

**Mortgaging Away Our Future: An Examination of U.S. Congressional Opinion Regarding the**

**Home Mortgage Interest Deduction**

by

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## **Abstract**

The goal of this project is to summarize what sort of benefits and costs the mortgage interest deduction creates for the economy and society in the United States, and to research how lawmakers have treated the deduction in light of these effects. Ultimately, this project found that scholars and commentators of all economic and political stripes are virtually unanimous in their opposition to the deduction. In fact, they contend it has myriad negative effects on the economy and society, serving only to help some taxpayers buy bigger and more expensive homes. Congress for the most part has ignored these facts. Legislators of both parties from states with high home prices predominantly oppose any changes, casting the deduction in hyperbolic terms as a gift to the entire nation when in fact it mostly serves to please their own constituents and fund their own campaigns. While the Tax Cuts and Jobs Act of 2017 includes much needed reforms to the deduction, the nation's tax code is still a long way from treating home ownership in a sensible manner.

## Introduction

In order to understand the mortgage interest deduction and its flaws, it helps to understand the history of taxes in America, starting with the U.S. Constitution and the basic principles it lays out for a tax system. This nation's citizenry has always had a unique, combative relationship with taxes. When the framers of the Constitution met in Philadelphia, taxation was a controversial subject. The nation needed a responsible, balanced tax system and thankfully, the framers were well equipped to solve this problem, as many of them knew how to manage money well. To give just two examples, George Washington, president of the Convention, kept meticulous double-entry records of the daily operations of his massive estate at Mount Vernon; and Alexander Hamilton of the New York delegation would go on to be America's first secretary of the treasury and the architect of the country's modern financial system.<sup>1</sup> The Constitution they produced emphasizes accountability and fairness in taxation. Article I, Section 7, Clause 1 specifies that "all bills for raising revenue shall originate in the House of Representatives, but the Senate may propose or concur with amendments as on other bills."<sup>2</sup> This suggests that the framers wanted the House, which would be more connected with the common man than the Senate, to set the pace in federal spending. Additionally, Article I, Section 9, Clause 7 says that "No money shall be drawn from the Treasury, but in consequence of appropriations made by law; and a regular Statement and Account of the Receipts and Expenditures of all public money

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<sup>1</sup> Jacob Soll, *The Reckoning: Financial Accountability and the Rise and Fall of Nations* (New York, NY: Basic Books, 2014), 156, 163.

<sup>2</sup> U.S. Const. art. I, § 7, cl. 1

shall be published from time to time.”<sup>3</sup> It is important to remember as Congress debates the specific provisions of the Internal Revenue Code that its members should be striving for a code that reflects the needs of the people and remains accountable and understandable to them.

The income tax in the United States has taken many forms since it was first adopted permanently in 1913 after a temporary experiment during the Civil War.<sup>4</sup> The Internal Revenue Code (IRC) which governs the collection of internal taxes in the U.S., has been overhauled about every thirty years, with successive versions released in 1922, 1954, and 1986. The 1986 reform is particularly notable because it was accomplished under a Republican president and a Democratic Congress, showing that tax reform is a priority that can cross party lines. The goal, in the words of President Ronald Reagan, was to reform the Code “for the sake of fairness, simplicity, and growth.”<sup>5</sup> The reform was successful because it combined the closing of many tax loopholes (a Democratic priority) with a reduction in tax rates (a Republican priority), so members of both parties got something they wanted. Across the Pacific Ocean, New Zealand also reformed its tax code in the 1980s. The Kiwis managed to cut rates across the board for both companies and individuals, and they did it by eliminating the vast majority of incentives in their tax code. One opposition parliamentarian drew a key lesson from this:

A key reason [for the reform’s success] was that we did it big. They changed almost everything at once. And that’s an important lesson: if you’re going to do tax reform, you’d

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<sup>3</sup> U.S. Const. art. I, § 9, cl. 7

<sup>4</sup>“Lincoln Imposes First Federal Income Tax,” History.com, accessed April 20, 2018.

The Revenue Act of 1861 imposed a 3% tax on all income over \$800 (about \$21,000 today), but Congress repealed it in 1871

<sup>5</sup> Ronald Reagan, “Address to the Nation on Tax Reform” (address, May 28, 1985).

better make it a large reform. That way, for every change a taxpayer does not like, there's something else in the package that he wants.<sup>6</sup>

Today New Zealand has the lowest tax rates for average workers of any developed nation and prospers enough to have a place in the Organization for Economic Cooperation and Development (OECD), an influential organization of the world's richest developed democracies.<sup>7</sup> Not incidentally, the reforms removed New Zealand's mortgage interest deduction.<sup>8</sup>

New Zealand has been successful in tax reform because it has followed the OECD's blueprint for an effective tax system. This idea is called Broad Base, Low Rate (BBLR). Tax systems are distinguished both by their rates, or the portion of one's income, sales, or property that the government collects in taxes, and by their base, or how much of one's income, sales, or property is available for taxation in the first place. Every incentive added to the tax system is a reduction in the tax base because it means fewer things in the economy can be taxed. Bases and rates have an inverse correlation so any reduction in the base from an incentive means that average rates have to go up in order for the government to receive the same amount of revenue. The problem with a narrower base, higher rate system, besides the fact that it adds complexity to the tax code, is that it can distort citizens' behavior; citizens in this sort of system might choose to take out a mortgage, donate to a charity, or buy an electric car not because it is the best overall choice for them, but because it will get them a tax write-off. The OECD understands this and has published a 160-page report titled *Choosing a Broad Base-Low Rate*

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<sup>6</sup> T.R. Reid, *A Fine Mess: A Global Quest for a Simpler, Fairer, and More Efficient Tax System* (New York, NY: Penguin Press, 2017), 62.

<sup>7</sup> Reid, 63, 59.

<sup>8</sup> Reid, 62.

*Approach to Taxation*. “In general,” this report states, “tax reforms that broaden tax bases and lower rates should reduce the extent to which tax systems distort work, investment and consumption decisions, increasing output and enabling improvements in social welfare.”<sup>9</sup>

### **History of the Mortgage Interest Deduction**

The mortgage interest deduction has been around, in some form, for as long as the income tax itself. While mortgages were not widespread at the time of the first income tax, that tax code included a blanket deduction for all interest on any sort of loan, including mortgages.<sup>10</sup> At first the tax was aimed only at the very rich – it excluded the first \$3,000 of income, which at the time meant only the top 1% of income earners had to pay it.<sup>11</sup> There is little information about the origins of this deduction or the debate over its implementation, but it was not designed to encourage home ownership. It was aimed at the very rich, who obviously did not need a tax incentive to buy homes, and at the time there were very few mortgages in America anyway, even in the middle class as most people either rented or bought their homes with cash.<sup>12</sup> However, things started to become more complicated in the 1920s as consumer credit became popular and people began borrowing money for both personal and business expenses.

Mortgages became more popular in America in the decades after the Second World War. Postwar prosperity, combined with the security provided by organizations like the Federal Housing Administration (FHA) and the Federal National Mortgage Association (FNMA or “Fannie

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<sup>9</sup> Organization for Economic Cooperation and Development, *Choosing a Broad Base -- Low Rate Approach to Taxation* (Paris: OECD, 2010). 9.

<sup>10</sup> Roger Lowenstein, “Who Needs the Mortgage-Interest Deduction?” *The New York Times*, March 05, 2006, accessed February 27, 2018.

<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

Mae”), allowed the national homeownership rate to reach 64% by 1963.<sup>13</sup> The FHA insured mortgages, while the FNMA bought mortgage debt from private lenders allowing those lenders to make more mortgage loans. These organizations, not the deduction, were what made America a nation of homeowners, as the government specifically designed them to encourage homeownership.<sup>14</sup> The blanket interest deduction remained until 1986 when Congress replaced it with a specific deduction for mortgage interest. This reform meant citizens could no longer deduct interest on credit card debt or loans for refrigerators, but it could have gone further. Only heavy lobbying from the mortgage industry allowed mortgage interest to remain deductible. The Treasury Department’s initial plan included cutting the deduction, but the National Association of Realtors “hounded” President Reagan until he declared in a 1984 speech to them that he would “preserve that part of the American dream which the home mortgage interest deduction symbolizes.”<sup>15</sup> A year later, Reagan reiterated in an address to the nation on tax reform that “The mortgage interest deduction on your home will be fully retained.”<sup>16</sup> Reagan’s promise held and the deduction did not change until the 2017 tax reforms.

