Speaker Newt Gingrich was candid about the reasons for HUD’s vulnerability. Its “weak political constituency,” he told the *Washington Post* in December 1994, “makes it a prime candidate for cuts” (Gugliotta 1995). Many Americans now believe that federal low-income housing programs reward a combination of government bureaucrats, politically connected developers

and people who engage in antisocial or self-destructive behavior. In particular, stereotypes with regard to public housing and its residents as havens of social pathology have cast a long shadow on all federal housing programs for the poor.

One can identify at least ten major factors that have contributed to the erosion of political support for HUD in general and low-income housing programs in particular.

First, the private housing and financial industries' support for HUD has primarily focused on the Federal Housing Administration (FHA), not its low-income housing programs. The industries have used their political muscle to maintain support for FHA's mortgage insurance program, particularly the segment that promotes homeownership, but has used little of their influence on behalf of HUD's low-income programs.

Second, the business community's support for HUD was limited to its role in revitalizing central business districts through the urban renewal program. This program was torn by controversy during the 1960s, especially among residents of low-income neighborhoods opposed to bulldozer-style renewal. The controversy over urban renewal led to its demise in the early 1970s, eliminating the backing of local urban growth coalitions (Mollenkopf 1983) from the HUD constituency.

Third, the political influence of big-city mayors (and urban voters) has waned as the nation has become (thanks in part to federal highway and housing policies) increasingly suburbanized. In 1992, for the first time, suburbanites represented an absolute majority of voters in a presidential election. The gap between the growing number of suburban Congressional districts and the declining number of central city Congressional districts has widened (Wolman and Marckini 1998; Sauerzopf and Swanstrom 1999; Dreier, Mollenkopf and Swanstrom 2005). With the exception of the FHA, HUD-funding formulas (such as the CDBG program) have little to offer suburbanites, including blue-collar inner-ring suburbs.²³

Fourth, HUD has typically been viewed as primarily serving the very poor, with few benefits for the struggling working class. HUD programs have increasingly been targeted to the

poorest of the poor. This is reflected in eligibility standards for public and assisted housing. It is reflected in the visibility of HUD efforts to house the homeless. Nevertheless, HUD provides significant support for middle-class families through its FHA homeownership program. Perhaps few Americans identify the well-known FHA with HUD. Also, since HUD programs are neither an entitlement for the poor nor are available to many working- and lower-middle-class people, many families who are not well served by the private housing market still fall between the cracks of HUD's programs—a recipe for resentment and weak political support.

Fifth, as American cities have declined, especially when they erupt in riots, HUD is often blamed for failing to solve the "urban crisis," even though it has never had the resources or authority to address the vast array of urban problems. In fact, other agencies, especially the Department of Transportation (in terms of the emphasis on highways over public transit) and the Department of Defense (in terms of the location of defense facilities and contracts; see Markusen et al. 1991; Anderson and Dreier 1993), play a much greater role in determining the fate of urban areas. Even during the height of the 1960s' War on Poverty, as illustrated by the short-lived Model Cities program, HUD has lacked the power to coordinate the various agencies involved in antipoverty efforts, such as the Office of Economic Opportunity, the Labor Department and the Commerce Department. Since then, HUD's efforts to trigger economic development in cities have been hampered by its lack of control over agencies with key programs, such as the Small Business Administration within the Department of Commerce. Even within its narrow mandate to address housing problems, HUD was not given authority over such agencies as the Federal Home Loan Bank, the Veterans Administration housing programs and the Farmers Home Administration (Bratt and Keating 1993; Mitchell 1985; Scruggs 1995). At the same time, HUD is given little or no credit for the nation's housing successes, including the improvement, in terms of size, amenities and the dramatic decline of physically substandard housing, of the quality of American housing since the 1960s.

Sixth, many Americans identify HUD with public housing and consider HUD-subsidized developments as having contributed to urban misery by warehousing the poor in high-rise "projects." Newspaper stories consistently identify HUD-subsidized housing developments with crime, welfare and social pathology, compounding the media's general misleading stereotypes with regard to the poor (Gilens 1999; Gilliam et al. 1995; Entman and Rojecki 2000).

Seventh, HUD has become increasingly identified as serving the interests of racial minorities. Ironically, one criticism of HUD is that its programs segregate racial minorities and concentrate the poor in urban ghettos (Massey and Denton 1993; Schill and Wachter 1995a, 1995b; Goering, Kamely and Richardson 1994; Fischer n.d.; Hughes 1997; Jargowsky 1997). A more recent criticism is that HUD seeks to deconcentrate the minority poor into white and more affluent areas. When the Clinton Administration sought to deconcentrate the poor through "Moving to Opportunity"—a small pilot program to help the ghetto poor find apartments in better neighborhoods—Republicans and conservative pundits attacked it as "social engineering" (Dreier and Moberg 1996; Rockwell 1994; Goering and Feins 2003; Rubinowitz and Rosenbaum 2000; Turner 1998).²⁴

Since the 1968 Fair Housing Act, one of HUD's responsibilities has been to monitor racial discrimination by landlords, real estate agents, local governments and banks, and to punish violators. In recent years, HUD has also been involved in uncovering redlining by banks. Although HUD has often been lax in carrying out these responsibilities, this mandate has not endeared HUD to the real estate industry.

Eighth, HUD's low-income housing programs have continuously been torn by corruption and mismanagement scandals. Already identified with the poor, ghettos and minorities, HUD also became identified with mismanagement and corruption. Since HUD began, politically connected developers have fed at its trough of lucrative subsidies and mortgage insurance. Beginning in the 1960s, HUD shifted its emphasis away from public housing toward reliance on the private sector to provide low-income federally-assisted housing. This led

to abuses and rip-offs, exacerbated by HUD's inability or unwillingness to effectively monitor its programs. No sooner had these programs started than members of Congress and the media exposed numerous problems, including excessive profits, poor construction, razing stable neighborhoods as part of "slum clearance" and using HUD grants as political pay-offs to campaign contributors (Gans 1962; Fried 1972; Boyer 1973; Liston 1974). The first major scandal, which emerged in the early 1970s, involved the abuse of HUD's Sections 223(e) and 235 homeownership programs by realtors and lenders as well as the Section 236 rental program by developers. "This scandal contributed to the quick demise of these programs following the 1973 Nixon moratorium on the construction of federally-subsidized low-income housing" (Bratt and Keating 1993:13). The elimination of these programs further weakened political support for HUD, not only by the public, but also by those private sector constituencies who had profited from them.

And in 1989, as noted previously, soon after Reagan left office, the nation's media uncovered another HUD scandal, revealing that upper-level Reagan Administration officials had used political favoritism to allocate HUD low-income housing production funds, activities which later led to the conviction of several top officials (Howlett 1993). General Accounting Office reports to Congress consistently highlighted HUD's terrible track record of monitoring its programs, contributing to its image as an out-of-control bureaucracy. For more than a decade, the taint of these scandals eroded public and Congressional support for HUD.

