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The Role of Subsidies in the Economics of Housing

James R. Barth, Ross Levine, and Moutusi Sau

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> You see, we want everybody in America to own their own home. That's what we want.
>
> — *President George W. Bush, Oct. 15, 2002*
>
> A home is supposed to be our ultimate evidence that in America, hard work pays off, and responsibility is rewarded.
>
> — *President Barack Obama, Aug. 6, 2013*

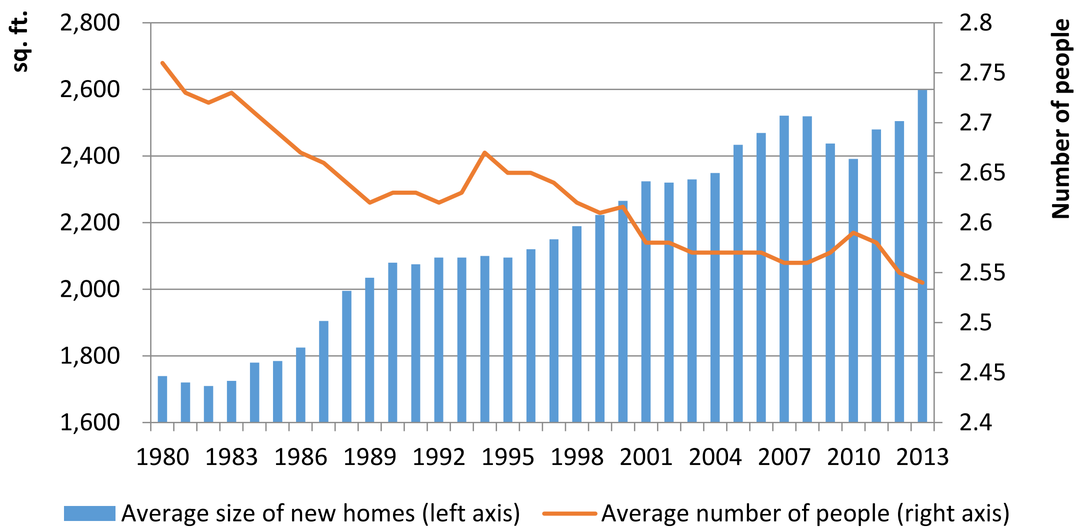
Leaders from across the political spectrum articulate the virtues of homeownership. As expressed in the above quotations, both Republican and Democratic presidents emphasize that homeownership is part of the American dream. Besides the direct benefits accruing to a family owning its own house, proponents stress that higher rates of homeownership boost civic activity, reduce crime, and create communities more conducive to the cognitive and non-cognitive development of children.

Unsurprisingly, bipartisan consensus has produced public policies with the express purpose of increasing homeownership. The U.S. government allows homeowners to deduct mortgage interest payments from income for tax purposes. Furthermore, the U.S. subsidizes the multitrillion-dollar government-sponsored mortgage entities Fannie Mae and Freddie Mac in the hopes of boosting homeownership. Other programs, such as the Federal Home Loan Banks, exist with the stated goal of encouraging homeownership. Of course, some politicians challenge such policies. For example, Sen. Bob Corker (R-Tenn.) has noted that "[B]y subsidizing housing the way we do … we have actually done some pretty perverse things in our society as it relates to housing.…" But neither political party is pushing to dismantle policies designed to support homeownership.

But are these policies subsidizing the building of the American dream for more people, or are they bankrolling bigger dream houses for a few?

Chart 1 shows that the average size of new homes has been trending upward and reached an all-time high, of 2,598 square feet, in 2013. This represents more than a 50 percent increase over the previous three decades. At the same time that the floor area of homes has increased, so too has the ceiling height. Only about one-quarter of new homes built in the 1980s had ceilings higher than eight feet, whereas as of 2013 more than half have ceilings of that height.[1] Yet at the same time that square footage has increased, family size has decreased, also shown in Chart 1. The result is that each person occupying a new home now has access to an additional 563 square feet of livable space.