### **The Deduction Today**

Until December 2017 when the deduction was changed by the new tax code, taxpayers could deduct interest on up to \$1 million in acquisition indebtedness and on \$100,000 of home

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<sup>13</sup>William R. Emmons, "The Past, Present and Future of the U.S. Mortgage Market," of St. Louis, July 20, 2016, accessed April 23, 2018,

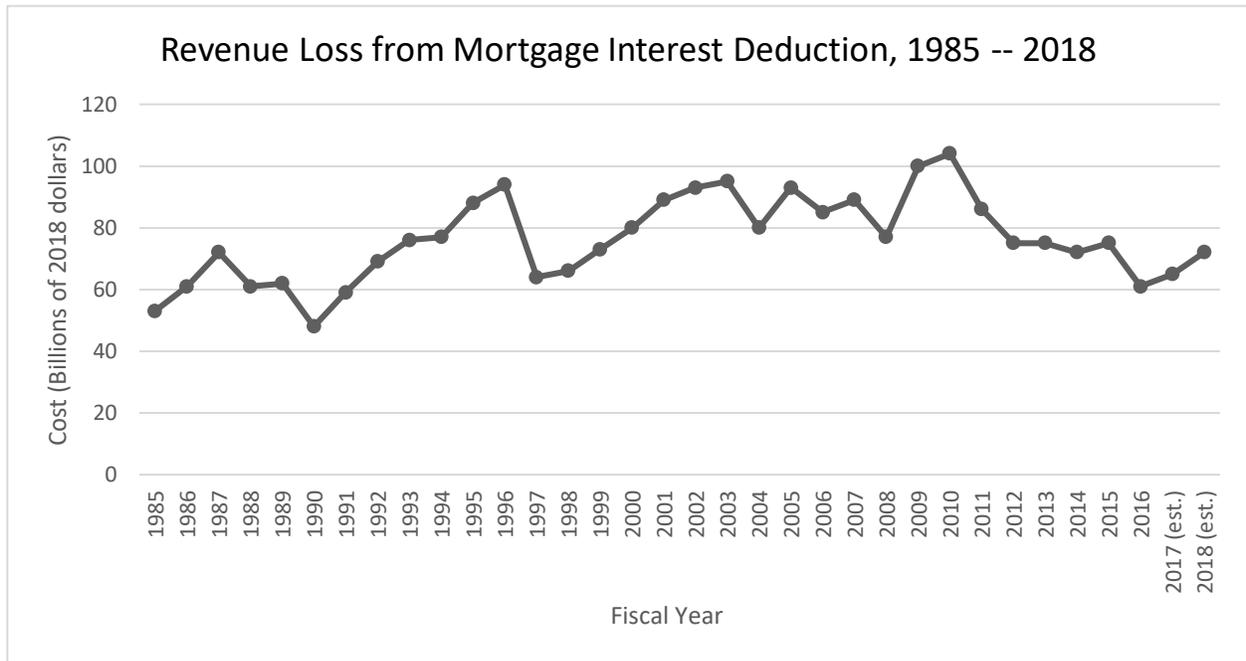
<sup>14</sup> Dennis J. Ventry, Jr., "The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest," *Law and Contemporary Problems* 73 (Winter 2010): 246-247.

<sup>15</sup> Jeffrey H. Birnbaum and Alan S. Murray, *Showdown at Gucci Gulch: Lawmakers, Lobbyists and the Unlikely Triumph of Tax Reform* (Westminster, MD: Random House Inc., 1987), 56-57.

<sup>16</sup> *Ibid.*

equity debt (loans for any purpose, secured by a home). In its current form, the mortgage interest deduction appears in Section 163 of the Internal Revenue Code and allows taxpayers to deduct interest on up to \$750,000 of “acquisition indebtedness” -- that is, debt secured by a first and/or second home, for the purpose of buying or improving a home. The cost of the mortgage interest deduction is quite substantial, as the following graph of data from the U.S.

Senate Joint Committee on Taxation shows:



The cost has fluctuated over time, rising in 2010 to over \$100 billion which was “more than the budgets of the departments of Agriculture, Commerce, Energy, the Interior, and the Treasury combined.”<sup>17</sup> This monetary cost might be worth it if the deduction produced positive externalities such as increased rates of homeownership, but overall most of its effects are negative. A review of relevant literature shows that the deduction hurts the economy by

<sup>17</sup> T.R. Reid, *A Fine Mess: A Global Quest for a Simpler, Fairer, and More Efficient Tax System* (New York, NY: Penguin Press, 2017), 89.

destabilizing the job market, reducing housing stock, driving up housing prices, and reducing economic mobility, and hurts society as a whole by not encouraging homeownership, discriminating against minorities and the poor, and encouraging suburban sprawl.

### **Economic Impacts**

The most straightforward arguments against the mortgage interest deduction pertain to its negative effects on the economy. The deduction not only costs the government tens of billions of dollars in lost revenue, but also makes homes more expensive across the country and makes it harder for economic refugees from the declining “Rust Belt” to find new homes in thriving cities.

#### **1. The Deduction and the Housing Market**

The mortgage interest deduction artificially inflates housing prices. Due to an inelastic supply of housing, especially in center-city areas, the market can only respond to increased demand from the deduction by raising prices. According to one 2013 study of the U.S. deduction by the London School of Economics (LSE):

...the MID [mortgage interest deduction] only boosts homeownership attainment of higher income households in less tightly regulated housing markets. In more restrictive places – typically larger coastal cities – an adverse effect exists. The MID is an ineffective policy to promote homeownership and improve social welfare.<sup>18</sup>

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<sup>18</sup> Christian A. L. Hilber and Tracy M. Turner, "The Mortgage Interest Deduction and its Impact on Homeownership Decisions," *Review of Economics and Statistics* 96, no. 4, April 10, 2013, abstract, accessed February 26, 2018.

The LSE goes on to point out that these market results drive away the very sort of people who should logically benefit from a home ownership incentive. The idea of an incentive, the article says, should be to help people who would otherwise be stuck renting become owners so they can generate positive externalities in their cities. However, because the deduction makes housing more expensive and the market less predictable it drives away short-term buyers, poorer potential buyers who cannot afford the down payments, and residents who are generally risk averse.<sup>19</sup> These are the sort of quiet, reliable people who would generate many of the community benefits of homeownership in urban areas, but the deduction in its current form drives them away from center cities to the suburbs where the positive externalities from additional homeowners are less pronounced. There were approximately 115 million households in the U.S. in 2010 according to the Census Bureau; the LSE concluded that every year the deduction generates approximately 1.95 million new households who are more likely to own than rent; and in 2011 the deduction cost the U.S. government over \$100 billion according to the Office of Management and Budget.<sup>20</sup> The cost to the U.S. government of subsidizing these new homeowners in their suburban habitats is thus a “staggering” \$28,397 per new homeowner, per year, and if Congress eliminated the deduction the cost of homes across America would drop by 2-13%<sup>21</sup>. While the whole point of the deduction, as its advocates

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<sup>19</sup> Christian A. L. Hilber and Tracy M. Turner, "The Mortgage Interest Deduction and its Impact on Homeownership Decisions," *Review of Economics and Statistics* 96, no. 4, April 10, 2013, 6-7, accessed February 26, 2018.

<sup>20</sup> United States, The White House, Office of Management and Budget, *Analytical Perspectives -- Budget of the U.S. Government, Fiscal Year 2011* (Washington, DC: U.S. Government Printing Office, 2010). 210.

<sup>21</sup> Hilber and Turner, 35, 4.

describe it, is to make homes more affordable, the data suggests home sellers have long since capitalized the deduction into home prices, meaning it does not accomplish this goal.