Ninth, the consumers of HUD's low-income programs have become increasingly fragmented and politically isolated. HUD's current constituency is composed primarily of those who have a direct stake in housing the poor: big-city mayors and local government housing bureaucrats; private housing developers, landlords and speculators; and poor people and their advocacy organizations. These groups are politically weak, fragmented and generally viewed unfavorably. The various segments of the housing constituency often work at cross-purposes, lobbying for their own specific piece of the HUD

pie, weakening the overall impact of their efforts and undermining the likelihood of building broad support for federal housing programs (Dreier 2000). The mayors and housing bureaucrats depend on HUD funding and programs. This "urban lobby" (such as the U.S. Conference of Mayors and the National Association of Housing and Redevelopment Officials) has been steadily losing clout for years, as cities come to represent a smaller portion of the overall electorate and national PACs replace city-based political machines as the keys to winning urban seats in Congress (Nardulli, Dalager and Greco 1996; Paget 1998). HUD's private-sector constituency consists of landlords, developers and real estate lawyers. Advocacy groups—including organizations like the National Coalition for the Homeless, the National Low Income Housing Coalition, Association of Community Organizations for Reform Now (ACORN), the National Community Reinvestment Coalition and the National Congress for Community Economic Development—are often referred to as the "housing movement" (Dreier 1984, 1996). Funded primarily by liberal foundations, these public interest organizations occasionally activate their loose networks of local housing activists (tenants groups, homeless shelters, community and church organizations, non-profit developers) to protect or expand federal housing programs for the poor. These advocacy groups have had some success in protecting and even improving HUD programs, but they mostly put their fingers in the dike.

Tenth, HUD's programs have increasingly resembled a crazy quilt, with no overall coherence. They have been less ambitious and have become increasingly narrow and balkanized. Since the 1960s, HUD has added a patchwork of programs to accommodate its various narrow constituencies. This makes it a cumbersome and confusing bureaucracy that is ripe for mismanagement and corruption. HUD has many different pockets of money to help public housing agencies and an almost equal number of distinct programs for private owners of HUD-subsidized developments. HUD also has two programs allocated by formulas to municipal governments—the Community Development Block Grant and HOME, both of which have various strings attached.

There are distinct programs for new housing construction, for moderate rehabilitation and for major rehabilitation. There are separate programs to house the elderly, Native Americans, rural populations, people with AIDS and homeless people as well as various subpopulations of the homeless (e.g., veterans, people with AIDS, the elderly, and women and children).

One byproduct of the gradual but steady shift away from production programs toward vouchers is the further weakening of HUD's constituency. Today, about one-third of the households with HUD subsidies are renters with vouchers. This proportion is likely to steadily increase. Tenants who live in a building or complex, or residents who live in a geographic neighborhood, can be mobilized to defend their interests. But tenants with vouchers, scattered across many buildings and neighborhoods, cannot easily be identified, much less organized, to protect these subsidies from elimination by Congress.

The Paradox of the Low-Income Housing Tax Credit

In terms of political support for low-income housing, the federal Low-Income Housing Tax Credit represents an interesting contrast to the programs sponsored by HUD. Since its creation in 1986, the LIHTC has received growing support, not only among low-income housing advocates but also among business leaders as well as the private housing industry. In contrast to the HUD budget, LIHTC funding has increased, reaching approximately \$3.2 billion in 2000. It is the largest federal subsidy for new construction and substantial rehabilitation of low-income housing (Newman and Schnare 1997).

What explains the LIHTC's success? There are at least five factors that make the LIHTC politically attractive to a broad coalition of supporters.

First, it is relatively invisible. Like other tax expenditures, it is a subsidy allocated through the tax code rather than through a federal government agency. In theory, it requires no bureaucracy, such as HUD or the Department of Agriculture. Thus, it is not subject to the same political conflicts as programs tied to agencies. In fact, there are administrative costs, primarily

borne by state housing finance agencies, but also borne by the Internal Revenue Service (IRS) in monitoring the tax credits.²⁵ And although the transaction costs are substantial, such costs do not show up in the federal budget, thus masking the LIHTC's inefficiencies.

Second, per unit LIHTC subsidies are quite low (\$27,300) compared with other federal housing programs, making the LIHTC appear to be an attractive program. But this figure hides the real subsidy costs. Many LIHTC projects require additional subsidies, including federal subsidies like Section 8 vouchers and certificates. The General Accounting Office estimates that "almost three-fourths of the households in these projects benefitted either directly or indirectly from other housing assistance, such as rental assistance to residents or loan subsidies to project owners" (U.S. GAO 1997:4).²⁶ Indeed, the patchwork of subsidies necessary to "make the numbers work" is one of the major inefficiencies of the LIHTC program. Some have argued that the structure of the LIHTC is highly inefficient in terms of delivering scarce dollars to the poor because the investors receive so much of the subsidy (Stegman 1990; Stanfield 1994). The LIHTC has become more efficient over the years as state housing agencies and developers become more sophisticated in getting investors and syndicators to put more dollars back into the housing developments. Even so, one housing expert likened the LIHTC to "feeding the sparrows by feeding the horses" (Hartman 1992)—an inefficient and indirect way to accomplish the goal of housing the poor.

Third, corporate investors earn substantial profits through the tax credit—typically a 15 percent return on equity, and they, in turn, have become part of a powerful lobbying group. The LIHTC is not a form of corporate philanthropy, but many corporations nevertheless also earn positive publicity for investing in low-income housing and inner-city neighborhoods. LIHTC investors are recruited by syndicators, state housing finance agencies and other intermediaries. This has spawned an entire industry around the LIHTC: syndicators, intermediaries, lawyers, accountants, development consultants and others. Thus, in addition to some major corporations that act as investors, this "LIHTC industry" has a vested interest in protecting

the program when it comes up for renewal in Congress. In addition, the LIHTC industry is able to marshal support from the more influential corporate investors, who represent Fortune 500 and comparable firms. Further, the tax credit constituency is also supported by two of the major intermediaries that support housing production using the tax code—the Enterprise Foundation (founded by developer James Rouse) and the Local Initiatives Support Corporation, which both provide technical assistance and channel private and public resources to community development corporations (CDCs).

Fourth, the banking industry has played a significant role in lobbying on behalf of the LIHTC in Congress. Banks that utilize the LIHTC as investors not only earn substantial profits, they also get credit under the federal Community Reinvestment Act for addressing the credit needs of low-income communities and consumers. As a result, banks are the corporate sector most engaged in LIHTC investment.

Fifth, many of the developers of housing projects utilizing the LIHTC are nonprofit organizations, typically community development corporations, giving the program a positive public image of addressing community needs.²⁷ CDCs have become the "public face" of the LIHTC and provide legitimacy and positive public relations. They are built by "the community," through partnerships with the private sector. The LIHTC is thus not identified with the same stigmatizing factors—government bureaucracy, large-scale "projects"—as are HUD-subsidized housing developments. CDC projects tend to be smaller in size (see Chapter 16). Also, because the LIHTC does not provide sufficient subsidies to cover the operating costs for 100 percent low-income projects, a significant number of LIHTC developments are mixed-income (U.S. GAO 1997).

In combination, these factors help to explain why Congress has acted favorably in renewing and expanding the LIHTC at the same time it has attacked HUD.

Challenging the Housing Industry's Sacred Cow—The Mortgage Interest Deduction

How do we account for the huge gap between federal housing subsidies for the affluent and

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TABLE 5.8 Newspaper Citations for Mortgage Interest Deduction, 1985–1999

Year	All	New York Times	Los Angeles Times	Washington Post
1999	37	4	1	4
1998	58	2	5	6
1997	43	4	1	7
1996	129	7	2	15
1995	109	2	8	11
1994	77	2	5	6
1993	50	6	5	4
1992	83	6	6	4
1991	44	2	5	4
1990	58	7	8	7
1989	62	2	6	11
1988	56	4	11	17
1987	61	10	9	12
1986	49	14	6	14
1985	54	10	12	11

Source: Lexis/Nexis.

those for the poor? Political power and ideology are key factors in answering this question. The disparity in federal housing subsidies for the well-off and the poor is due primarily to the relative political influence of the constituencies who benefit from these different subsidies. The real estate industry's ability to protect the mortgage interest deduction illustrates how the allocation of housing subsidies reflects inequalities of political power rather than the provision of social needs. For example, the industry is among the largest contributors to Congressional campaigns, as Tables 5.9 and 5.10 reveal.