Chart 1. Bigger Homes, Smaller Households

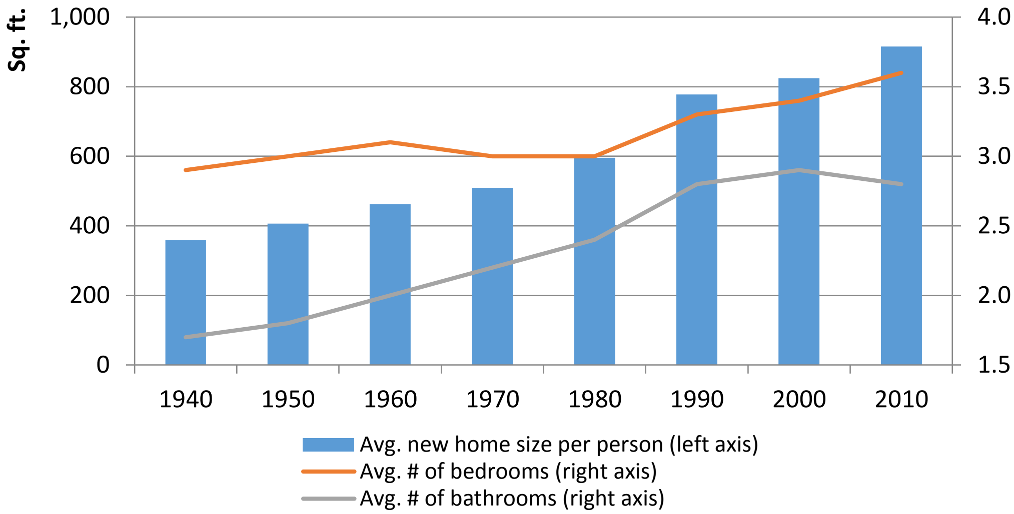


Sources: U.S. Census Bureau, Milken Institute.

Chart 2 shows that the increasing size of new homes per person is not a recent trend. In 1940 each member of a household had 360 square feet of livable space, in contrast to 1,042 square feet in 2013, a nearly threefold increase. Despite fewer people per household, moreover, the average number of bedrooms and bathrooms increased over time, as also shown in Chart 2.

[1] Jo Craven McGinty, "Why Energy Use Won't Go Down," Wall Street Journal, December 13 and 14, 2014.

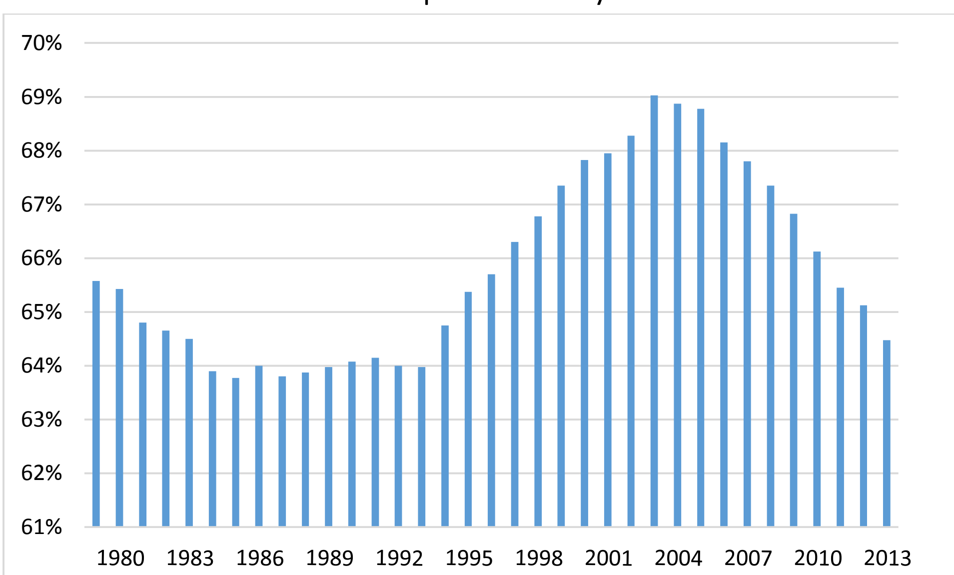
Chart 2. More Bedrooms and Bathrooms, Smaller Households



Sources: U.S. Census Bureau, Milken Institute.

