The Nation.

May 2, 1994 $2.25 U.S./$2.75 Canada

TAX BREAK FOR THE RICH

Reforming the Mansion Subsidy

PETER DREIER AND JOHN ATLAS

In the recent infighting over the Clinton Administration's budget, Henry Cisneros, Secretary of Housing and Urban Development, emerged a winner. His agency received a $1 billion increase to $26 billion, most of which is targeted for the poor. Missing from the public debate, however, was the question of what to do about the nation's largest housing subsidy—the $54.1 billion that goes to homeowners in the form of tax deductions for mortgage interest and property taxes.

Most Americans think federal housing assistance is a poor people's program. In fact, fewer than one-fifth of all low-income Americans receive federal housing subsidies. By contrast, more than three-quarters of wealthy Americans—many living in mansions—get housing aid from Washington.

Most affluent homeowners do not believe they live in subsidized housing. But in fact, the federal tax code allows them to deduct property taxes and mortgage interest payments from their income taxes. The homeowner deduction is a government subsidy that goes primarily to the affluent. In a perversion of progressive tax policy, those with the highest incomes and the most expensive homes (including a second home) get the largest subsidy. An analysis of recent data published by the Congressional Joint Taxation Committee (J.T.C.) shows that more than one-third (38.5 percent) of the $54.1 billion homeowner subsidy goes to the 5 percent of taxpayers who have

Peter Dreier is professor of public policy at Occidental College in Los Angeles and a National Housing Institute board member. John Atlas is president of N.H.I., which is based in Orange, New Jersey.

incomes above $100,000. About 12 percent goes to the wealthiest 1 percent of taxpayers, those with incomes above $200,000.

Wealthy households are most likely to own homes and to itemize deductions. Half of all homeowners do not claim deductions at all. Tenants, of course, don't even qualify. As a result, more than 80 percent of households with incomes above $100,000 receive a homeowner tax break, averaging $4,464. By contrast, fewer than 1 percent of households with incomes below $20,000 get this subsidy, averaging $515.

Contrary to the rhetoric of the real estate industry, these deductions aren't the salvation of the middle class. Only one-quarter of the 26 million households with incomes between $30,000 and $50,000 receive any homeowner subsidy, and what they get, on average, is quite meager—$967 a year. According to a study by economists James Follain of Syracuse University and David Ling of the University of Florida, for homeowners who do not have sufficient nonhousing deductions to itemize, "the mortgage interest and property tax deductions become worthless."

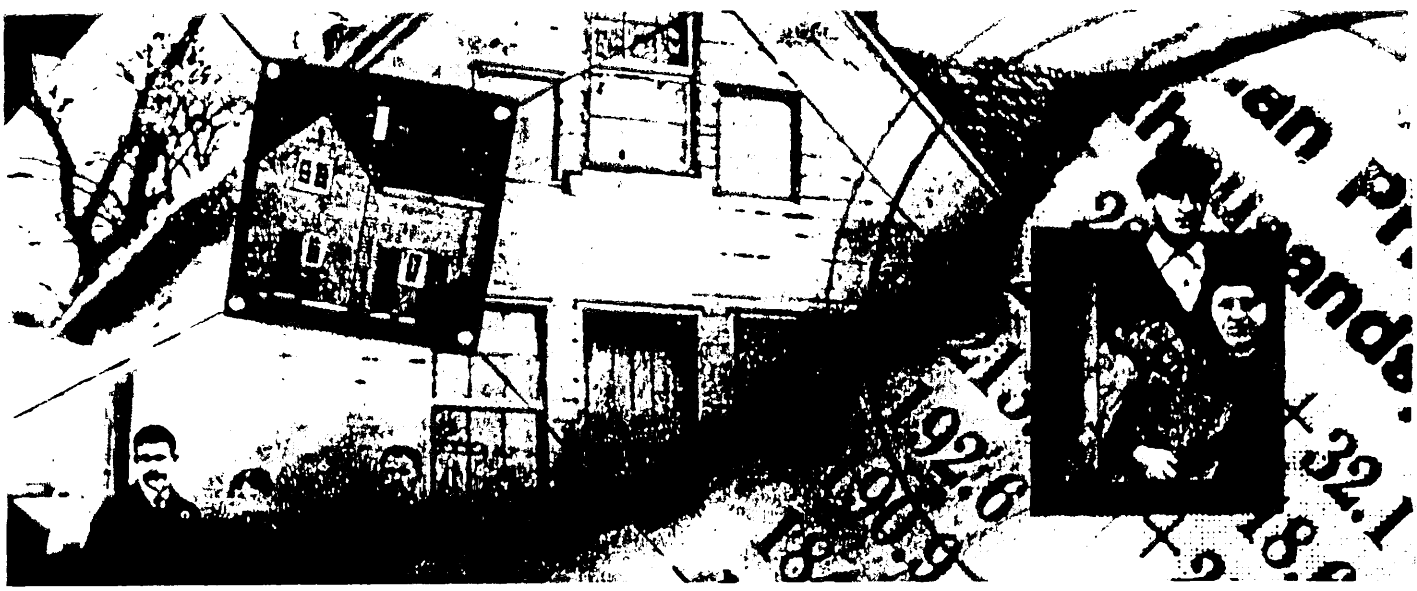
Add to this the fact that the United States provides the least housing assistance to the poor of any industrial nation. According to a recent HUD report, fewer than one-third of the eligible 13.8 million low-income renter households receive any federal housing assistance, either by living in a government-subsidized apartment building or by receiving a rent voucher. Among poor homeowners, the federal tax deductions are virtually worthless.

