



RETHINKING FEDERAL HOUSING POLICY

HARVARD AND WHARTON HOUSING EXPERTS FIND LOCAL BUILDING LAWS INFLATE PRICES IN AFFLUENT MARKETS

FOR IMMEDIATE RELEASE: December 8, 2008

Over the past twelve months, millions of Americans have lost billions of dollars in housing wealth. Those homeowners were encouraged to borrow heavily to invest in housing by federal policies such as the home mortgage interest deduction. For seventy years, the federal government has tried to make housing affordable by subsidizing borrowing. Those policies have encouraged Americans to bet heavily on housing, but failed to keep housing affordable in much of the country. Particularly along the east and west coasts, housing remains extremely expensive relative to historical prices, construction costs, and average incomes. In *Rethinking Federal Housing Policy: How to Make Housing Plentiful and Affordable* (AEI Press, December 2008), Edward L. Glaeser and Joseph Gyourko explain why these areas are so expensive and outline a plan for making them more affordable, while reducing the government subsidies that have encouraged so much betting on housing.

The current housing crisis provides an opportunity to rethink federal housing policies aimed at housing affordability. Good housing policies should be rooted in good economics and a recognition that America's diverse housing markets are treated poorly by one-size-fits-all policies. Glaeser and Gyourko's thorough examination of national housing policy emphasizes the role that local conditions play in determining whether housing is affordable for the poor and the middle class. They divide the nation into three types of housing markets:

- Economically stagnant regions have low consumer demand for housing; in these areas, prices are low, but there is little new construction because construction costs are greater than most consumers are willing to pay.
- In most of America, competitive housing markets provide affordable homes. House prices reflect general economic conditions, as local laws permit housing supply to rise and contract quickly in response to consumer demand.
- In an increasing portion of the country—mainly affluent areas in California, the eastern seaboard, and Florida—governments have imposed significant restrictions on housing supply. These restrictions, such as minimum lot sizes and other growth controls, create permanently high prices as demand by affluent customers greatly outstrips the supply permitted by local laws.

Policymakers must recognize that conditions differ across housing markets, so housing policies need to reflect those differences. Our current housing market crisis is playing out very differently in areas where housing supply is quite elastic as opposed to areas where housing supply is significantly constrained. In the latter case, price declines have been relatively modest to date. In the more elastic areas, prices are rapidly heading back toward historical norms, which accurately reflect the costs of supplying homes. Basic economics suggests that there is little that can be done to stop the return of prices to those historical norms and that cheaper housing in these areas also brings many benefits.

The poor and the middle class do not struggle with the same affordability issues, so housing policy needs to address each problem differently. The poor cannot afford housing simply because their incomes are low; the solution to that problem is direct income transfers to the poor, rather than interference with the housing market. In contrast, housing is unaffordable for the middle class because of local zoning restrictions on new home construction that limit the supply of suitable housing. The federal government can address this issue by providing incentives for local governments to allow more construction.

Ironically, current subsidies for the construction of low-income housing only tie impoverished Americans to areas where they have limited job prospects. These supply subsidies also crowd out private-sector construction and benefit politically connected developers. Mortgage interest deductions, which are intended to make housing more affordable for the middle class, simply encourage families who can already afford a house to borrow to purchase a bigger one. In restricted, affluent markets, these deductions increase the amount families can pay for a house, driving up prices even higher. The current crisis should raise doubts about federal policies that encourage Americans to leverage themselves heavily to buy more expensive homes.

Glaeser and Gyourko propose a comprehensive overhaul of federal housing policy that takes into account local regulations and economic conditions and emphasizes the need for local governments to reduce supply restrictions and let housing markets operate freely. Specifically, they recommend:

- Reforming the home mortgage interest deduction to provide incentives that will induce overly restrictive regions to permit more housing. In counties in which the total number of annual housing permits is less than 1 percent of the total housing stock, the cap for mortgage deductions should gradually be lowered from \$1 million to \$300,000. The money raised by the increase in federal revenues should be given back to the counties to subsidize new housing construction.
- Eliminating all federal supply subsidies for the production of low-income housing in all regions of the country and using those funds to increase the scope of tenant-based Section 8 housing vouchers. The Section 8 program should be made national in scope (currently, vouchers are allocated by local housing authorities) so that poor households can use the voucher to move to more economically vibrant regions.

Glaeser and Gyourko's policy reforms would have three primary effects. First, reducing housing restrictions in expensive markets would prevent unsustainable price inflation. Second, allowing housing markets to function freely will make housing more affordable for the middle class. Third, providing Section 8 vouchers will help reduce poverty by allowing poor households to move to regions of the country with growing economies, where they are more likely to find jobs.

The authors conclude that a radical rethinking of housing policy is needed if the federal government is to make housing affordable and plentiful for the middle class as well as the poor. Their timely book articulates policies that are rational, flexible, and truly in the public interest.

Edward L. Glaeser is the Fred and Eleanor Glimp Professor of Economics at Harvard University.

Joseph Gyourko is the Martin Bucksbaum Professor of Real Estate and Finance at the Wharton School of the University of Pennsylvania.

###

**RETHINKING FEDERAL HOUSING POLICY:
HOW TO MAKE HOUSING PLENTIFUL AND AFFORDABLE**

Edward L. Glaeser and Joseph Gyourko

978-0-8447-4273-1 • 220 pages • \$20.00 • December 2008