While houses steadily got bigger and the number of bathrooms increased between 1940 and 2013, homeownership did not enjoy such a steady upward trend. Chart 3 shows that the size of new homes and the homeownership rate increased from 1994 to 2004. Thereafter, however, they moved fairly sharply in opposite directions. The homeownership rate reached a high of almost 70 percent in 2004, before reversing course and declining to 65 percent in 2013. In contrast, the size of new homes, aside from a brief, two-year decline, continued its longer-term path upward.

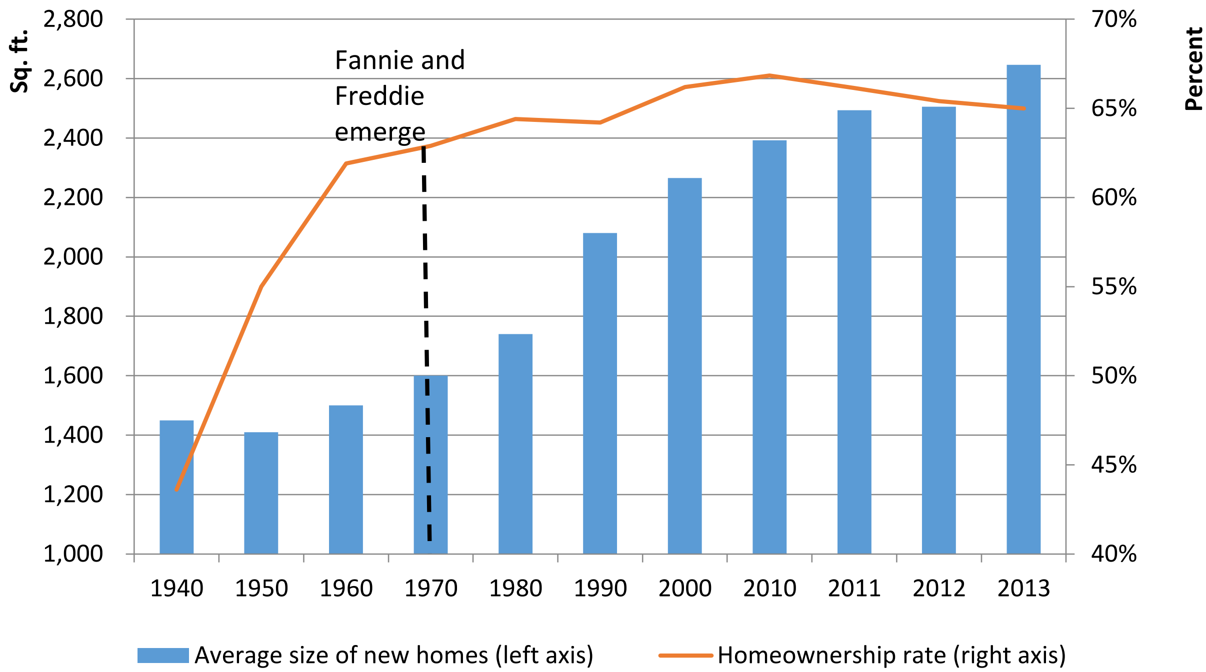
Chart 3: Homeownership rate steadily increased till 2004



Sources: U.S. Census Bureau, Milken Institute.

Given all the attention paid to Fannie Mae and Freddie Mac, the two big government-sponsored enterprises that, after their emergence in 1970, have played such an important role in helping fund the purchase of homes, it is somewhat striking to see in Chart 4 that their emergence and expansion were associated with a rapid increase in the size of homes but not much of an increase in the rate of homeownership. Certainly, this was not their mission.