## **2. The Deduction and Economic Mobility**

On a larger scale, the mortgage interest deduction also contributes to economic stagnation in the American heartland. Stagnation and frustration in small towns across the country was a key force that got Donald Trump elected president and addressing it might go a long way toward reducing the political polarization and income inequality that often seems to be tearing American society in two. The LSE study shows that the mortgage interest deduction might be part of this problem. People in areas with few jobs cannot afford to move to areas with more jobs because the deduction has made housing too expensive. The economic and cultural divide between the city and the country is an old problem with many causes, but reforming the mortgage interest deduction could help mitigate it.

### **Social and Environmental Criticisms**

The negative effects of the mortgage interest deduction extend beyond mere economics. While scholars concede that there are many benefits to increasing home ownership, they argue that this deduction is an inefficient way of bringing about those benefits. In fact, they say, in many ways the deduction has a net negative effect on society as it also aggravates inequality, discriminates against minorities, and encourages damaging sprawl.

## 1. The Deduction and Homeownership

Perhaps the most fundamental social criticism of the mortgage interest deduction is that it does not do what people think it should do. Study after study has found that the deduction has a negligible effect on home ownership. The London School of Economics study found in 2013 that while the deduction did encourage some people to move from renting to owning in areas with an elastic supply of housing (that is, suburban areas); it had no effect in inner city areas where the housing supply is inelastic. Another study done in 2003 for the journal *Tax Policy and the Economy* included a graph showing that while subsidies for home ownership have gone up and down over the years, the actual ownership rate has remained constant at around 65% since the 1960s.<sup>22</sup> Evidence from across the world bears this out. New Zealand eliminated the deduction during its 1980s reforms with no ill effects, and a 2005 study by an advisory panel to President George W. Bush found that ownership in the U.S. is the same as in Canada, Australia and the United Kingdom where no deduction exists.<sup>23</sup> The United Kingdom used to have the deduction, until the 1980s when it decided to take action. The government gradually restricted the deduction from 25% of tax liability, to 20%, to 15% and so on until, by 2000, the deduction was completely phased out.<sup>24</sup> Home values were not greatly affected, and the party which presided over the cuts won the next two national elections.<sup>25</sup> The U.K. thus joined the U.S. and New Zealand in reforming its government through tax cuts in the

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<sup>22</sup> Edward L. Glaeser, and Jesse M. Shapiro, "The Benefits of the Home Mortgage Interest Deduction," *Tax Policy and the Economy* 17 (2003): 45.

<sup>23</sup> Roger Lowenstein, "Who Needs the Mortgage-Interest Deduction?" *The New York Times*, March 05, 2006, accessed February 27, 2018.

<sup>24</sup> T.R. Reid, *A Fine Mess: A Global Quest for a Simpler, Fairer, and More Efficient Tax System* (New York, NY: Penguin Press, 2017), 90.

<sup>25</sup> Reid, 90.

1980s. While evidence such as this indicates that the deduction is not integral to homeownership, lobbyists for the real estate sector continue to push the narrative of its importance. The National Association of Realtors spent \$65 million on lobbying activities during 2016, which made it the second largest lobbyist in Washington behind the U.S. Chamber of Commerce.<sup>26</sup> On its website the NAR characterizes any changes to the deduction as “ill-timed and ill advised”, and says emphatically:

NAR opposes any changes that would limit or undermine current law. The MID has been in place as long as there has been an Internal Revenue Code. Its value is capitalized into the price of all houses. Decreasing the value of the MID, even for just a limited group, would hurt all homeowners because of the chilling effect any reduction would cause in the market.<sup>27</sup>

While the NAR is right that the deduction is capitalized into the price of homes, experimental evidence from researchers and historical data from across the world shows that it has played no great part in increasing homeownership, and that it can be cut without destroying the housing market.

## **2. The Deduction and Inequality**

The mortgage interest deduction does not merely fail at doing much good for the housing market; it also does much ill to the nation as a whole by widening the gap between rich

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<sup>26</sup> Geoff West, "Drain the Swamp? Lobbyists are Filling it Up," Center for Responsive Politics, January 26, 2018, accessed February 27, 2018.

<sup>27</sup> "Mortgage Interest Deduction," National Association of Realtors, accessed February 27, 2018.

and poor. In 2000, according to an article in *The Arizona State Law Journal*, over 50% of the deduction's tax relief helped people with incomes of \$100,000 per year or more -- the top 8% of taxpayers.<sup>28</sup> If a family earned \$30,000 per year and bought a \$140,000 house, the article found that the government would subsidize only .75% of its housing costs through the deduction...meanwhile, another family earning \$121,500 and buying a \$550,000 house could get 21% of their costs subsidized. If Bill Gates took out a mortgage on a million-dollar mansion, the article calculated, he would receive \$30,000 in benefits. "The home mortgage interest deduction", the article concluded, "thus constitutes an upside down subsidy—the greater the need, the smaller the subsidy."<sup>29</sup> *The New York Times* found in 2006 that more than 70% of taxpayers, and 50% of homeowners, got no benefit at all from the deduction. In fact, 50% of the benefit went to the top 12% of taxpayers.<sup>30</sup> The story is the same today, especially after the housing crisis. In May 2017 *The New York Times Magazine* published an exhaustive article on how the deduction helps the rich at the expense of the poor. The article's comparison of benefits for different income levels is noteworthy:

In 2014, 1.5 million households earning between \$40,000 and \$50,000 a year claimed the MID, receiving an average benefit of \$14 a month. That same year, 6.5 million households with earnings above \$200,000 claimed the MID and enjoyed an average benefit of \$391 a month. What this means in aggregate is that households with at least

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<sup>28</sup> Roberta F. Mann, "The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction," *The Arizona State Law Journal* 32 (Winter 2000): 5.

<sup>29</sup> *Ibid.*

<sup>30</sup> Roger Lowenstein, "Who Needs the Mortgage-Interest Deduction?" *The New York Times*, March 05, 2006, accessed February 27, 2018.

six-figure incomes receive more than four-fifths of the total value of mortgage interest and property-tax deductions.<sup>31</sup>

Even the more conservative *Wall Street Journal* has pointed out this absurdity of the deduction on several occasions. The new tax law caps the deduction at \$750,000 which the NAR opposes, but the *Journal* pointed out in December 2017 that fewer than 4% of mortgages are over \$750,000.<sup>32</sup> Additionally, in October the *Journal* ran an editorial titled, “The Realtors Take a Tax Hostage”, in which it accused the NAR of “trying to take a central element of reform as a political hostage” and criticized the Association’s “self-serving tax flimflam.”<sup>33</sup> There is nothing wrong with well-off families using their own money to buy expensive houses. However, research like this makes it clear that the deduction is giving wealthier taxpayers a disproportionate break as they seek to upgrade their homes and is not helping the poor who would benefit more from housing assistance. The government is spending enormous amounts of money every year on a regressive subsidy which helps those who do not need help and does not help those who do.

### **3. The Deduction and Racial Discrimination**

The inequality which the mortgage interest deduction fosters hits minorities particularly hard. Across the country, minorities are likely to have lower incomes, invest less, and spend less on homes than whites do. This means the deduction’s benefits are less accessible to them than to

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<sup>31</sup> Matthew Desmond, "How Homeownership Became the Engine of American Inequality," *The New York Times Magazine*, May 09, 2017.

<sup>32</sup> Christina Rexrode, "What the Tax Bill Does to Homeowners," *The Wall Street Journal*, December 19, 2017, accessed February 27, 2018.