Although homeownership has long been a cornerstone of the American belief system (Heskin 1981; Dreier 1982; Carliner 1998), tax

breaks for homeowners initially were not viewed as a key component of federal policy to encourage homeownership.²⁸ The original income tax applied only to the wealthiest 1 or 2 percent of the population, so the deduction was clearly not intended to broaden homeownership. But as the taxpaying population broadened, particularly after World War II, the deduction grew almost by accident, at first small and little noticed. By the time Brookings Institution, Urban Institute and other economists began suggesting in the 1960s and 1970s (Aaron 1972; Surrey 1973; Andreassi and MacRae 1981; Aaron and Galper 1985; Surrey and McDaniel 1985) that the homeowner deduction was inequitable and unnecessary, the real estate industry was already declaring it sacrosanct (e.g., "Elimination of Mortgage Deduction" 1989).

There is no evidence that when the income tax on individuals was introduced in 1913, its framers viewed it as a vehicle to promote homeownership. The initial bill made a distinction between total income and taxable income; individuals were permitted to deduct from their total income specific sources of income (e.g., gifts and inheritances and interests on state and local bonds) and specific expenses in order to generate a lower level of taxable income. Included in these expenses were interest paid of all indebtedness, including but not limited to home mortgages. At a time when personal and business debt were highly comingled, in part because so many Americans were engaged in agriculture, allowing individuals to deduct all consumer debt was administratively simpler than trying to

TABLE 5.9 Largest Business Contributors to Federal Candidates and Parties, 2000, by Industry (\$ millions)

Category	2000	Democrats (%)	Republicans (%)
Finance/Insurance/Real estate	\$303.2	41	59
Communications/Electronics	133.3	53	46
Lawyers and lobbyists	128.1	67	33
Health	96.4	39	60
Energy/Natural resources	67.0	25	74
Agriculture	59.2	26	74
Transportation	57.2	28	72
Construction	55.8	32	68
Defense	14.1	35	64
Miscellaneous business	173.7	38	60

Source: Center for Responsive Politics, <http://www.crp.org>.

Note: Totals include PAC, soft and individual contributions over \$200 to federal candidates and parties.

TABLE 5.10 Contributions to Federal Candidates and Parties by Finance, Insurance, Real Estate, and Construction Industry Sectors, 2000
(\$ millions)

Category	Total	Democrats (%)	Republicans (%)
Commercial banks	\$26.0	37	63
Savings & loans	2.5	43	56
Credit unions	2.4	47	52
Finance/credit companies	9.7	31	69
Securities & investment	91.8	44	55
Insurance	41.8	34	65
Real estate	79.8	45	55
Accountants	15.3	38	61
General contractors	20.1	30	69
Home builders	7.3	32	68
Special trade contractors	7.2	30	70
Construction services	11.8	45	54
Building materials/equipment	9.3	19	80
TOTAL	\$356.7	39.5	60.5

Source: Center for Responsive Politics, <http://www.crp.org>.

Note: Totals include PAC, soft and individual contributions over \$200 to federal candidates and parties.

figure out what was personal debt and what was business debt (Howard 1997:53–54).

The major tax break for homeowners—the mortgage interest deduction—did not affect a large proportion of the population until after World War II. Before that time, it was a tiny item in the overall federal budget.²⁹ But changes in tax policy and an expansion of homeownership gave a growing number of Americans a stake in the mortgage interest deduction. Thanks to a strong economy, rising incomes and federal policies to promote homeownership and suburbanization, homeownership increased significantly after World War II. The homeownership rate increased steadily from 43.6 percent in 1940 to 55 percent in 1950 to 62 percent in 1960. It then grew more slowly to 65.6 percent in 1980.

During this three-decade period, the federal government lowered the personal income tax exemption and raised tax rates. In 1941, it lowered the personal exemption (which added 5 million additional taxpayers) and increased the tax rate on the lowest brackets from 4.4 percent to 10 percent. A year later, Washington lowered the personal exemption again and raised the tax rate on the lowest bracket to 19 percent. These policy changes meant that millions of middle-class and even working-class families who had previously been exempt from the federal income tax were now paying taxes. In 1939, only 6 percent of all

employees paid income taxes; by 1945, the figure had grown to 70 percent (Howard 1997).

In 1944, Congress enacted the standard deduction, which simplified the tax system and lowered taxes for most families. Many homeowners used the standard deduction rather than itemized their deductions because their interest payments were relatively small. By the 1950s, however, the standard deduction did not keep pace with increases in income and the size of mortgages; so as incomes rose, and homebuying and homebuilding grew, more Americans took advantage of the homeowner deduction. They viewed this deduction as part of their calculation when deciding whether to buy a home and how big a home to buy.

At several points during the latter half of the 20th century, whenever there was a suggestion to cut back on the mortgage interest deduction, there was a strong wave of protest, led by the private real estate industry. The visibility of this issue was increased when the concept of “tax expenditures” reached the mainstream in the 1970s. In January 1969, Joseph Barr, the outgoing secretary of the Treasury under President Johnson, testified before Congress, criticizing tax loopholes for the wealthy. He unveiled the nation’s first “tax expenditure budget,” which exposed the size of the many tax loopholes and even noted how many millionaires

had paid no income taxes because of various tax breaks. One of his examples was the mortgage interest deduction, which, he said, cost the government \$1.9 billion a year and which disproportionately helped affluent taxpayers. A few years later, Congress required that the list of tax expenditures be published annually. As a result, economists such as Henry Aaron (1972) and Joseph Pechman, echoed by others (Manvel 1991; Poterba 1992; Follain and Ling 1991), began to question the efficiency of the homeowner deductions. Starting in the 1980s, Cushing Dolbeare, founder of the National Low Income Housing Coalition, persistently issued reports identifying the widening gap between housing subsidies for the poor and tax expenditures for the well-off (Dolbeare 1983), and a number of journalists began paying attention to the issue (Downey 1989; Garner 1991; Goodgame 1993; Harney 1990, 1992; "Housing Subsidies for the Well-Off" 1992; Marino 1998; Passell 1993; Salmon 1992). In the late 1980s, Anthony Downs, a prominent Brookings Institution economist and housing expert, drafted a paper for a Senate task force on housing policy that pointedly noted the disparities in federal housing assistance. Downs wrote:

[H]omeownership tax benefits provide enormously disproportionate aid to high-income taxpayers, even though they need such aid least. Reducing only partly the amount of assistance they receive would make substantially more funds available for housing assistance to low-income taxpayers without increasing federal deficits. It would also increase the equity of housing assistance considered as a whole. By reducing homeownership tax benefits less than 20 percent and taking almost all of that reduction from high-income households the United States government could probably pay for a housing voucher entitlement program serving all eligible very-low-income renter households who applied. (Downs 1990:76)

In 1991, the Twentieth Century Fund issued a report, *More Housing, More Fairly*, that recommended "shifting federal (housing) commitments to make current allocations fair," in particular the tax expenditures for housing.³⁰

These reports helped to lay the groundwork for elected officials and their advisers to inject

the issue of homeowner deductions into the political arena.

