Homeownership is Over-rated: Did Homeowners in Atlantis enjoy being Underwater?

For years the US federal government has been obsessed with increased home ownership. This obsession has led to the slowing of the US economy. The problem began with the creation of the income tax in 1913 that excluded interest payments on all debt from being considered taxable income. In 1986 that personal interest deduction was removed for other consumer debt but kept in place for homes.

The home mortgage interest deduction makes it more profitable for the average American to buy a house (or two) as a form of savings rather than save their money in stocks or bonds. This reallocates scarce capital away from companies looking to borrow for new tools, machines, equipment, software, and factories to the housing industry. Government GDP accounting even counts the building of new homes as investment rather than consumption thereby skewing the real effect of the housing subsidy on actual investment in the economy. Building a house that is not rented out is not investment, it is consumption. It generates no additional GDP. Imputed rent that a homeowner does not charge himself is not treated as income because it really is consumption.

As scarce capital is diverted away from productive industries to consumption, economic growth is retarded. Furthermore, a falling of home values can lead to a retardation of labor mobility which itself slows down economic growth. If an unemployed, or underemployed, person has a great job opportunity in a different city, but cannot sell their existing home without taking a huge loss, they are less inclined to move where their skills are most valuable. When people used to live in the same small town their whole lives, homeownership didn’t drag down the economy as much. As the labor market became wider, incomes rose. Incomes would rise further if people’s mobility equaled the size of their labor market. Renting provides way more labor force mobility than homeownership and is preferable in a dynamic economy.

The macroeconomic arguments against homeownership are clear. Homeownership incentives from the government waste scarce capital by incentivizing the consumption of larger, and often second, homes than the market would naturally create. Homeownership leads to less labor force mobility. The free movement of people and their skills is a key component to economic growth. Having the federal government encourage bad credit risks to take on debt they couldn’t repay isn’t exactly helping out our economy either. Still, there are also microeconomic arguments against homeownership.

Once upon a time, self-sufficient farmers were the norm. They were also very poor. They grew their own food, built their own cabins, and generally eeked out an economically poor existence, except when they didn’t. (Life expectancy was low). Specialization, the division of labor, and trade have made the world a richer place with longer life expectancies. Fewer than 2% of Americans are farmers and yet people don’t starve to death. Fewer than 10% of America’s workforce is employed in manufacturing, yet our GDP is higher than ever. Why do we “need” 60% of Americans owning homes and thereby serving as landlords (to themselves). Are we all equally good landlords, or is being a landlord a specialized skill?

Let’s start with lawn care. It turns out that having every home owner buy a multi-thousand dollar lawnmower they use once a week is very inefficient (and a waste of scarce capital). Lawn care services exist because there are gains from specializing in law care. I don’t have a comparative advantage in lawn care. For that matter, I don’t have a comparative advantage in plumbing, electrical repair, HVAC service, gutter cleaning, house painting, or any general household repairs. As far as I’m concerned, the fact that I own any tools at all means that resources have been wasted (except when they are used by my wife to fix stuff).

I don’t need to contract with an electrician or a plumber on a routine basis. I don’t have a comparative advantage in searching out people to work on “my” house. People who specialize in landlord services are either skilled themselves, or are skilled at contracting low cost specialists. This specialization allows them to offer housing services at a fraction of the cost of what individuals would have to pay if they “owned” their own home. (Few people own their homes straight out – usually the bank owns them for 30 years first).

There are two major things standing in the way of increasing economic growth through lower home ownership. The first is bad government policy. Congress and the President should end the home mortgage interest deduction for homebuyers. Politically it might work best to grandfather that policy in so that some existing homeowners aren’t forced to dump their existing over-sized or second homes. Economically, it would be better to end it at once (even if they compensated existing home owners with some cash payment like what was included in the 1996 Freedom to Farm Act when Congress decided to end farm subsidies as an end around the transitional gains trap).

The second thing standing in the way of increasing economic growth is the cultural idea that homeownership is somehow better than renting. Mind you, there are people who still think you should grow your own food (the local food movement). Owning your own home makes no more economic sense than growing your own food or sewing your own clothes. (You should see the sweatshirt I “made” in junior high home economics class!) I know this because I own two homes and am the second worst landlord I have ever had. In a country so desperately in need of economic growth, we need to remove barriers to specialization and trade, and the removal of the home mortgage interest deduction is as good a place as any to start.

Note: Enacting this policy would mean that I would probably have to sell my new house, and do so at a loss, so it is hardly a self-serving policy recommendation. Then again, I have tenure so I don’t personally need a dynamic labor market or economic growth to remain employed.