<sup>33</sup> The Editorial Board, "The Realtors Take a Tax Hostage," *The Wall Street Journal*, October 17, 2017, accessed February 27, 2018.

whites. Professor Dorothy Brown describes this situation in a masterful 2009 article in the *Washington University Law Review*, titled “Shades of the American Dream.” The article opens with an anecdote from successful black comedian Chris Rock:

In my neighborhood, there are four black people. Hundreds of houses, four black people. Who are these black people? Well, there’s me, Mary J. Blige, Jay-Z and Eddie Murphy. Only black people in the whole neighborhood. . . . Do you know what the white man that lives next door to me does for a living? He’s a . . . dentist!<sup>34</sup>

Rock’s experience is borne out in the data. Professor Brown explains that nationwide, only 48% of blacks and 49% of Latinos were homeowners in 2009, compared to 76% of whites.<sup>35</sup>

Currently there are no deductions allowed in the U.S. for rent, so in this case the majority of whites are receiving an advantage the majority of blacks and Latinos cannot access. Even Asians, who make more money than whites, are less likely to own than whites.<sup>36</sup> Black investors hold more of their wealth in their homes than whites (61% vs. 38%), and are more likely to invest in real estate while whites are more likely to invest in the stock market; so why aren’t they mostly homeowners, Brown asks?<sup>37</sup> The answer is, blacks do not buy houses because they feel they will not or cannot gain much from home ownership under the current system of subsidies. Brown calls this phenomenon the “Ten Drop Rule”; when the proportion of black homeowners in an area surpasses 10%, the value of all homes in the area starts going down.<sup>38</sup>

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<sup>34</sup> Dorothy A. Brown, "Shades of the American Dream," *Washington University Law Review* 87, no. 2 (2000): 330.

<sup>35</sup> Brown, 348.

<sup>36</sup> Brown, 351.

<sup>37</sup> Brown, 350.

<sup>38</sup> Brown, 355.

In 1999, values were going down by up to 40% in the South, and 70% in the Northeast in such situations.<sup>39</sup> More recently, in 2011, a study by the Institute for Assets and Social Policy at Brandeis University found that the gap in ownership rates had actually increased, to 73% for whites compared with 45% for blacks.<sup>40</sup> One of the solutions it suggests is to cap the mortgage interest deduction at 28% of total tax liability for families earning \$250,000 or more per year. “Such a policy could be helpful in reducing the racial wealth gap,” they say, “particularly if the additional tax revenues were used to fund foreclosure prevention programs and first-time homebuyers’ assistance programs, which are more likely to benefit Black and Latino households.”<sup>41</sup> The IASP followed up on this subject in a 2017 joint report with the National Low Income Housing Coalition, and concluded:

While whites are 67 percent of households, they gain about 78 percent of benefits from the MID...while representing about 13 percent of households, blacks and Latinos are estimated to enjoy just 6 and 7 percent of the total MID benefits provided by the federal government. As whites are more likely to be homeowners and more likely to be among the highest income households who benefit from the MID, they disproportionately benefit from the current MID.<sup>42</sup>

The basic problem with the MID in this situation is that it does not help lower-income households become homeowners, because it is only available to people who can afford to

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<sup>39</sup> Nancy A. Denton, “The Role of Residential Segregation in Promoting and Maintaining Inequality in Wealth and Property”, *Indiana Law Review* 34 (2001): 1207-1208.

<sup>40</sup> Laura Sullivan et al., *The Racial Wealth Gap: Why Policy Matters*, report, Institute for Assets and Social Policy, Brandeis University (2011): 1.

<sup>41</sup> Sullivan et al., 15.

<sup>42</sup> Sullivan et al., 7.

itemize their deductions. Across the United States, these people are likely to be overwhelmingly white, and minorities are held back because they cannot afford these incentives. In this case, the mortgage interest deduction is part of a larger problem of racial discrimination in the United States; but reforming it would be a good step toward removing institutional barriers that minorities face. The money the government would save by reforming the deduction, could be invested in subsidies for low-income housing or other programs that could be of more benefit to minorities.

#### **4. The Deduction and Suburban Sprawl**

The mortgage interest deduction is also connected to excessive suburban sprawl, which harms both human society and the natural world. In 1998, the Sierra Club chronicled these effects in a report called "The Dark Side of the American Dream." While the figures may be outdated, the country faces the same basic problems today. From 1970 to 1990, 19 million acres of land were developed in the U.S., at a dizzying rate of 400,000 acres per year.<sup>43</sup> 70% of open land was in the path of development in 1998.<sup>44</sup> Las Vegas gained a new resident every nine minutes from 1990 to 1996, for a total of 238% growth during the period.<sup>45</sup> In the Washington, D.C. metropolitan area, the government was losing \$1,700 for every new house constructed, despite having the highest property taxes in Virginia, as spending on city services for every new house exceeded the property tax revenue the house generated.<sup>46</sup> In Minneapolis,

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<sup>43</sup> "Sprawl: The Dark Side of the American Dream." Sierra Club. 1998. Accessed February 28, 2018.

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid.*

<sup>46</sup> *Ibid.*

water and sewage systems to new outlying areas were estimated to cost \$3.1 billion by 2020.<sup>47</sup> In the *Arizona State Law Review's* "The (Not so) Little House on the Prairie", the authors quote the Environmental Protection Agency describing sprawl as "one of the greatest threats to quality of life", and point out that it increases commutes, consumes open space, evicts wildlife and pushes the middle class out of the inner cities.<sup>48</sup> This last effect exacerbates the problems previously discussed, as the middle class leaving means center city areas suffer from more crime and segregation. The 2010 London School of Economics study links the deduction solidly to sprawl, as it explains that due to simple economics, the deduction is only effective in areas where the supply of housing is elastic -- that is, in suburban areas where new houses can be built. Finally, on top of everything else, suburban sprawl contributes to increased automobile usage and carbon emissions, accelerating the effects of global climate change. Sprawl may not be discussed as much as other weaknesses of the deduction, but it is no less important and if the deduction is left in place there will be no economic reason for this compulsive development to stop.

### **The Policy Process**

Before seeing what legislators have to say about the mortgage interest deduction it helps to understand the policy process model, as outlined in the textbook *Understanding Public*

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<sup>47</sup> *Ibid.*

<sup>48</sup> Roberta F. Mann, "The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deductions," 32 (Winter 2000): 5.

*Policy.* This model is a description of how the government turns an issue into legislation, and which groups have input in that process.

It begins with agenda setting, the determination of what issues should receive the government's attention.<sup>49</sup> This determination does not always flow directly from the wishes of the people. America is a republic, not a pure democracy, so elected officials are ultimately free to choose what will be on the agenda. In the case of the mortgage interest deduction the problem is that some people want to be homeowners but **cannot** afford mortgage payments; legislators mention that issue frequently.

In the next phase, called policy formulation, the government considers different ideas to solve the problem.<sup>50</sup> This phase, however, is not a closed system where the government considers ideas solely on their own merits. Legislators are accessible to lobbyists and campaign contributors who advocate for solutions that serve their own interests. In this case, the National Association of Realtors is a major contributor. The NAR and other organizations spend this money on all sorts of activities, including official interactions with Congress; campaign contributions; social "schmoozing"; litigation, and grassroots mobilization efforts.<sup>51</sup>

The next phase of the policy process is policy legitimation. In this phase the government actually decides which policy option or options to pursue, the public and lobbyists react to that decision, and the process can start over as a debate over the new way of doing things.<sup>52</sup> The

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<sup>49</sup> Thomas R. Dye, *Understanding Public Policy*, 12th ed. (Upper Saddle River, NJ: Pearson Education, 2008), 32.

<sup>50</sup> Dye, 41.

<sup>51</sup> Dye, 43.

<sup>52</sup> Dye, 46.

history of the mortgage interest deduction since the 1980s illustrates this phase well. President Reagan and Congress yielded to the NAR and enshrined the deduction in the 1986 tax code; the public, scholars, and lobbyists argued back and forth; and then in 2017 Congress compromised and reformed the deduction. A possible reason why the reforms did not eliminate the deduction is that they took place in a mostly united government where there was no major opposition that could have led to true, large-scale compromise. A united government is efficient for passing legislation, but a divided government may produce better, longer-lasting legislation in accordance with the OECD's ideals of compromise.

