Lecture 16 – Housing

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1 Public policy and housing

1. Tax policy gives incentive to own (income tax).
   (a) Tax policy lowers the user cost of owning relative to renting.
2. Positive question. Why is this the case?
   (a) What factors determine government actions?
      i. Goals of government (i.e. government utility function)
         A. Goals of government are determined by people who run government.
         B. To some degree they act to carry out goals of voters. Tax incentives to owner occupied housing are politically popular because they benefit the middle class at the expense of the poor and the wealthy.
         C. To some degree they act to maximise own utility.
      ii. Beliefs about policy effects.
         A. Government actors and/or voters may believe that policy A has impact X. This belief may or may not be correct.
         B. For example, governments and/or voters may believe that tax incentives to own housing help low income people obtain housing. In the US, this is clearly not true. Tax incentives to owner occupied housing clearly benefit middle class.

C. Governments may believe there is a market imperfection that can be corrected by government intervention or that a policy succeeds in acheiving a desirable redistribution of income.

3. Normative question. Should tax policy give incentive to own?

   (a) Is income tax benefit to ownership good or bad?

   (b) Efficiency. Does such an incentive contribute to economic efficiency? In the absence of market failures, no. If there are market failures, maybe.

      i. The subsidy in favour of owner occupied housing is a subsidy to remain in one place. If positive externalities are created by people remaining in one place (for example, when they remain in one place they may get to know their neighbours and create a network or community that creates positive social benefits.), then this could improve welfare. So, do stable communities create positive externalities? Do they create negative externalities?

   (c) Equity. Does such an incentive result in a desirable redistribution of wealth?

      i. Does this subsidy help the government achieve its goals for wealth distribution? Does it do this at low cost? To answer this we must answer who benefits and who loses from this tax policy, what alternatives are available, and what are the costs of the alternatives.

4. Many other public policies have direct impacts in the housing market.

   (a) Subsidisation of housing demand or housing supply.

   (b) Regulation of housing quality or housing prices.

   (c) Land use controls.

   (d) Policies toward police protection, schools, parks, and other local public services.

2 Housing demand and supply subsidies.

1. Governments often subsidise housing either by subsidising the supply of housing or by subsidising the demand for housing.

   (a) Demand subsidies

      i. Housing benefit

   (b) Supply subsidies

      i. Public provision of housing.

      ii. Public subsidy to private provision of housing.

2. Normative theory of housing demand subsidies: Should the government subsidise housing?

   (a) If goal is to reduce poverty or redistribute wealth, cash transfers are preferable, more efficient

      i. Draw food/housing picture. Higher welfare can be achieved at lower cost with direct cash transfer.

      ii. Consumer maximises $U(c,h)$ subject to $c + p(1-s)h = I$.

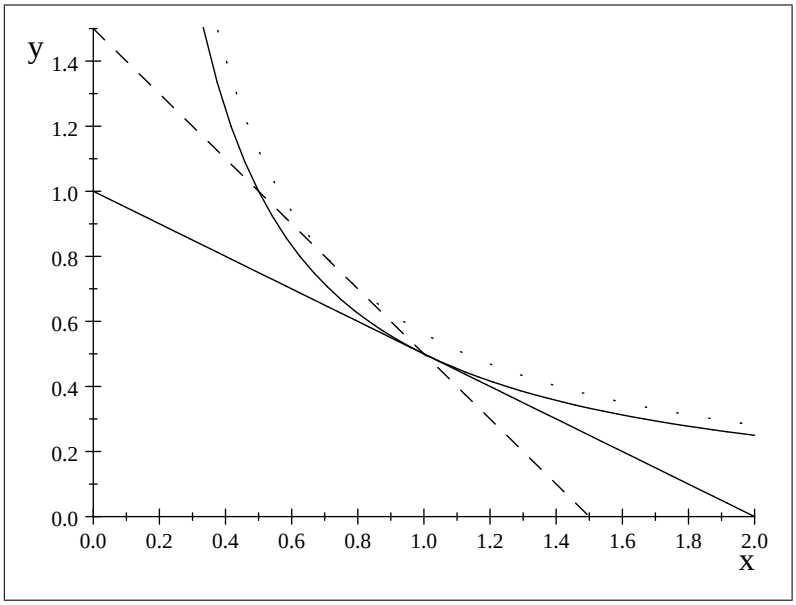
      iii. This is a housing demand subsidy.

      iv. Suppose $I = 1$, $p = 1$, and $s = 0.5$. Further suppose $U(c,h) = c^{0.5}h^{0.5}$. Consumer demand is

$$c = \frac{1}{2}I$$

$$h = \frac{1}{2}\frac{I}{p(1-s)}.$$

      The optimal choice looks like this.



