Newsweek

Why Mortgage Tax Relief Should Be Abolished

Vanessa Brown Calder

August 25, 2017

Rumors are swirling that mortgage interest deduction reform is “on the table” for the White House and House Republicans. Is that a good thing or a bad thing?

In order to answer that question it is first necessary to determine whether the deduction works as intended.

In our forthcoming chapter on international homeownership in *The Routledge Handbook of Housing Policy and Planning*, Mark Calabria and I discuss the deduction’s impact on homeownership rates.

For years, the mortgage interest deduction has been justified under the pretense that it supports homeownership.

Spoiler alert: empirical evidence suggests it does not.

Most studies find the mortgage interest deduction has no impact on homeownership rates, and at least one study finds that eliminating the deduction would boost homeownership.

People generally find this counterintuitive. Why wouldn’t a subsidy for homeowners increase the amount of homes owned?

A simple way of thinking about it is that some people are like Person A: they are both financially qualified and want to buy a home. People like Person A will buy a home with or without the subsidy.

On the other hand, some people are like Person B: they are not financially qualified to buy a home or do not desire homeownership. The mortgage interest deduction does not address the reasons Person B is financially unqualified (income instability, weak credit, or poor savings) or the reasons that Person B doesn’t desire homeownership (maintenance, debt, reduced geographic mobility).

A more economically sophisticated way of understanding the mortgage interest deduction is that it reduces the cost of housing for existing homeowners, but increases the price of homeownership for non-homeowners.

In other words, any positive impacts on homeownership rates are canceled out by the negative impacts.

So what does the deduction do, if it doesn’t boost homeownership?

Research indicates the deduction encourages people to buy larger or more expensive homes. In other words, it motivates homeowners to over-consume housing.

Studies indicate that mortgage subsidies distort the allocation of saving and investment across OECD countries and redistribute income "from new entrants in the housing market to insiders."

What does the path forward look like? House Republicans have a proposal for reform; Paul Ryan's *A Better Way* plan suggests doubling the standard deduction and reducing use of the mortgage interest deduction, though not eliminating it. Theoretically, under his plan taxpayers will have more money in their pockets they can use that to pay mortgage interest or something else.

There are also other possibilities for reform, like capping, limiting, and phasing the benefit out. Great Britain did so over a twenty year period (1974-1994), and far from a housing market catastrophe, Great Britain's homeownership rates rose during this time period.

Although the rise in homeownership was partly attributable to the privatization of public housing stock in the 1980s, it's still notable that market turmoil was avoided.

Whatever shape reform ultimately takes, Republicans are smart to flag the opportunity. Since the mortgage interest deduction disproportionately benefits high-income blue states while also redistributing to the wealthy, the politics of reform could unite some unlikely rivals.

That might be just what tax reform needs.

Vanessa Brown Calder is a policy analyst at the Cato Institute.