### **Congressional Discussion of the Mortgage Interest Deduction**

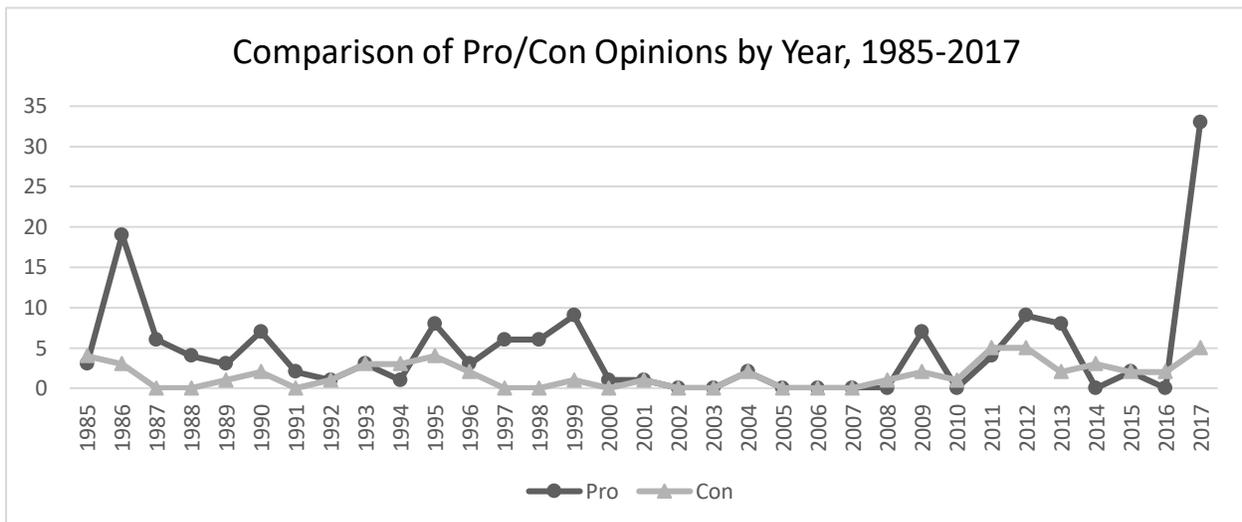
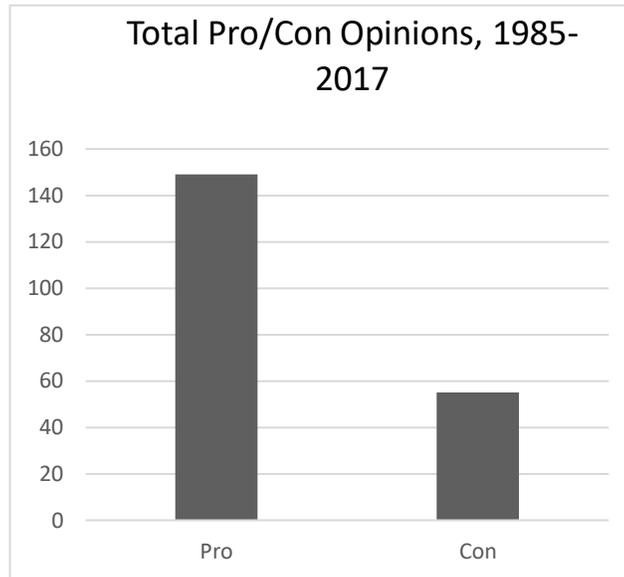
All the scholarly studies in the preceding pages seem to present a compelling set of arguments against the mortgage interest deduction. However, the only group capable of actually changing the tax law, the United States Congress, has ignored these recommendations. The short answer to “what has Congress said about the mortgage interest deduction?” is that representatives and senators on both sides of the aisle have largely ignored the advice of experts since the 1980s and have stubbornly defended the deduction. Their arguments in favor of the deduction have centered on portraying it as a key piece of the American economy, an incentive whose limitation would evict many middle-class families from their homes. Their defense of the deduction can often be linked to the districts they represent -- more expensive housing markets tend to elect legislators who will jealously defend this tax break. While the latest tax reform law shows that Congress has made some progress in coming to its collective senses, the U.S. is still a long way from having sensible tax treatment of home mortgages.

## Research Methodology

The methodology of this study is straightforward. I looked up all 260 times when the phrase “mortgage interest deduction” appeared in the Daily Edition of the U.S. Congressional Record since 1985, categorized in the online database ProQuest Congressional. I then organized the data into a spreadsheet on Microsoft Excel, cataloging the names of representatives who mentioned the deduction; their party affiliation; the state they represented; whether they supported (“Pro”) or opposed (“Con”) the deduction; their reasons for having that opinion, and any notable quotes or recommendations they made. I limited my study to comments that included arguments, and so eliminated times when legislators mentioned the deduction only in a list of things they did not want to change. The study covers the period from 1985 to the present day, because 1986 was the first time the IRC specifically singled out the deduction.

## Research Results

### 1. Comparison of Pro/Con Opinions



The first thing that stands out when looking at these charts is that a considerable majority of legislators from 1985 to 2017 have supported the mortgage interest deduction.

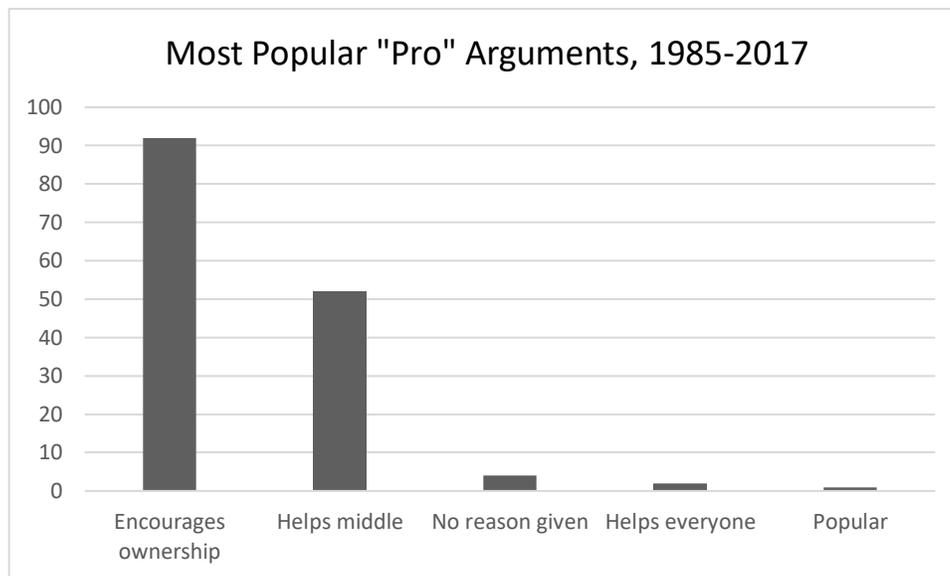
There are 273 total instances where the phrase “mortgage interest deduction” appears in the Congressional Record Daily Edition for that time period, and of those 273 instances, 204 are defenses or attacks accompanied by arguments. Of those mentions, 149, or 73%, are positive and 55, or 27%, are negative. The year-by-year graph gives further information that reinforces these initial observations. During most of that time, members of Congress expressed more positive opinions of the deduction in a given year than they did negative ones.

The six observable exceptions came in 1985, 1994, 2008, 2010, 2014, and 2016. In 1985, Congress debated the 1986 tax reform bill, which limited personal interest deductions to mortgages. The National Association of Realtors relentlessly lobbied President Reagan until he promised them that he would keep their deduction. The next exception to the trend, in 1994, might be connected to the 1994 midterm elections which saw the Democrats lose their majority in the House for the first time in four years. In such a realigning election, it makes sense that the new Congress would question existing controversial policies. Interestingly, however, from 1994 until the mid-2000s there was a decrease in annual mentions of the deduction. This might be linked to the historically strong housing market which existed from the 1990s until the Great Recession; Logically, when homeowners were benefiting from the boom, legislators saw little reason to question the deduction. The recession may have briefly prompted more negative discussion of the deduction, but the overall opinion quickly shifted back to positive.