For example, Stanley Surrey, who coined the term "tax expenditures" and became Assistant Secretary of the Treasury for Tax Policy under President Kennedy (Surrey 1973), helped to draft JFK's April 1961 special message to Congress on taxation, which called for limiting the number of tax preferences while reducing overall tax rates, which he claimed would stimulate economic growth and also be fairer. These ideas were embodied in the Revenue Act of 1964, which Kennedy submitted to Congress. One provision permitted taxpayers to deduct only those itemized expenses that exceeded 5 percent of their income. This would lead more taxpayers to take the standard deduction and reduce the value of itemized deductions for many well-off taxpayers. Kennedy's proposal ran into a political buzz saw. For the first time, the major real estate industry organizations—homebuilders, bankers and realtors—lobbied to protect the tax breaks for mortgage interest and property taxes. These combined political forces killed the proposal in Congress. The lobbying effort over Kennedy's proposed tax reform served as a warning that they needed to protect tax benefits for homeownership, which they had previously taken for granted (Howard 1997).³¹

In his 1984 State of the Union speech, President Reagan announced that he had asked the Treasury Department to conduct a comprehensive review of the tax system, with the goal of lowering tax rates, simplifying the system and reducing government. Some Treasury staff were ready to propose sweeping changes, ending or reducing many tax breaks for business and wealthy individuals, including elimination of the mortgage interest deduction.³² The real estate industry learned what Treasury officials were thinking and launched a political offensive. They lobbied Reagan heavily. In May 1984, an election year, Reagan spoke before the National Association of Realtors in Washington and was asked whether or not the mortgage interest deduction was in jeopardy. Reagan stated: "In case there's still any doubt, I want you to know we will preserve the part of the American dream which the home mortgage deduction symbolizes" (McClure 1986:57).

After the 1984 election, Reagan unveiled his tax reform plan, which called for eliminating some key tax breaks, including charitable contributions and state and local taxes. It also limited the mortgage interest deduction to one home, and it eliminated the deduction for property taxes altogether. This proposal galvanized the real estate industry in an unprecedented lobbying effort.

The various industry lobby groups hired consultants to do studies demonstrating that any tampering with these tax breaks would hurt the economy, undermine the real estate market and reduce homeownership. They argued that vacation states would be hurt by eliminating tax breaks for second homes. They got state and local government officials to join them in claiming that eliminating tax breaks for property taxes would hurt state and local governments. They organized a grassroots lobbying campaign, mobilizing realtors, bankers, builders and others to arrange meetings with members of Congress. They increased their campaign contributions to these officeholders, and they threatened to run candidates for Congress against members who voted to cut real estate tax breaks. Congress bowed to the pressure. Representative Fortney Stark, a key advocate for eliminating some of the tax breaks, observed: "I was just outgunned by a real estate lobby that knows no limits to its greed" (Birnbbaum and Murray 1987:140).

Although Congress adopted much of the Reagan tax plan, reducing tax rates and eliminating many tax breaks dear to business groups, it bowed to the real estate industry's pressure by preserving the mortgage interest and property tax deductions for homeowners.³³ By lowering overall tax rates, however, the Reagan plan actually reduced tax expenditures, including the value of the homeowner tax breaks. Also, by increasing the standard deduction and the personal exemption, and indexing both to inflation, it reduced the number of families who would utilize the mortgage interest deduction. The real estate industry could not publicly oppose these provisions to lower income taxes on ordinary families.

The industry got another big scare in 1987, when Congress limited the deduction to mortgage interest on just two homes and capped the

subsidy at \$1 million of principal eligible for the mortgage interest deduction. These moves frightened the housing industry. The \$1 million cap itself affected few taxpayers. But industry lobbyists worried that it might snowball, leading Congress to lower the proposed cap again and again.

Soon after taking office in 1989, President Bush, speaking at a National Association of Realtors convention, vowed to defend the existing homeowner subsidy. Even so, to ensure its support in Congress, the industry's lobby escalated its efforts, highlighting the disastrous consequences of eliminating the deduction (National Association of Home Builders 1989). The industry initiated a nonbinding resolution, sponsored by Representative Marge Roukema (a Republican representing affluent New Jersey suburbs) and Representative Les AuCoin (a Democrat from lumber-intensive Oregon, which provides materials to the housing industry), in support of protecting the existing homeowner tax break.³⁴ Over one-half of the members of the House of Representatives (including many liberal Democrats) signed on.

An important part of the story concerning the debates about the mortgage interest deduction involves the many proposals to reduce the federal deficit and the need to cut the budget. The Reagan era, by reducing taxes and expanding military spending, left a legacy of a ballooning deficit. By the 1990s, conservatives and liberals alike began looking for ways to reduce the federal deficit and get closer to a balanced budget. Conservatives sought to do it by further slashing domestic social programs. Liberals looked toward raising taxes on the well-off as well as "reinventing government" to be leaner and more efficient. Faced with these dilemmas, both conservatives and liberals began to look at the list of tax expenditures as possible ways to achieve their goals. Not surprisingly, both political camps noticed that one of the largest items on the list was the mortgage interest deduction. A growing number of public officials, policy experts and media outlets began to identify these homeowner tax breaks as being possible targets for reducing the deficit.

Thus, the 1990s saw a new wave of concern about the mortgage interest deduction, fueled primarily by efforts to reduce the federal deficit.

The mainstreaming of this issue is reflected in a 1989 cover story in *Forbes*, a conservative business magazine, entitled "Is the Mortgage Interest Deduction Sacred?" The article quoted veteran Congressman Sam Gibbons (D-FL), who said: "I have no objections when the deduction goes for houses. When it comes to castles, I do."

A Lexis/Nexis search of major newspapers from 1985 through 1992 (see Table 5.8) revealed that articles referring to the mortgage interest deduction remained at a steady level except for two significant upward bumps—in 1992 (when presidential candidate Ross Perot and a number of policy advocacy organizations introduced the notion of revising the deduction to help reduce the federal budget deficit) and in the period from 1995 to 1996 (when the controversy over the flat tax was injected into the presidential campaign).

During the 1992 presidential campaign, candidates' proposals to reduce the deficit were a serious issue, particularly since Reform Party candidate Ross Perot, a Texas billionaire, made it the focus on his platform. Part of Perot's deficit-reduction plan included limiting the homeowner tax break. During the campaign, two centrist policy organizations—the Democratic Leadership Council's Progressive Policy Institute and the Concord Coalition (headed by former U.S. senators Paul Tsongas, a Democrat, and Warren Rudman, a Republican)—issued reports calling for reform of the mortgage interest tax break to reduce the deficit.

After the 1992 election, with deficit reduction a major concern of key opinion makers, the issue remained on the public agenda. A *New York Times* editorial argued that newly elected President Clinton "could also reduce deductions for mortgage interest" in his plan to reduce the deficit ("The Economy" 1993). The *Washington Post* editorialized that what Congress should do is "trim the interest deduction from the top and use the proceeds to support the poor" ("Upside Down Housing Policy" 1994). Other mainstream media outlets kept the story in the public eye (Starobin 1994; Peirce 1994; Inman 1994; Lehman 1994; "20 Ways to Deflate a Deficit" 1993). There was some speculation that Clinton was eyeing the deduction (particularly lowering the ceiling) as part of his deficit reduction plan, especially since one of his key economic

advisers during the campaign, Robert Reich, had criticized the deduction as a major loophole (Klott 1992; Church 1993; Samuelson 1993). Controversy erupted in February 1994, when a draft of a Clinton Administration plan to reduce homelessness, leaked to the *New York Times*, included a critique of the regressivity of the mortgage interest deduction (DeParle 1994). Secretary Henry Cisneros of HUD quickly responded that the Administration opposed eliminating the deduction ("Mortgage Interest Deduction May be Target" 1994).

After the Republicans took control of Congress in November 1994, the momentum for tax reform and deficit reduction—and the controversy over the mortgage interest deduction—escalated.