Yet because the press and public officials focus attention on federal aid to the poor, programs such as public housing and rent subsidies are much more visible than the tax subsidies to the wealthy. The upshot is that housing programs for the poor have been slashed, while few Americans worry about getting the wealthy off welfare. The Reagan and Bush administrations cut the federal housing program from $33 billion to $10 billion. President Clinton did increase the HUD budget to $26 billion, but this amount is far below the agency's allotment in constant dollars in the pre-Reagan years and less than half of what the government spends for homeowner tax subsidies that disproportionately benefit the rich. Moreover, the J.T.C. projects that the homeowner subsidy will reach $74.3 billion by 1998, further widening the gap between the rich and the poor.

The housing industry argues that the homeowner tax break is the linchpin of the American Dream. This is nonsense. Neither Canada nor Australia has a homeowner deduction, and their homeownership rate (some two-thirds of all households) is about the same as ours. And during the past decade, the rate of homeownership in the United States has steadily declined, especially for young families. According to a recent Census Bureau report, 86.7 percent of renter households—including 83.5 percent of married couples with incomes between $30,000 and $50,000—cannot afford to buy a home. Even with today's relatively low interest rates and a depressed housing market, the American Dream is beyond the reach of most young families.

If anything, these tax deductions artificially push up housing prices because buyers include the value of the tax subsidy in their purchase decision. At a conference on the topic sponsored last September by Fannie Mae, the Federal National Mortgage Association, the top economists from the major housing industry groups admitted that eliminating the homeowner tax break would have no major impact on home buying. If the tax break were abolished, builders and sellers would lower prices to reflect the real value of houses.

Everyone supports the American Dream of homeownership, and no one wants to eliminate existing homeowner subsidies for middle-class families. But the current system is in desperate need of reform. The homeowners' deduction was never intended to be the costly element of housing policy that it has become. When the tax code was enacted in 1913, it made some sense to allow taxpayers to deduct mortgage interest because they used personal debt to finance small businesses and family farms. But the deduction grew, at first in small and little-noticed increments. By the 1960s, when Brookings Institution economists were among the first to suggest that the homeowner deduction was inequitable and unnecessary, the real estate industry had declared it sacrosanct and used its political muscle to protect it.



Political leaders have occasionally challenged the orthodoxy, only to beat a hasty retreat. In 1963 the Kennedy Administration proposed limiting all personal deductions, including interest on home mortgages, but in the face of intense industry lobbying of Congress, it backed off before the measure could come to public hearings. In a speech in October 1969, HUD Secretary George Romney tossed aside a prepared speech and proposed repealing the homeowner deductions and channeling the revenue "to meet the problems of the slums." The Nixon Administration, and then Romney himself, soon rejected the idea.

In 1984, at a question-and-answer session before the National Association of Realtors, President Reagan said that everything, including the homeowner deduction, was on the table as his Administration pursued a complete overhaul of the tax system. But under intense election-year lobbying from the real estate industry, Reagan backed off the very next day and affirmed his support for the homeowner deduction. Speaking at a realtors' convention soon after taking office, President Bush vowed to defend the existing subsidy. During his 1992 campaign, candidate Bill Clinton repeated the same mantra. He hasn't spoken publicly about the issue since taking office.

Congress has long remained in the thrall of the real estate lobby. The political action committees of the National Association of Realtors, the National Association of Home Builders and the Mortgage Bankers Association have extensive local networks and deep pockets. (In 1991-92 only the American Medical Association gave more campaign contributions than the N.A.R.) Few members of Congress want to offend these generous campaign contributors or be labeled as anti-homeownership.

The industry got a big scare in 1986, however, when Congress limited the mortgage interest deduction to two houses. The next year, it capped the amount of mortgage principal eligible for interest deduction at $1 million. These moves frightened the housing industry, which then mounted a major campaign to protect the tax break from further tampering, making the homeowner deduction the litmus test for its financial support.