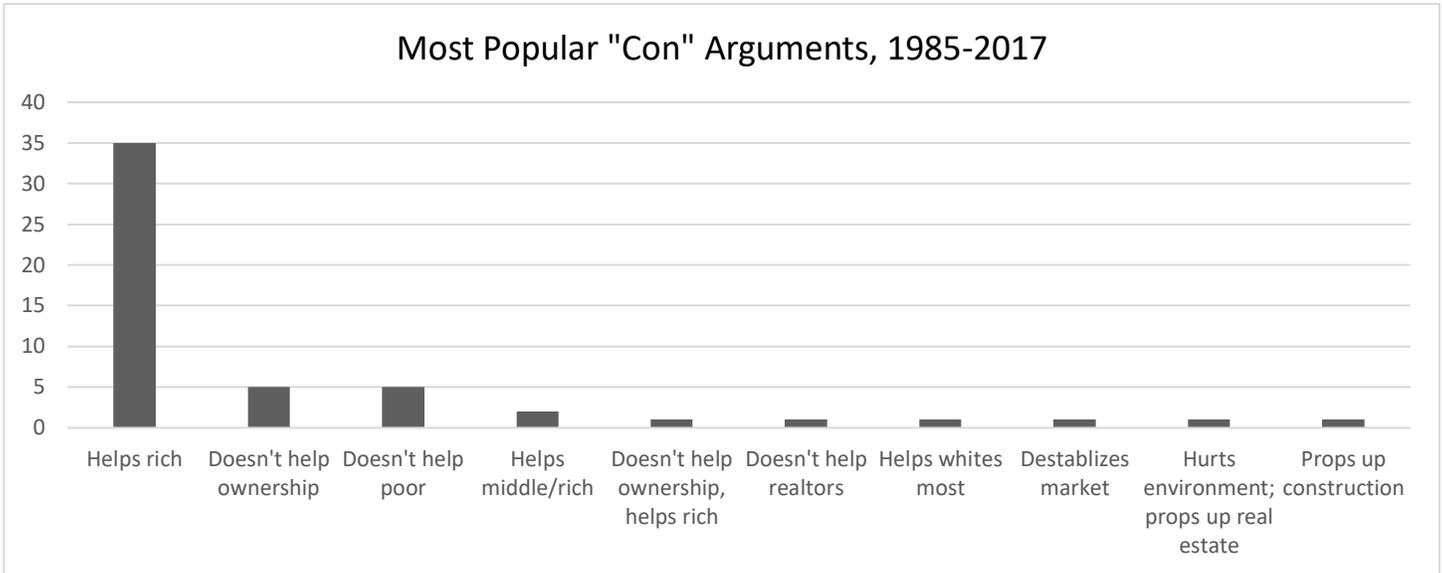
The other times when critiques exceeded complaints, in 2008, 2010, 2014, and 2016, all coincide with elections as well. It also makes sense that in 2008, in the midst of the Great Recession, legislators would be inclined to question the deduction which had helped prop up

the housing market. Many of their arguments for the deduction have assumed home ownership is an unambiguously positive thing. However, housing is not a very reliable sector to build an economy around, and for that reason it has received some of the blame for the Great Recession. As a 2015 article on the deduction in *The New Yorker* put it, "Housing does not have the kind of spillover benefit that you get from investment in other areas....the government has been subsidizing a notoriously manic-depressive sector of the economy."<sup>53</sup> Ultimately, what this graph shows is that while tax reform, elections and economic crises may temporarily lead legislators to question the deduction, opinion has consistently shifted back to supporting it.

## 2. Most Popular "Pro" and "Con" Arguments over Time



<sup>53</sup> James Surowiecki, "The Mortgage Mistake," *The New Yorker*, June 19, 2017, accessed March 29, 2018



A simple survey of how often legislators have discussed the deduction is useful, but it does not tell the whole story. To gain additional insights, it is important to examine arguments defenders and critics have used to support their opinions over the years. These charts give some visual answers to that question. Two things are immediately apparent: first, that the “pro” side uses fewer separate arguments than the “con” side; and second, that the vast majority of “pro” arguments claim the deduction either encourages homeownership or helps the middle class, while the majority of “con” arguments claim it favors the rich over the poor. In the 1980s and 1990s, arguments for retaining the deduction portrayed it in optimistic, aspirational terms, claiming it was the reason many Americans were able to become homeowners for the first time. Out of 84 positive comments on the deduction between 1985 and 2000, 76 argued that the deduction helped increase homeownership. An excellent example of this argument occurred in 1991, when Representative Marge Roukema (R-NJ) delivered a full-throated defense of the deduction she feared would be cut in budget negotiations. She described it as “a cornerstone of the Nation’s housing policy” and warned it was about to be

“violated on the altar of budget summitry.”<sup>54</sup> A few years later in 1998, Representative Neil Abercrombie (D-HI) said he proudly stood by the Hawaii Association of Realtors which said the deduction was “fundamental to the American dream of homeownership.”<sup>55</sup> The changes Roukema, Abercrombie, and their comrades feared would not come to pass until 2017, but they evidently believed the deduction was very important to their constituents, or that donations from realtor’s lobbies were crucial to their campaigns. Roukema and Abercrombie received \$207,000 and \$307,000 in campaign contributions from these lobbies over their respective careers; and the National Association of Realtors has contributed a total of \$3 million to Congressional candidates in the 2018 election cycle which is 48 times the amount individuals have contributed to these campaigns.<sup>56</sup>

Starting in the 2000s and continuing today, the defenders of the deduction have changed their main argument slightly. Their argument has shifted to focus on how the deduction helps the middle class and protects their home investments. This is a more “defensive” view of the deduction, treating it as something which protects homeownership rather than expanding it. 42 of the 66 positive mentions of the deduction between 2000 and 2017, used “helps the middle class” as their primary argument. Senator Orrin Hatch (R-UT) has said cutting the deduction “reduces the value of millions of homes”<sup>57</sup>; his colleague Michelle Bachmann (R-MN) has claimed cuts “will hurt people who have already made thirty years’

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<sup>54</sup> 137 Cong Rec E 71

<sup>55</sup> 144 Cong Rec H 2298

<sup>56</sup> "Rep. Marge Roukema -- Campaign Finance Summary", "Rep. Neil Abercrombie -- Campaign Finance Summary", and "National Assn of Realtors: Total Contributions", Center for Responsive Politics, accessed March 30, 2018.

<sup>57</sup> 155 Cong Rec S 2995

worth of planning on their finances”<sup>58</sup>, and during the most recent reform debate, Representative Michael Thompson (D-CA) rhetorically asked voters: “Do you own a home? If you do, you will pay more when [the Republicans] limit the mortgage interest deduction.”<sup>59</sup>

The opposition to the deduction in Congress, meanwhile, has centered on three main arguments. The first and most popular argument, is that the deduction helps the rich and not the poor. As Senator Steven Symms (R-ID) put it in 1985:

The explicit purpose of the [mortgage interest] deduction is to help Americans purchase homes. Yet the low-income tenant, who pays little or no income tax, has no such incentive—so he must pay a higher after-tax price than higher-income citizens buying exactly the same property.<sup>60</sup>

Simms went on to call this situation an “inequity” and encouraged the Reagan administration to establish an equivalent subsidy for low income citizens, perhaps through the sale of public housing projects in the inner cities.<sup>61</sup> While he did not call for the elimination of the mortgage interest deduction, his argument pointed out several flaws in it which still exist today. In 1994, Representative Major Owens (D-NY) criticized it and other itemized housing deductions for not helping the right people:

While these tax deductions have helped millions of higher income Americans achieve financial stability, they represent too high a proportion of Federal housing expenditures.