Soon after taking over as chairman of the Finance Committee, Senator Bob Packwood (Rep-OR) proposed limiting the mortgage deduction to \$250,000 in debt (Mariano 1995). Around the same time, the new House Majority Leader Dick Armey (Rep-TX) proposed a 17 percent flat tax that would do away entirely with all deductions, including the homeowner breaks (Brownstein 1995). And a report by the Congressional Budget Office presented ideas for cutting federal spending, among them several ways to reduce the deficit by limiting deductions for mortgage interest:

Preferential treatment for home ownership encourages people to become homeowners and to purchase larger homes. Increasing home ownership may contribute to social and political stability by strengthening people's stake in their communities and governments. In addition, such preferential treatment may stabilize neighborhoods by encouraging longer-term residence and home improvement. The amount of preference, however, is probably larger than needed to maintain a high rate of home ownership. For example, Canada, which grants preferential tax treatment to capital gains from home sales but does not allow deductions for mortgage interest, has achieved about the same rate of home ownership as the United States.

The CBO estimated that eliminating the mortgage interest deduction would save the federal government \$313.3 billion between 1996 and 2000. It also offered three more modest

suggestions to limit this tax break for better-off homeowners.³⁵

In response to Senator Packwood's proposal to lower the ceiling on the mortgage interest deduction, *Time* magazine and the Cable News Network (CNN) commissioned a national poll on the subject. This is perhaps the only poll that has specifically asked about change in the mortgage interest deduction. Conducted by Yankelovich Partners in May 1995, it found substantial support for a Packwood-style reform. It asked 800 American adults: "As you may know, the tax code subsidizes mortgage loans, even for the most expensive homes. One proposal would limit the tax deduction to \$300,000 in mortgage principal, and would save the Treasury \$35 billion over five years, while affecting only 1.2 million of the wealthiest taxpayers. Would you favor or oppose such a limit?" Overall, 68 percent of the respondents said they would favor it. There was almost no difference between Democrats, Republicans and independents.

The 1996 presidential elections brought the issue to the fore again, primarily in reaction to candidate Steve Forbes' proposal for a flat tax (Gravelle 1996). Flat tax proponents produced studies claiming that lower tax rates would make homeowners and would-be homebuyers better off, even without the mortgage interest deduction (Seldon and Boyd 1996). The flat tax debate exacerbated divisions among conservatives. Right-wing think tanks like the Heritage Foundation and the libertarian Cato Institute, along with Citizens for a Sound Economy (CSE), a conservative advocacy group, supported the flat tax, including elimination of the mortgage interest deduction (Rosin 1997).

Seeking to ambush any attempt to tamper with this homeowner tax break, five housing industry lobby groups—the National Association of Homebuilders (NAHB), the National Association of Realtors (NAR), the American Bankers Association, the Mortgage Bankers Association (MBA) and America's Community Bankers—issued a 47-page study in March 1996 examining the impact of changing the mortgage interest deduction (Brinner et al.; *The Impact...* 1995). A month later, the MBA issued its own report, concluding that housing values could decline by as much as 25 percent under the flat tax proposed

by Representative Armev (Isaac and Marigon 1996; Sichelman 1996).

The industry also used its political and financial clout to protect the deduction. Unlike industries dominated by a few large corporations, the real estate industry is composed of tens of thousands of firms—builders, real estate agents, lenders and others. The NAR political action committees have vast local networks and deep pockets. The National Association of Realtors' political action committee (PAC) is the largest in the country in terms of contributions. The real estate/finance/insurance industry (through PACs and individuals) is the most generous contributor to Congress of any business sector. As Tables 5.9 and 5.10 show, the industry divides its contributions between Democrats and Republicans. Few members of Congress want to offend these generous donors or be labeled as being anti-homeownership. According to one account, the NAR spent \$750,000 in 1995 defending the deduction (Shear 1995). During the 1996 New Hampshire and Iowa presidential primaries, Fannie Mae and Freddie Mac spent over \$100,000 in advertising to attack the flat tax proposals, arguing that it would drive down housing values. One ad put the flat tax in the same category as termites and tornadoes, labeling all three "famous American home wreckers" (Haggerty 1996).

The tone of the industry's response suggests that it was clearly on the defensive and that it sensed the public mood was changing. Stephen Driesler, chief lobbyist for the NAR, told the *National Journal*, "It's fair to say that when it's the chairman of the major tax-writing committee saying these things, it's a lot more serious than in the past, when it was usually just a member of the committee, or an isolated member" (Jacobson 1995). An article in *Mortgage Banking* expressed concern that challenges to the mortgage interest deduction indicated that "the quintessential American dream of owning one's home is under attack" (England 1992)

The NAHB's chief economist admitted that the housing lobby was losing the public debate over the mortgage interest deduction. In the February 1995 issue of the NAHB's magazine, *Builder*, David F. Seiders acknowledged that the "once-sacred" tax break was no longer

sacrosanct (Seiders 1995:38). "Questions are being raised about the deduction's cost-effectiveness as a tool to broaden homeownership," Seiders wrote. He admitted that "Frankly, it's possible to find countries with homeownership rates comparable to those of the United States without deductions." Seiders also acknowledged that "it's also hard to defend the deduction in terms of equality or fairness." "Some characterize the deduction as 'welfare for the rich,'" Seiders noted, admitting that "If the deduction were eliminated or capped even lower, it would fit with the Clinton administration's theory of 'progressive restructuring' of the tax system." Seiders warned his readership of homebuilders that "[I]t's going to be hard to defend the mortgage-interest deduction using only the old arguments about homeownership and the democratic process." A few months later, NAHB president Jim Irvine warned his fellow homebuilders that the deduction is "seriously threatened as Congress works to contain the deficit," citing Packwood's proposal (Irvine 1995:48).

But the real estate industry's intense lobbying efforts paid off. Forced to take a position on the issue, the GOP candidates differed on the flat tax, but even those who supported the flat tax (Forbes excepted) came out in support of exempting deductions for mortgage interest and charitable contributions (Johnston 1996). During the 1996 campaign, both Dole and Clinton came out against the flat tax and in favor of preserving the tax break. Speaking to the National Association of Realtors, Dole said:

When we were taking all the heat . . . on the flat tax, millions and millions of dollars of TV advertising directed right at Bob Dole, I stood my ground and said I don't care what happens, we're going to keep the mortgage interest deduction. . . . (Dole 1996)

The same day, President Clinton addressed the NAR. He noted the increase in homeownership rates under his presidency, touted his plan to expand homeownership further and attacked the flat tax plan while implicitly endorsing the mortgage interest deduction:

So we ought to balance the budget, but I don't think we should do it in a way that undermines the ability of people to own their own home. If

we can simplify the tax code, I'm all for it. But I don't think we ought to adopt a flat tax that will raise taxes on everybody making less than \$100,000 a year, and put homeownership out of the reach of all the people in those categories. (Clinton 1996)

Since the 1996 election, political interest in revising the mortgage interest deduction has waned, although there have been occasional echoes of concern. A number of policy experts and newspaper reporters and columnists have continued to beat the drum for reform (Johnston 1999; Nelson 2000). Most politicians who favor tax reform, including a flat tax, have with a few exceptions exempted the mortgage interest deduction from their proposals. During the 2000 presidential elections, only GOP candidate Steve Forbes (who favored a flat tax that did not retain the deduction) and Ralph Nader (who favored lowering the ceiling on the deduction and targeting the savings for low-income housing) raised the issue (Garvey 2000; Brownstein 2000). Neither Al Gore nor George Bush addressed the issue.

At the same time, the nation's widening economic disparities generated considerable political and media attention during the mid- and late 1990s. Secretary of Labor Robert Reich sparked a public debate in the mid-1990s when he put the issue of "corporate welfare" on the nation's agenda (see, e.g., Hage, Fischer and Black 1995). Public debate over economic "fairness" is unlikely to abate in the near future. To the extent that the mortgage interest deduction is viewed as primarily subsidizing the well-off without at least comparable government assistance going to the middle class and poor, reform will continue to resonate within public opinion, although whether this translates into political change depends on many other factors.