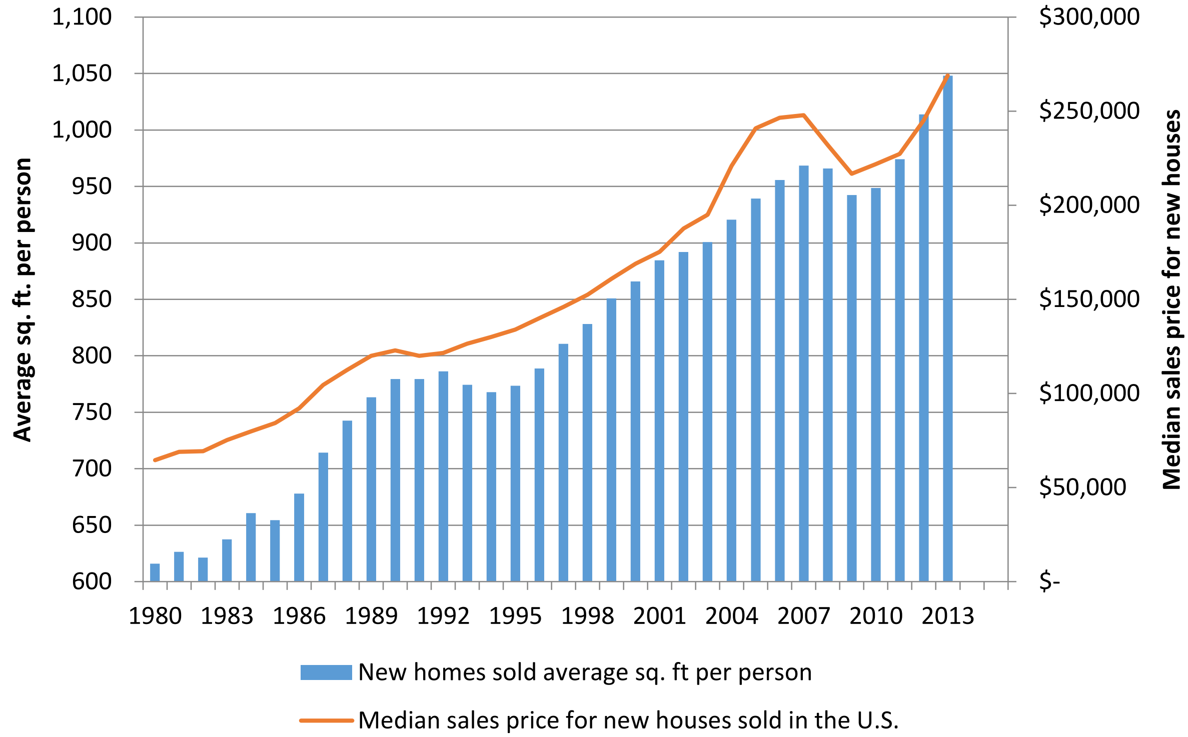
Chart 4. Did Fannie and Freddie Contribute to Homeownership or Simply to Bigger Homes?



Sources: U.S. Census Bureau, Milken Institute.

Chart 5 shows that as the size of homes per person increased, so too did their prices. Clearly, the extra space does not come without a cost. Based on the median sales price and average square footage of a new home in 2013, the price per square foot per person was $257. If the square footage per person were the same as in 1980, the price of the average home would be roughly $110,000 less.

Chart 5. As Homes Grow Larger, Median Prices Rise



Sources: U.S. Census Bureau, Milken Institute.

That the U.S. has devoted enormous resources to subsidizing homeownership is indisputable. Though subject to many assumptions, the average annual subsidy from taxpayers to homeowners over the period from 2015 to 2024 is about $231 billion.[2]

What is in question is the effect of this large and enduring subsidy. As the subsidy grew after 1970 with the emergence and expansion of Fannie Mae and Freddie Mac, the size and price of homes also grew rapidly, but the rate of homeownership did not rise much. Though one might argue that homeownership rates would have fallen without the enormous subsidies, the above graphs suggest that U.S. housing policies have done little to build the American dream for a larger proportion of Americans and more to build bigger dream houses for a few.

[2] Based on assumptions from the Analytical Perspectives, Budget of the United States Government, Fiscal Year 2016, Tax Expenditures.

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