For every dollar the Federal Government spends to provide housing assistance to a low-

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<sup>58</sup> 155 Cong Rec H 3426

<sup>59</sup> 163 Cong Rec H 9365

<sup>60</sup> 131 Cong Rec S 1290

<sup>61</sup> *Ibid.*

income family, a family in the top fifth of the income distribution receives \$3 in benefits from homeowner deductions, primarily for mortgage interest and property taxes...The sad fact is that this Nation's housing subsidy system is upside down.<sup>62</sup>

Representative Keith Ellison (D-MN) has proposed six separate bills to amend the deduction since 2012 -- three of them specifically propose lowering the upper limit. In 2014 he argued that 80% of the deduction's benefits went to the top-earning 20% of taxpayers.<sup>63</sup> More recently, during the 2017 reform debates Senator Jeff Flake (R-AZ) mentioned in a general litany of complaints about entitlements, that under the then-current rules yacht owners could treat their luxurious boats as "residences" for the purposes of the deduction.<sup>64</sup> Another popular argument against the deduction is that it wastes potential tax revenue because it does not do anything useful. In 1990, Senator Jesse Helms (R-NC) said the deduction "inefficiently shifts resources to the housing stock and away from more valuable investment and savings"<sup>65</sup>; Senator Ernest Hollings (D-SC) described it in 1993 as "consumption oriented spending"<sup>66</sup>; and in 2015 Senator Angus King (I-ME) said, "This is on autopilot...this is a new kind of mandatory spending."<sup>67</sup> The third primary argument against the deduction is that it does not help the poor. Senator Pat Kennedy (D-RI) argued in 2004 that for 10% of the deduction's \$70 billion cost that year, Congress could create \$500 universal savings accounts for every child in America.<sup>68</sup> Senator Keith Ellison -- he of the six proposals to cut the deduction -- has called on three

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<sup>62</sup> 140 Cong Rec E 2272

<sup>63</sup> Ellison's proposals are HR6677(2012); HR1213(2013); a proposed amendment to HR4745(2014); HR6492(2016); HR516(2017); and HR948(2017)

<sup>64</sup> 163 Cong Rec S 6464

<sup>65</sup> 136 Cong Rec S 2915

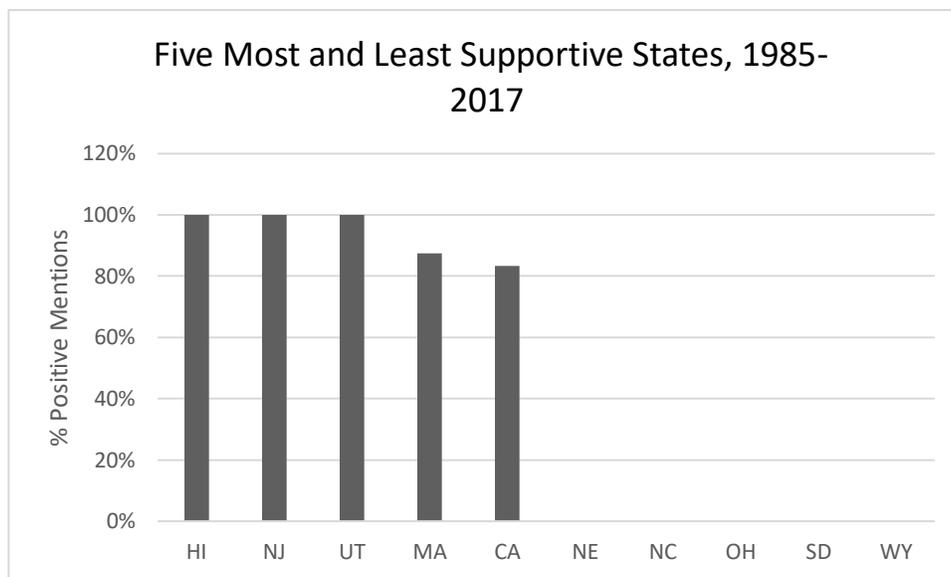
<sup>66</sup> 139 Cong Rec S 14438

<sup>67</sup> 161 Cong Rec S 8739

<sup>68</sup> 150 Cong Rec E 1499

occasions for a refundable credit to replace it.<sup>69</sup> Finally, Representative Sheila Jackson-Lee (D-CA) has suggested Congress use the revenue from the 2017 cuts to the deduction, to invest in rental housing for low income families.<sup>70</sup> All three of these arguments against the deduction -- that it exacerbates inequality; does not increase homeownership, and does not help the poor -- correspond with arguments used by academics to criticize the deduction.

### 3. Congressional Support for the Deduction by State



So where is defense of the deduction geographically concentrated? As the graph above shows, most of the defense seems to come from states like California, Utah, New Jersey, Hawaii, and Massachusetts -- states with some of the highest home prices in the country.<sup>71</sup> One defender of the deduction, Representative Marge Roukema (R-NJ) illustrates this correlation particularly well. In 1990 she claimed any limits to the deduction “will drive young couples out

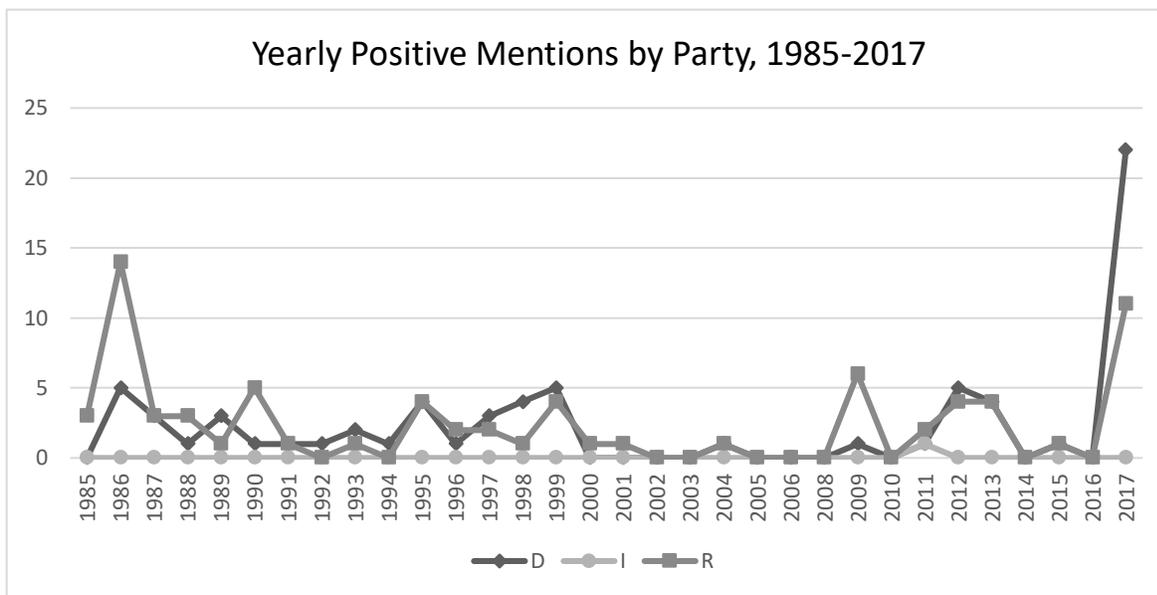
<sup>69</sup> HR6677(2012); HR1213(2013); HR948(2017)

<sup>70</sup> 163 Cong Rec H 9381

<sup>71</sup> "U.S. Home Prices and U.S.A Heat Map," Trulia, accessed March 06, 2018

of the housing market”, and sponsored a bill to permanently protect it from limitation.<sup>72</sup> Her opinions reflected the desires of her constituents; average prices for a three-bedroom home in her district were approximately 350,000 in 1989, according to *Forbes* magazine.<sup>73</sup> It seems likely that Representative Roukema’s defense of the deduction, was an effort to stay popular with voters who were using the deduction more often than the average American. Conversely, states where legislators have exclusively recorded negative opinions of the deduction include North Carolina, Ohio, Nebraska, South Dakota, and Wyoming. These states where housing is less expensive and therefore the deduction would be in less demand, compared to states where it sees more Congressional support.<sup>74</sup>

#### 4. Congressional Support for the Deduction by Party



<sup>72</sup> 136 Cong Rec H 5729

<sup>73</sup> Laura Saunders, "House Hunting? Read this First," *Forbes*, March 1989.

<sup>74</sup> "U.S. Home Prices and U.S.A Heat Map," Trulia, accessed March 06, 2018

The mortgage interest deduction is something rare in Washington: a genuinely bipartisan problem. Overall, Republicans have defended it slightly more often with a total of 75 positive mentions compared to 70 from Democrats, but such a slight difference should not detract from the main theme of the results. This graph shows that neither party has had a long-term monopoly on support for the deduction. One party will support it more for a few years at most, before the other party takes the lead again, and then gives it back to the original party. So why does this matter? It matters because it shows that this is truly not a partisan issue. The solution to the problem does not lie in denouncing “socialist liberals” or “greedy conservatives”. Instead, members of both parties are prioritizing lobbying contributions and the desires of their constituents over the best interests of the country. They are hearing voters in wealthy neighborhoods voice concern about protecting their home prices, and extrapolating these local issues into national policy to protect a tax provision that does much more harm than good across the country.