CONCLUSION

The United States has serious housing problems, not only among the poor but also among middle-income households (Stegman 2000; Lipman 2001; Joint Center for Housing Studies 2001; Harkness, Newman and Lipman

2002). The widening gap between the rich and poor, the proliferation of low-wage jobs and the economic insecurity that even many middle-income families face in the new economy exacerbate our national housing crisis (see Chapter 1).

The federal government's efforts to address this problem have been shaped by the realities of political power. There has been much more federal housing assistance for the well-off than there has been for the poor and near-poor. HUD plays only a small part in the federal government's housing puzzle. Despite its name, the agency has much less impact on the economic and physical conditions of our cities and metropolitan areas than other federal agencies and policies. On its own, HUD, with its limited authority and budget, can do little to address the current plight of our cities—including the concentration of poverty, the suburbanization of people and jobs, suburban sprawl and the economic and racial segregation of our metropolitan areas (Markusen et al. 1991; Jackson 1985; Gyourko and Voith 1997; Gyourko and Sinai 2001).

Clearly, the battle over federal housing subsidies must go beyond the HUD budget to address the disparities between assistance for the poor and assistance for the well-off.

During the 1990s, efforts to revise the mortgage interest deduction emerged from three different directions. First, advocates of deficit reduction saw in the deduction a means to address the nation's budget dilemmas. Second, advocates of tax simplification viewed the mortgage deduction as an example of the complexities of the tax code. But one proffered solution to this—the flat tax—proved extremely controversial, particularly since its consequences would have been to make the tax code even more regressive while simplifying it. The flat tax idea still has its advocates, but it has few strong political forces behind it. Third, advocates for the poor, spearheaded by the National Low Income Housing Coalition (NLIHC) and the National Housing Institute, sought to redress the vertical inequalities reflected in the gap between federal tax expenditures for the well-off and housing assistance for the poor (Lehman 1991; Burns 1998). The chief vehicle for this was a bill, drafted by the Coalition, to create a national housing trust fund targeted for low-income

households. In its original version, the bill called for lowering the ceiling on the homeowners deduction in order to fund the trust. The Coalition abandoned that approach, and its current version focuses on other sources of funding (see <http://www.nhtf.org>). In the early years of the 21st century, the Coalition built by the NLIHC has been more successful in getting a significant number of persons in Congress as well as senators to support a housing trust fund, a result of better grassroots organizing, but strong opposition from the Bush II Administration has stymied its efforts to get Congress to enact it.

In recent years, those who view the deduction in terms of economic unfairness have taken a somewhat different approach, seeking to design a progressive tax break for homeowners that would reach households who do not benefit from the current tax provisions (Dreier and Atlas 1992, 1997; Green and Vandell 1996; Collins, Belsky and Retsinas 1999; Green and Reschovsky 2001). The popularity of the Earned Income Tax Credit, a refundable credit for the working poor, suggests that this approach has considerable support. A homeowner tax credit has the advantage of using the same policy tool—tax expenditures—toward the well-recognized benefit of homeownership. Still controversial is whether revenues for this approach should come from reducing the ceiling on the current deduction (i.e., a revenue-neutral approach) or from another source in the federal budget. Regardless, advocates of this approach recognize that this tool is unlikely to benefit very-low-income households in many markets and that increased direct federal housing subsidies for the poor are still necessary. Nevertheless, it suggests that housing advocates have learned some political and policy lessons from the past half-century's experience of trying to reform this tax provision.

Any effort to address this issue must calculate the political consequences—the winners and losers, the geographic impacts (by state and Congressional districts) and the intensity of support and opposition among households in general and lobby groups in particular. One analysis that explored the consequences of substituting a tax credit for the current deduction found that losers would be concentrated in only

a few states and Congressional districts, while the winners would be spread out geographically. It also found that a handful of households would lose big, while a much larger number of households would gain benefits though those benefits would be relatively small. The capacity to mobilize political support for reform would be limited by these political calculations (Green and Reschovsky 2001).

Within the homebuilding industry, if a mortgage tax credit significantly helps builders of starter homes targeted for families earning, say, less than \$60,000, but hurts builders of luxury homes and second homes, that could potentially divide the homebuilding industry, depending in part on the internal dynamics of the industry's lobby groups (including the number and location of builders that specialize in starter homes).

In light of these political realities, advocates for reform have focused on adding a mortgage tax credit without eliminating the current deduction (Collins, Belsky and Retsinas 1999; Green and Reschovsky 2001). President Bush proposed a very small homeowner tax credit in 2001 with benefits targeted to developers rather than consumers. The Millennial Housing Commission, a bipartisan blue-ribbon task force appointed by Congress to make recommendations to address the nation's housing problems, also proposed a homeownership tax credit in its 2002 report (Millennial Housing Commission 2002). The report briefly mentioned the disparities in federal housing subsidies but did not recommend reducing tax subsidies for the affluent. There is reason to think that a well-crafted proposal could marshal support to increase homeownership by revising the tax code in order to benefit those left out by current regressive tax deductions.

The global assault on labor standards has transformed the U.S. economy and produced growing economic inequality and deepening poverty. America's persistent economic disparities are mirrored in the nation's housing conditions. America's housing crisis is fundamentally about affordability: the gap between housing costs and household incomes. It requires money to fill the gap. Only the federal government has the resources to address the problem, even though federal policy is implemented at the

state, metropolitan and local levels. Some form of government support is necessary to make housing economically manageable for the poor as well as for growing segments of the troubled middle class. The current disparities in housing assistance for the affluent and the poor exacerbate the nation's inequities.

In earlier periods, radical "housers" proposed bold alternatives to existing policies. Their demands were perhaps brazen, but they managed to walk the political tightrope. In today's terminology, they thought "outside the box." Not only did they think big, they organized well. They did not sit on the sidelines and criticize. They were political activists. They built movements and coalitions. In particular, they hitched their ideas to the one political vehicle that could effectively mobilize the political power to enact progressive housing legislation—organized labor. As Catherine Bauer wrote, "there would never be a real housing movement until workers and consumers organized an effective demand: that housing is a major political issue or it is nothing" (Oberlander and Newbrun 1999:106). Bauer's words remain true.

NOTES

1. This analysis excludes a number of other forms of government-subsidized housing. It excludes housing assistance provided by the U.S. Department of Defense for military families who live on and off military bases in the U.S. and overseas. It also excludes federal antipoverty programs, such as AFDC/TANF and the Earned Income Tax Credit, whose recipients use part of this assistance to help pay their housing costs. It also excludes the housing programs of the Federal Deposit Insurance Corporation, the government agency that insures banks that make mortgage loans and which disposes of the real estate assets of failed banks and S&Ls. Also excluded is the Federal Housing Administration (FHA); many middle-class Americans purchased their homes with mortgages insured by FHA, which is a division of HUD. This insurance, backed by the U.S. government, allows banks to reduce the monthly mortgage payments, which is a form of government subsidy. Also excluded are the Veterans Administration (VA, which guarantees mortgages for veterans), Fannie Mae, the Federal Reserve System and the Federal Home Loan Bank System. In addition to providing various housing subsidies, the federal government (primarily through

the Department of Justice but also through HUD) has sought to monitor and reduce housing discrimination, beginning with the Fair Housing Act of 1968. These costs are also not included in this analysis.

2. Overall, the largest 25 tax expenditures cost the federal government more than \$550 billion in 1999, as the data in Table 5.7 reveal. See also Howard 1997.

3. Unless otherwise specified, HUD figures used in this chapter are for HUD's budget outlays, most of which are for low-income housing.

