MONTANA STANDARD

Alas, the mortgage interest deduction cannot be pried away

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Attempting comprehensive tax reform is like trying to tug many bones from the clamped jaws of many mastiffs. Every provision of the code — now approaching 4 million words — was put there to placate a clamorous faction, or to create a grateful group that will fund its congressional defenders. Still, Washington will take another stab at comprehensiveness, undeterred by the misadventures of comprehensive immigration and health-care reforms. Consider just one tax change that should be made and certainly will not be.

The deductibility of mortgage interest payments, by which the government will forgo collecting nearly $1 trillion in the next decade, is treated as a categorical imperative graven on the heart of humanity by the finger of God *because* it is a pleasure enjoyed primarily by the wealthy. About 75 percent of American earners pay more in payroll taxes than in income taxes, and only around 30 percent of taxpayers itemize their deductions. Ike Brannon, of the Cato Institute and Capital Policy Analytics in Washington, argues that, given America's homeownership rate of about 63 percent, not even half of all homeowners use the deduction. Its principal beneficiaries are affluent (also attentive and argumentative) homeowners, and its benefits, as Brannon says, "scale up" regressively: The larger the mortgage and the higher the tax bracket, the more valuable the deduction is.

Perhaps the deduction's net effect is a higher rate of homeownership, which can benefit society by encouraging respect for property rights, the thrift necessary for a substantial investment and a sense of having a stake in the community. But the unpleasantness of 2008 demonstrated the downside of encouraging too much homeownership. Furthermore, the deduction might actually suppress homeownership by being priced into rising housing costs. Besides, Australia, Canada and Britain, which have no mortgage interest deductions, have homeownership rates comparable to that of the United States.

Homeownership is, Brannon argues, a way for people to hold their wealth; it is *not* an investment because "it does not improve the productive capacity of the economy." Indeed, the more money that flows into housing, the less flows into stocks, bonds or banks.

Government policy is like a Calder mobile — touch something here and things jiggle over there. For example, the president has acted to discourage the use of Canadian wood when making planks for the rising edifice of American greatness. A 20 percent tariff on softwood imports from Canada — about 30 percent of the softwood lumber used in U.S. residential housing construction — is retaliation for Canada's government supposedly charging Canadian lumber interests too little for trees harvested in government forests. The tariff will raise the price of flooring and siding and therefore of houses.

Dismayed U.S. homebuilders foresee a 6.4 percent increase; U.S. lumber interests say that is an exaggeration. Even allowing for theatricality on both sides, lumber protectionism will certainly deepen two problems: Because the mortgage interest deduction enables higher housing prices, Americans will continue to pour too much wealth into housing. And inequality will be exacerbated. Homeownership is crucial to the accumulation of wealth. But as social scientist Joel Kotkin writes, millennials are caught in a pincer of low incomes — the Census Bureau estimates that even those with a full-time job earn $2,000 less in real dollars than the same age cohort did in 1980 — and high housing prices. Kotkin says "homeownership rates for people under 35 have dropped 21 percent" since 2004.

And there is this: The percentage of persons ages 25 to 34 who have never been married has risen from 12 in 1960 to 47 today. There are cultural as well as economic reasons for this delay in two powerful economic multipliers — family formation and house-buying — but certainly, the rising cost of housing is a factor. This is just one of the unseen costs of protectionism's seen benefit of a small number of domestic jobs protected.

Elimination of the mortgage interest deduction would have to be grandfathered to accommodate those who budgeted for their home purchases with the deduction in mind. Even so, it will not happen. Neither will limiting the deduction by denying it to a tiny top sliver of the largest mortgages — say, portions of mortgages over $500,000. People are loss-averse — they resist surrendering any benefit, even if they would reap bigger benefits from increased economic growth that would result from a more sensible allocation of society's resources. And the political class is risk-averse, unwilling to challenge the affluent, or 1 million organized Realtors. The sound you hear is of mastiffs growling.