### **Recipes for Reform**

Think tanks, government offices, magazines, and newspapers of all political leanings have offered their own solutions to fix the mortgage interest deduction. One of the most prolific is the Tax Policy Center, part of the well-known Brookings Institution. In 2015, Brookings researchers examined three different proposed replacements: a 15% nonrefundable credit, a reduction of the acquisition indebtedness ceiling to \$500,000, and a combination of both of these options. All of these plans, they concluded, would raise more revenue for the government with little effect on the average taxpayer, but the credit-cap combination would be the most effective, raising \$212.9 billion in new revenue between fiscal years 2016 and 2025

with a tax cut for all taxpayers making less than \$150,000 per year.<sup>75</sup> In November 2017, they offered another option: replacing the deduction with a \$10,000 refundable credit for 2 million first time homebuyers, at a cost of \$20 billion.<sup>76</sup> This option would still be expensive, but it would balance the benefits of the deduction. In 2017, according to the TPC, a whopping 75% of taxpayers using the deduction belonged to the top 20% of taxable incomes.<sup>77</sup>

The idea for a credit is shared by the Congressional Budget Office, a nonpartisan group that analyzes Congress' budget proposals and tax plans. In 2013, the CBO pointed out that a 15% credit, capped at \$500,000 could be phased in gradually over six years.<sup>78</sup> This would reform the policy, spreading its benefits more evenly across the population and removing the incentive for taxpayers to buy bigger homes than they otherwise might, while safeguarding current homeowners from sudden drops in their home values. However, the CBO concedes, changing the deduction would not be without its ill effects. Any ill-timed changes could play havoc with the housing industry, as many homeowners who use the deduction secure home loans under the assumption they will be able to continue using it for the foreseeable future. Phasing in any reforms over an extended period, the CBO concludes, would alleviate these problems, but it would be important to watch out for economic crises that could disrupt the rollout. However, despite these caveats this nonpartisan government group still recommends cuts to the deduction.

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<sup>75</sup> Chenxi Lu, "Options to Reform the Deduction for Home Mortgage Interest," Tax Policy Center, December 8, 2015, 1, accessed March 6, 2018.

<sup>76</sup> William G. Hale, "Gutting the Mortgage Interest Deduction," Tax Policy Center, November 06, 2017, accessed March 06, 2018

<sup>77</sup> *Ibid.*

<sup>78</sup> "Convert the Mortgage Interest Deduction to a 15 Percent Tax Credit," Congressional Budget Office, November 13, 2013, accessed March 6, 2018

The idea of reform also crosses ideological lines. Alan D. Viard of the right-leaning American Enterprise Institute writes in an article for the Brookings Institution that the deduction “cries out for reform” and “does little to promote homeownership by those of more modest means.”<sup>79</sup> He proposes a 15% refundable credit capped at \$300,000 in acquisition indebtedness on a first home, phased in over six years, which could raise as much as \$300 billion in new revenue even while slowly phasing out the current policy for current mortgage holders. *The National Review* goes even further, by recommending the deduction be removed entirely over five years, without any replacement -- an idea shared by the libertarian Cato Institute.<sup>80</sup> Finally, *The Atlantic* describes the deduction as “one part of the tax code which is almost universally excoriated by economists” and endorses a simple \$500,000 cap, which would only affect about 6% of households.<sup>81</sup> University of Pennsylvania professor Todd Sinai, the author of this proposal, says “It’s about as innocuous a limitation as you can do, it only affects a couple percent of households, and they are the households that can buy expensive houses.”<sup>82</sup> While all these proposals differ in precise details, they do share general ideas of capping the deduction and/or converting it to a credit. Most seem to recommend the credit, which would make the measure more equitable by allowing taxpayers of all income levels to deduct the same proportional amount of their interest payments.

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<sup>79</sup> Alan D. Viard, "Replacing the Home Mortgage Interest Deduction," The Brookings Institution, July 28, 2016, accessed March 06, 2018.

<sup>80</sup> Kevin D. Williamson, "Elections Have Tax Consequences," *National Review*, January 30, 2017, accessed March 06, 2018

<sup>81</sup> Derek Thompson, "The Shame of the Mortgage-Interest Deduction," *The Atlantic*, May 14, 2017, accessed March 06, 2018; Mark A. Calabria, "Now Is the Time to End the Mortgage Interest Deduction," Cato Institute, April 15, 2010, accessed March 06, 2018

<sup>82</sup> *Ibid.*

## The Latest News

Last year's tax reform effort successfully eliminated the deductibility of home equity loans and reduced the cap on acquisition indebtedness from \$1,000,000 to \$750,000. By removing the home equity portion of the deduction, these new standards limit homeowners' ability to use their homes as "cash cows" to fund loans unrelated to home improvement. These are the first significant changes to the deduction, since its inception in 1986. Only 14.4% of homes in the U.S. are now worth enough for the deduction to be useful to their owners, compared to 44% before the reforms.<sup>83</sup> The reforms also doubled the standard deduction, making the itemized mortgage deduction even less useful for many Americans.<sup>84</sup> The changes have prompted stern criticism from real estate lobbyists -- the California Association of Realtors has said the new measure "punishes homeowners and weakens homeownership, and in fact, it looks at homeowners and the housing market as nothing more than a piggy bank."<sup>85</sup> However, many newspapers, magazines, and academic journals support the direction Congress is taking. The current reform was a compromise between two plans, one from the House of Representatives and the other from the Senate. The House plan called for a \$500,000 cap on the deduction, while the Senate plan left it unchanged.<sup>86</sup> Since the reforms are very recent there is little concrete evidence of their effects on the economy, but predictions as of December were optimistic. *The Los Angeles Times* has surveyed industry analysts and concludes

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<sup>83</sup> Svenja Gudell, "Tax Reform With \$750k Cap on Mortgage Interest Deduction Would Leave 1 in 7 U.S. Homes Eligible," *Forbes*, December 18, 2017, accessed March 06, 2018

<sup>84</sup> Conor Dougherty, "Homeowners *Have* Had It Good. Too Good, Says the Tax Bill.," *The New York Times*, December 16, 2017, accessed March 06, 2018

<sup>85</sup> *Ibid.*

<sup>86</sup> Kathryn Vesel, "Senate, unlike House, would keep mortgage deduction intact," *CNNMoney*, November 9, 2017, accessed March 06, 2018

that “any ramifications [of the reform] will largely be restricted to well-to-do neighborhoods.”<sup>87</sup>

In the words of Christopher Thornberg, a California economist interviewed for the article, “If you are borrowing a million bucks to get a home, the write-off is not your primary concern.”<sup>88</sup>

Such optimism from California, a state with some of the highest home prices in the country, suggests that the reforms will indeed have a net positive effect, and should encourage policy makers to seek further opportunities to improve U.S. housing policy.

### **Conclusion**

Overall, the costs of the mortgage interest deduction in the U.S. outweigh its benefits. From an economic standpoint it inflates housing prices and hurts economic mobility in the heartland; while from a social standpoint it not only does not increase home ownership rates, but also contributes to income inequality, discriminates against minorities, and is a key source of costly and environmentally damaging suburban sprawl. Unfortunately, politicians are ignoring this scientific data and prioritizing the comforts of a few of their constituents over the well-being of the entire nation. They are prizing their lobbying dollars and constituents over the national welfare. The burden is thus on the people to speak up and campaign for further reforms in this area, if they want to see modern, sensible tax treatment of home ownership. Reforming or eliminating the mortgage interest deduction would be a step towards a fair, simple, broad base, low rate tax system.

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<sup>87</sup> Andrew Khouri, “How GOP Plan Could Affect State’s Home Buyers,” *The Los Angeles Times*, December 20, 2017, accessed March 06, 2018

<sup>88</sup> *Ibid.*

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