

# Rethinking Mortgage Interest Deduction?

**Lawrence Yun, Ph.D.  
Chief Economist  
NATIONAL ASSOCIATION OF REALTORS®**

**Presentation at Tax Policy Center of Urban/Brookings Institute in  
conjunction with Reason Foundation  
Washington, DC  
July 28, 2011**

# Worst Possible Time to Discuss

- 2011 ... Very Fragile Housing Market !!!
- Any obstacle to recovery ...
  - Home price growth stunted or further declines
  - Slower consumer spending growth ... negative wealth effect
  - Slower growth in residential investment to GDP
  - Unnecessarily higher foreclosures
  - Hurts bank balance sheet

# MID should have been discussed during Bubble Years?

- MID was not the source of the bubble
  - Need to examine special factors peculiar to past decade and not something in place for 100 years like MID
  - Community Reinvestment Act also not a source of bubble
- Causes of Bubble?
  - Growth of GSE Portfolio
  - Higher HUD mandate on housing goals
  - Credit Rating Agencies perverse incentives
  - Subprime credit bubble
  - Low interest rate monetary policy
  - Pronouncements that it is not a bubble because “this time is different”

# Facts

- MID was part of the original income tax code from 1913
  - Without MID, taxpayers will fork over more dollars to Washington (about \$120 billion in additional taxes)
- Removing MID is a **tax increase** on the Middle Class
  - Given the long history of MID ... the removal of MID should be viewed as not a removal of a tax break, but a tax increase on the middle-class homeowners
- A full MID removal will lower property value by 15% and destroying middle-class wealth accumulation
  - Federal Reserve data shows that homeowners' housing asset value as \$16.1 trillion (as of 2011 Q1) ... 15% reduction means \$2.4 trillion destruction in housing value
  - Even people who do not have mortgages will suffer the price decline ... all 75 million home-owning families will suffer

# Myth about the Rich Benefitting from MID

- MID is said to principally benefits the super rich with huge mortgages
  - \$1000 deduction yields \$350 tax savings for people in 35% tax bracket
  - \$1000 deduction yields \$250 tax savings for people in 25% tax bracket
- In percentage terms (in relation to income), younger middle-class families get more MID benefits
  - Young families have higher mortgage balance at the early stage of their adult life
- 91% of MID beneficiaries earn less than \$200,000 per year
- 65% of MID beneficiaries earn less than \$100,000 per year
- Homeowners pay 80% to 90% of federal income tax with MID. Homeowners are already overburdened in their contribution to taxes. The share could rise to 95% if MID is removed
- In absolute dollar terms, wealthy families do get more MID benefits ... because they face higher tax rates. Lower tax rate will mean lower MID benefit for the wealthy ... essentially non-ending class warfare debate

# Positive Externalities

- Sustainable Homeownership (not bubble ownership) associated with
  - Higher student test scores
  - Lower juvenile delinquency
  - Higher health outcomes
  - Higher civic participation
  - Community investment and participation
  - More volunteer time for charity
  - Many more ....
- Economic Theory says
  - Tax negative externalities such as pollution
  - Provide incentives for positive externalities

# Real Estate Special Interest Group?

- NAR Political Power
  - A Leader in PAC dollars
  - Special interest group power or freedom of association and right to free speech
- Mancur Olson's Logic of Collective Action and the Rise and Decline of Nation
  - Is NAR a rent-seeking special interest group?
  - Is NAR promoting a common interest (of 75 million homeowners) that cannot adequately organize ... NAR protect consumers?

# Changing the Rules in the Middle of the Game?

- Assume rent-seeking and deadweight loss from MID
- Tabula Rasa without history ... MID issue should be fully debated to include or not include into the tax code
- But the U.S. is not tabula rasa ... millions of homeowners made decisions with the understood law in place ... MID since the inception of the federal income tax code in 1913
- Is there a Coase Theorem outcome to make everyone better off through private negotiations in presence of a dead-weight loss? Who has the property rights?

# Productivity Growth?

- GDP growth as best source for tax revenue
- Solow Growth model and the measure of our ignorance
- Biggest Growth from not capital deepening, but from productivity gains
- Sustainable Homeownership leads to ...
  - Long-term planning ... delayed gratification?
  - Pleasures of hard work?
- U.S. economy grew the fastest in the world from 1913 ... because of or in spite of MID?

# How to Stop the Leviathan?

- Remove MID in return for lower tax rates?
  - Devil's bargain of lower tax rates today but unknown higher tax rates in future?
  - What will be future Congressional makeup?

# Society of Renters?

- International (Canadian) Comparisons are apples-to-oranges comparison
- Landlords get MID and depreciation, but not homeowners
- Rent Control more likely in high rental population centers
- Renters seek ... redistributive society?
- James Madison's fear of "tyranny of the majority"

# Long-Term Deficit Pressures

- Safety Net Obligations growing
  - Health care needs and minimum basic standard of living in a wealthy country
  - Aging population
- Defense Spending Cuts from the End of History?
  - All countries moving towards democratic market system and no need for war
  - Or a replay of the 20<sup>th</sup> Century ... the Bloodiest Century in human history

# How to reduce the budget deficit

- My personal views because NAR does not take position on issues outside of real estate.
  - Raise retirement age for those who are young today
    - Honor full commitments to those in retirement or near retirement
  - Improve education for future economic growth
  - Reduce government spending
  - Reduce federal employment
  - Raise taxes outside of real estate

# Presidential Quotes

- Franklin Delano Roosevelt:

“A nation of homeowners is unconquerable.”

- Ronald Reagan

“We will preserve the part of the American dream which the mortgage-interest deduction symbolizes.”