4. In 1996, the Department of Defense spent \$5.7 billion to provide housing allowances for 569,000 military families in the United States. This covered 80 percent of the typical family's total housing costs, with the family paying the remaining portion. It also spent about \$3.9 billion to operate and maintain government-owned or -leased housing for 284,000 military families, covering 100 percent of their housing costs. These figures were provided by Pete Potochney and Dr. Saul Pleter of the Department of Defense. See also U.S. GAO 1996; U.S. Department of Defense 1998.

5. Until Congress passed a "welfare reform" bill in 1996, federal and state governments combined allocated about \$21.6 billion annually for Aid to Families with Dependent Children (AFDC), commonly called "welfare," distributed by the Department of Health and Human Services (HHS). Recipients received monthly checks to cover some of their living expenses. One study (Newman 1999) estimated that about 30 percent of this amount—about \$6.5 billion—was used to pay rent. Most AFDC recipients received no housing assistance and had to find accommodations in the private market. Most of this group paid at least one-half of their welfare check for rent—and frequently much more. Since most welfare recipients also receive food stamps, they used most (or all) of their AFDC benefits to pay rent. But the variations in housing costs across the country bore almost no relationship to variations in AFDC benefit levels. AFDC payments covered only 35 percent of average rent levels in Texas but covered 125 percent of average rents in Alaska. Nationwide, the median AFDC payment covered 66 percent of market rents. Even if most AFDC recipients found apartments cheaper than the average market rent, the AFDC payment was insufficient to keep a roof over their heads and have enough left over for other necessities (Newman 1999). It is hardly surprising that many welfare recipients supplemented their AFDC payments with work in the underground or informal economy (Edin and Lein 1997; Jencks 1997). Slightly more than 1 million families (about 23 percent) of AFDC recipients also received HUD subsidies. They lived in public or private government-assisted housing or had a rent certificate. These families paid 30 percent of their welfare income for rent, and HUD paid the rest. These families were better housed than those AFDC families without HUD assistance. Because federal housing assistance is

not an entitlement, the proportion of welfare recipients with housing subsidies varied considerably from state to state, from 12.1 percent in California to 56.8 percent in North Dakota. In seven states, fewer than one-fifth of welfare recipients receive federal housing subsidies. (See Newman and Schnare 1994; Newman 1999.) Benefits levels for AFDC and food stamps combined eroded significantly beginning in the early 1980s. They fell further and further below the official poverty line. In 1995, in every state, AFDC benefits were less than the typical monthly rents (see Dolbear 1996).

6. Each year, the Joint Committee on Taxation of Congress estimates the distribution of benefits of two of the major tax expenditures—the deduction of mortgage interest payment and the deduction for local property tax payments. Unfortunately, the JTC's estimates of the overall cost of these expenditures differ from other sources, including those of the Office of Management and Budget. When comparing tax expenditures with other housing subsidies, I use the OMB figures in *Analytic perspectives: Budget of the United States* (2000). When examining the distribution of tax benefits for mortgage interest and property taxes, I use the JTC figures.

7. In 32 of 42 states with individual income taxes, mortgage interest is deducted in the calculation of state income tax liabilities, increasing the tax subsidy for many homeowners. These states are Alabama, Arizona, Arkansas, California, Colorado, Delaware, Georgia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, Rhode Island, South Carolina, Utah, Vermont, Virginia and Wisconsin.

8. Prior to 1997, only homeowners over age 55 and homeowners who sold their homes and then purchased more expensive homes could exclude from their federal taxes capital gains from the sale of their homes. In 1997, Congress changed the law to allow all homeowners to exclude payment of capital gains taxes (up to \$250,000 for singles and \$500,000 for couples) when they sell their homes. They can only do so once every three years.

9. The figures used in Table 5.7 for the mortgage interest and property tax deductions are different from the figures used in Tables 5.3 and 5.4. The OMB uses a different method for calculating tax expenditures than the Joint Committee on Taxation, but only the latter disaggregates the benefits by income class.

10. These data come from Green and Reschovsky (1997).

11. Different reports use different estimates of both the total number of households eligible for HUD assistance and the total number of households receiving HUD assistance. A HUD study (Casey 1992) using 1989 data estimated the number of poor renters

eligible for HUD assistance at 13.8 million. A more recent HUD report (McGough 1997) put the figure at 15.8 million eligible households in 1993. A Harvard study (Joint Center for Housing Studies 1995) using 1993 data put the figure at 13.4 million. The Congressional Budget Office (1994) reports that 18.6 million households were eligible for aid in 1994. Regardless of which figures are used, the federal government's allocation of housing (via HUD) and income assistance (via AFDC/TANF) for the poor is unequal and inefficient. Of the 13.4 million low-income renter households in 1993, 7.4 million did not receive income or housing assistance; 1.9 million received both housing and income assistance; the other 4.3 million received either housing or income assistance (Joint Center for Housing Studies 1995; Newman and Schnare 1994; Casey 1992; Congressional Budget Office 1994; Kingsley 1997; McGough 1997; U.S. Department of Housing and Urban Development 1996, 1998).

12. Data provided by the Housing Assistance Council.

13. In 1985, the Department of Agriculture subsidized 88,228 housing units, 29.8 percent of which (24,428) were targeted to low-income households. In 1991, the figures were 45,873 total units, of which 61.9 percent (28,383) were targeted to low-income households. By 1995, the figures were 47,233 total units, of which 45.7 percent (21,569) were low-income. In 1997, the figures were 52,400 total units, 31.4 percent of which (16,456) were targeted for the poor—the lowest number since the figures were first tabulated for 1984. (The Rural Housing Program in Fiscal Year 1997; 1998.)

14. States vary considerably in the extent to which they favor MRBs compared with other bonds and in their capacity and commitment to implement this program. Fourteen state housing finance agencies accounted for more than one-half (53.5 percent) the total number of loans in 1997. This figure was calculated by the author from data provided by the National Council of State Housing Agencies. In descending order of number loans closed, these states are Pennsylvania, California, Virginia, Connecticut, Wisconsin, Nebraska, New York, Idaho, Missouri, Minnesota, Ohio, Michigan, Iowa and Alabama. The fact that many states with large populations are not among this group indicates that many large states prioritize uses other than housing under their bond volume cap, while several small and medium-size states prioritize housing over other uses.

15. The program grants investors a dollar-for-dollar reduction in their federal tax liability in exchange for providing funds for the development of qualified, affordable rental housing. The return to the investors largely comes in the form of tax credits, paid in roughly equal annual allotments over 10 years. Developers may claim the credits, but they typically

sell them to investors for up-front cash that is put into the project's development. The developer can sell the credits directly to one or more investors but typically sells them to a syndicator, who acts as broker between the developer and investors; the syndicator then markets the credits to potential investors. A number of national and regional syndicators, both for-profit and nonprofit, now dominate the field. Investor profits on the LIHTC have ranged from 10 percent to 18 percent. The proportion of the tax credit that goes into the housing developments (the "net equity") increased from 42 percent to 65 percent between 1987 and 1996, according to a E&Y Kenneth Leventhal Real Estate Group (1997) report, and to 75 percent, according to Cummings and DiPasquale (1997). (See also Cummings and DiPasquale 1998.)

16. The IRS oversees LIHTC compliance to ensure that states and investors do not use more tax credits than authorized.

17. The District of Columbia, the city of Chicago and two agencies in New York State (including New York City) administer their own allocations.

18. This formula has not changed since the LIHTC was initiated, despite the claims by developers that development costs have risen and that the LIHTC's purchasing power has been reduced.

19. Instead, Congress created a weak second-tier (rather than cabinet-level) agency called the Housing and Home Finance Agency to coordinate the public housing, mortgage insurance and urban renewal programs.