Utility gain from moving to lump sum income transfer

v. The consumer consumes $c = 0.5$, $h = 1.0$. The cost to the government is $s \cdot h = 0.5$. The consumer utility is $v_0 = \left(\frac{1}{2}\right)^{0.5} \cdot 1 = 0.707$.

vi. Suppose instead the government, gave the consumer $m = 0.5$ and set $s = 0$. Then the consumer would choose $c = \frac{1}{2} \cdot (1 + 0.5) = 0.75$ and $h = \frac{1}{2}\frac{1.5}{1} = \frac{3}{4}$. The cost to the government is the same. The utility is $v_1 = \left(\frac{3}{4}\right)^{0.5}\left(\frac{3}{4}\right)^{0.5} = 0.75$. The consumer obtains higher utility at the same cost to the government.

(b) If the government is paternalistic and believes that consumers should consume housing instead of other goods and commodities, then it may be better to subsidise housing.

(c) Lack of housing or consumption of low quantities or qualities of housing may lead to other bad outcomes which have bad social consequences (crime, low productivity). Hence, there may very well be negative externalities caused by low housing consumption.

(d) Consumption of housing by some groups (e.g. low wealth households) may be low because capital-market imperfections prevent them from borrowing against future income. Subsidisation of

housing could potentially improve social welfare to the extent it reduces inefficiencies associated with capital market imperfections. However, housing subsidisation may not be the best method to address these imperfections and could make them worse.

(e) If housing subsidy is tied to a particular place, which it often is, this can inhibit consumer's ability perhaps to move to a new job.

(f) This is true of all benefit programs, but, eligibility restrictions give public housing consumers incentives not to work or not to declare income. If declared income is too high, one does not qualify for public housing and so loses housing benefit. This, in essence is a high marginal tax rate. This is important in the UK and in US.

3. UK housing benefit

(a) In 1997/1998 around 4 million households claimed housing benefit with total payments amounting to £10 billion.

(b) The housing benefit is paid to low income households to assist with the cost of rental housing. The amount paid depends on a maximum benefit, $HB_{\max}$, household income, and "fair market rent" in the location the household lives. Fair market rent, R_{fair}, is determined by local authorities. For every, household the maximum housing benefit, $HB_{\max}$ depends on age and household structure. Part of the schedule defining this maximum is given here.

$$HB_{\max} = \left\{ \begin{array}{cc} \text{Pounds per week} & \text{Criteria} \\ 43.25 & \text{if single and age} < 25 \\ 54.65 & \text{if single and age} \geq 25 \\ 85.75 & \text{if in a couple} \\ +38.50 & \text{if the household has a child} \end{array} \right\}.$$

For each household there is also an income threshhold, I_1. This threshhold depends on the characteristics of the household including household assets. Households with income below the threshhold qualify for the full housing benefit equal to

$$HB = \min\left\{HB_{\max}, R_{fair}\right\}.$$

That is, the full benefit is equal to the minimum of $HB_{\max}$ and R_{fair}. Households with income above the threshold and below I_2 qualify for a housing benefit equal to

$$HB = \min\left\{HB_{\max}, R_{fair}\right\} - 0.65\left(I - I_1\right).$$

Households with income above I_2 do not qualify for any benefit. The complete schedule of the benefit then is

$$HB = \left\{ \begin{array}{cc} \min\left\{HB_{\max}, R_{fair}\right\} & \text{if } I < I_1 \\ \min\left\{HB_{\max}, R_{fair}\right\} - 0.65\left(I - I_1\right) & \text{if } I_1 \leq I < I_2 \\ 0 & \text{if } I \geq I_2 \end{array} \right\}.$$

(c) For incomes above I_1 and below I_2 the benefit is reduced at the rate of 0.65 per additional pound of income. For those with incomes in this range, this, effectively is an additional marginal tax on income of 0.65.

(d) The council tax benefit is similar to the housing benefit. The council tax benefit schedule is

$$CTB = \left\{ \begin{array}{cc} CTB_{\max} & \text{if } I < I_3 \\ CTB_{\max} - 0.20\left(I - I_3\right) & \text{if } I_3 \leq I < I_4 \\ 0 & \text{if } I \geq I_4 \end{array} \right\}.$$

The council tax benefit threshholds are in general different than the housing benefit threshholds. The reduction in council tax benefit from incomes above I_3 is at a rate of 0.2.