Still, there is growing interest in some kind of reform, although it mainly comes from opposite ends of the political spectrum, with different agendas—deficit reduction and housing assistance. During his presidential campaign, Ross Perot proposed limiting the homeowner tax break to help reduce the federal deficit. Recently, the Progressive Policy Institute, an arm of the middle-of-the-road Democratic Leadership Council, and the Concord Coalition, headed by ex-Senators Paul Tsongas and Warren Rudman, have issued reports calling for reform of the mortgage interest tax break to reduce the deficit. On *Meet the Press* on February 20, Senator Paul Simon, the new commander of the balanced-budget army, echoed the same theme.

These deficit-cutters generally borrow their ideas from the Congressional Budget Office, which each year publishes a report recommending options to reduce the federal deficit. In terms of the mortgage interest deduction, the C.B.O. offers three proposals:

First, it suggests lowering the limit on the amount of principal eligible for the mortgage interest deduction from the current $1 million to $300,000. This would touch only a small number of households and would generate $2.3 billion in tax savings next year alone. The Progressive Policy Institute has endorsed this idea.

Second, it recommends eliminating deductions entirely for second homes. Senator Simon said he favored this idea. Although it might seem fair to cut tax breaks for vacation properties when so many Americans can't even afford a first home, this proposal would net only $300 million in annual tax savings next year. It would also run into political opposition from vacation-industry strongholds like Florida, Maine and Colorado, where builders, bankers and realtors thrive on second houses.

The C.B.O.'s third proposal—to limit mortgage interest deductions to $12,000 per single return or $20,000 per joint return—would generate $3.8 billion in annual tax savings next year. Moreover, it would affect only 5 percent of all taxpayers—the wealthiest. It would allow a family to finance a fixed-rate mortgage of about $300,000. The Concord Coalition supports this approach.

The C.B.O.'s recommendations would reduce subsidies for the wealthy and cut the deficit, but they do nothing to address the nation's housing and unemployment problems. Not surprisingly, housing activists want to use the savings to fund programs to help the homeless and other Americans hurting from the shortage of affordable housing. Two years ago the mainstream Twentieth Century Fund sponsored a Task Force on Affordable Housing. Its report, "More Housing, More Fairly," recommends "shifting federal [housing] commitments to make current allocations fair," in particular the tax expenditures for housing. Anthony Downs, a real estate economist at the Brookings Institution, agrees. In a recent analysis of federal housing policy, Downs wrote that "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."

The National Low-Income Housing Coalition, a public interest advocacy group, wants Congress to create a housing trust fund that would use the added revenues to provide housing assistance to the poor. One possible approach for providing assistance is a universal housing voucher program that would provide all low-income households with sufficient income to rent an apartment in the private market—at a cost of an additional $20 billion to $25 billion a year. Still another tactic calls for expanding HUD's Community Housing Partnership program, a small but popular initiative begun in 1990 to help community-based nonprofit developers build low- and mixed-income housing.

In reality, both approaches are needed. Issuing vouchers is cheaper than building new housing or even rehabilitating old housing, but in many areas the shortage of rental dwellings is so severe that this would be like giving people food stamps when the grocery shelves are empty. There is still a need to expand the overall supply of housing.

Right now, the deficit-cutters have louder voices, but the housing advocates have the fairness argument on their side. Unfortunately, the way Congress operates—with its tax-writing and budget committees operating on separate paths—makes it difficult for this linkage to work.

So here's another idea, which keeps the issue in the tax committees' domain but incorporates the housing advocates' goals. We suggest scrapping the homeowner deduction and trying an entirely new approach—a homeowner tax credit. It would increase homeownership, catalyze building, generate jobs and help stimulate economic recovery.

The tax credit would be available to all families each year—including those moderate-income households that do not itemize their deductions and so cannot take advantage of the current tax break. Capping the credit (for example, at the levels recommended by the C.B.O.) or tying it progressively to income would limit subsidies for the wealthy while preserving them for the middle class. But it would also add a large number of poor and working-class families who do not benefit now. Thus a tax credit would be much more efficient, and more fair, than the current approach. The credit could be adjusted for regional housing costs in order to avoid penalizing buyers and owners in high-cost areas.

A tax credit would encourage homeownership more effectively than the mortgage deduction does. The wealthy would continue to purchase homes with or without a tax subsidy. Because housing demand is more elastic at the bottom and middle segments of the economy, a homeowner tax credit could make the difference between renting and owning for millions of working families now shut out of the American Dream. Moreover, by increasing the effective demand for housing, it would stimulate the building industry (and aid brokers and mortgage lenders), create jobs in the construction industry, have significant ripple effects throughout the economy and add to local tax bases.

The current way we distribute housing subsidy funds is wasteful and unfair. We have the resources to assist the millions of poor and working-class families who cannot afford market-rate rents or home prices. Let's stop subsidizing the mansions of the rich. Let Congress, housing experts and developers debate how best to spend the money in a cost-efficient way. But let's no longer argue whether we can afford to do so. □