20. During the 1960 elections, the Democratic platform called for replacing HHFA with a new cabinet-level agency. Upon his election, President Kennedy tried to create a federal department of urban affairs and housing but was stymied by Congress. Much of the opposition came from Southern Democrats who feared that Kennedy would appoint Robert Weaver (HHFA administrator and the highest-ranking black in the federal government) to run the new agency (Bratt and Keating 1993:6)—a fear that turned into reality in 1965 when the Department of Housing and Urban Development was created (see text below), headed by Weaver, the first African-American cabinet member in the nation's history.

21. Most HUD-subsidized projects—public and private—are well run, but quite a few have been mismanaged by incompetent public housing agency bureaucrats and private landlords who took the subsidies but failed to maintain their properties. Over the years, HUD has used little leverage to make these inept or unfit landlords (whether public or private) toe the line. In some cases, private landlords milked these properties for their tax breaks and then walked away from the buildings, leaving HUD to foreclose and become the owner of ghetto slum housing. Moreover, most HUD-subsidized projects were sited in

segregated neighborhoods, compounding the image of HUD housing as a major factor in creating isolated ghettos (Goering, Kamely and Richardson 1994; Massey and Denton 1993; Schill and Wachter 1995a, 1995b). Local housing agencies and landlords argue, with some justification, that HUD rules requiring them to house only the very poor are responsible for some of the problems. Many HUD-subsidized projects have, in fact, become ghettos filled with troubled families, some of whom engage in crime, join gangs, participate in the underground drug economy and live on welfare and food stamps (Keyes 1992). These "distressed" projects (as HUD labels them) cast a giant shadow on the entire HUD enterprise, stigmatizing "government housing" as housing of last resort.

22. By the early 1990s, about 13,000 developments, with about 1.5 million units, remained in the inventory, exposing the FHA insurance fund to more than \$34 billion in insurance obligations (Pedone 1991; Sternlieb and Hughes 1991; Wallace 1994).

23. Henry Cisneros sought to address this shortcoming by focusing attention on regional and metropolitan problems and on the interdependence between cities and suburbs. But neither the Clinton Administration in general nor HUD in particular was able to translate this political insight into a significant shift in federal programs.

24. Democratic senator Barbara Mikulski of Maryland, fearing a voter backlash from Baltimore's blue-collar suburbs, withdrew her support for the MTO program after Republican politicians claimed it would promote an exodus of public housing tenants into their communities (Mariano 1994).

25. According to GAO, state oversight of the LIHTC varies in terms of project costs, eligibility of residents and other matters. The IRS does not adequately monitor state compliance of LIHTC projects (U.S. GAO 1997).

26. Advocates of the LIHTC turn the program's inefficiencies into a benefit by claiming that the credits "allow nonprofit and for-profit developers to leverage additional money to make the housing affordable" and that "[b]ecause it depends on investor capital rather than just direct government subsidies, the LIHTC has imposed a market discipline that makes these housing investments fundamentally sound for the long term" (Enterprise Foundation 1996).

27. The IRS requires that at least 10 percent of each state's annual tax credit allocation be set aside for projects partially or wholly owned by nonprofit organizations, but many states allocate a much larger share.

28. Being a propertyless tenant has never been part of the American Dream. Housing in the United States is symbolized by the free-standing single-family home. Opinion surveys consistently confirm Americans'

strong preference for homeownership (Fannie Mae 1995; Koretz 1998). From the outset, European settlers sought to establish property relations as the legal and moral underpinning of the new colonies. The earliest settlers came to escape oppressive landlords. The abundance of land created enthusiasm about the possibility of individual ownership and "nourished the first settlers' vision of land as a civil right, a right against the long-standing obligations of a crumbling feudal society" (Warner 1972:16). Support for homeownership has been a key element of our civic religion. James Madison believed that "the freeholders of the country would be the safest depositories of Republican liberty" (quoted in Marcuse 1975:197). Thomas Jefferson, who was unusual in favoring tenant suffrage, nevertheless held that "the small landholders are the precious part of a state" (Jefferson 1956). President Andrew Johnson supported the Homestead Act to offer land ownership on the frontier because "it would create the strongest tie between the citizen and the Government" (Johnson 1850:951). In the six decades from the end of the Civil War to the Great Depression, as immigrants from abroad and from rural areas in the United States flocked to the nation's expanding cities, the nature of property ownership changed from an agrarian to an urban phenomenon, but property ownership continued to be viewed as an indication of one's ability and moral worth. Around the turn of the century, with the first wave of population movement away from the downtown industrial districts of cities, only the affluent middle class (thanks in part to the new trolleys) could afford to move to owner-occupied one- or two-family houses in the "streetcar suburbs" (Warner 1962). But as the economy grew and the middle class expanded, homeownership increasingly became not only a symbol of status and achievement but also a goal that working-class families could strive for. It was not until after World War II that this goal would be widely realized, but as early as the turn of the century, the ideology of homeownership as the "American Dream" took root (Marcuse 1980). Presidents Calvin Coolidge, Herbert Hoover and Franklin Roosevelt all waxed eloquent over the benefits of homeownership (see Dreier 1982 for evidence of this). Making the country a nation of homeowners became a central feature of public policy, since homeownership was seen as a bulwark of social stability. For example, during the depression, the banking system collapsed, and homebuilding, homebuying and homeownership declined dramatically. Starting in the depression, the federal government created several institutions (Fannie Mae, the Federal Deposit Insurance Corporation and the Federal Housing Administration) to stabilize the banking system and make the flow of mortgage funds more dependable. These policies created a national market for mortgages and insured individual

depositors' accounts from bank failures. These policies allowed lenders to make long-term (typically 30-year) mortgage loans with a relatively low (3 percent to 10 percent) down payment. After World War II, FHA and VA mortgage insurance and guarantees, along with federal highway programs, increased homeownership and suburbanization, especially among white middle-class families. (For a discussion of this history, see Jackson 1985; Mitchell 1985; Hays 1995; Stone 1993).

29. This discussion of the history of the mortgage interest deduction draws heavily on Howard (1997).

30. One member of the Twentieth Century Fund task force—Austin Fitts, an investment banker who served as Federal Housing Administration Commissioner from 1989 to 1990 under George H. Bush, told the *Washington Post*: "We are providing a lot of money for deductions for very big homes and for second homes. If you drive around McLean [Virginia] and Chevy Chase [Maryland], all of those homes were built with subsidies from the federal government" (Salmon 1992).

31. Previously, the real estate industry had exercised its political muscle to keep interest rates low, to get government insurance for mortgage loans and to limit government subsidies for public housing that competed with private rental housing.

32. In fact, Charles E. McLure, Jr. (1986), an economist who designed the Reagan Administration tax reform policy, later observed that, "[e]ven if one grants the case for substantial tax preferences for owner-occupied housing, it is impossible to justify this distributional pattern of benefits."

33. The same legislation reduced tax breaks for investors in real estate, including apartments, but in its place created the Low Income Housing Tax Credit, a new tax break for investors in low-income housing.

34. The resolution concludes with the following: "Resolved . . . that it is the sense of the Congress that the current Federal income tax deduction for interest paid on debt secured by a first or second home should not be further restricted." Memo from National Association of Home Builders in author's possession.

35. According to the Congressional Budget Office (1997), removing deductions just for second homes would increase federal revenues by \$3.5 billion over the five-year period from 1998 to 2002. Limiting deductions to \$12,000 per return (for single taxpayers) or \$20,000 (for couples filing joint returns) would have added \$19 billion to the federal coffers. Reducing the maximum mortgage debt eligible for interest deductions from the current \$1 million to \$300,000 would generate \$12.7 billion in additional revenue. The CBO noted that only a small fraction of homeowners—about one-half a million taxpayers—would be affected by the last policy recommendation.

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