

NOTEWORTHY

## Encouraging Homeownership — at What Cost?



As the cover story of this issue of *Region Focus* makes clear, affordable housing is a significant problem for many Americans. There are several reasons for the mismatch between consumer demand on the one hand and market supply on the other. In particular, land-use regulations appear to be an important factor driving up prices in some of the Fifth District's

highest growth regions. Policymakers should consider the costs such regulations impose on society before enacting or expanding these rules.

Reconsideration may also be worthwhile for the dominant policy response to shortages of affordable housing. In general, governments have preferred to subsidize the consumption of housing in various ways rather than to provide cash transfers to support the incomes of those most hurt by high housing costs. But it's not clear that this approach is a particularly efficient means of helping such consumers. It may have induced them to obtain more housing and less of other goods than they would have in the absence of such subsidies. Providing people with cash transfers, in contrast, would be a more direct solution to the problem and would let them choose how best to allocate their resources. It is a well-established economic principle that the provision of cash or cashlike assistance is the most cost-effective way to improve the well-being of low-income households. There is really nothing special or different about housing that suggests that deviation from this principle is warranted.

So if cash transfers would be a more desirable policy response, why do we subsidize housing instead? One reason — associated specifically with *homeownership* — may be the supposed “positive externalities” associated with ownership. Many believe that benefits accrue not just to the homeowners but to the larger community as well. For instance, several studies have suggested that homeowners tend to be more active in their communities, by participating in charitable, social, and political groups at relatively high rates. Others have claimed that homeowners tend to lead healthier, happier lives, thus reducing total public expenditures on medical care. And, finally, some have argued that homeowners generally take better care of housing than do renters, contributing to more pleasant, stable neighborhoods.

The last argument seems consistent with economic theory. We would generally expect owners to maintain things better than people who are just temporary stewards of the

property. And insofar as landlords often have difficulty assessing the character of prospective renters or monitoring their behavior once they have moved in, we might expect that rental properties will receive less care from their occupants.

The other examples of positive externalities discussed above may have causation problems, however. Community activism and personal health could be associated with homeownership but not a result of it. We know that, on average, homeowners tend to be wealthier than renters. But we also know that wealthier people tend to be more active in their communities as well as healthier than those near the bottom of the income distribution. Which factor — homeownership or wealth, or even some other, unobserved factor that is correlated with both of these — is driving higher rates of community activism and health? It's not obvious.

In addition, there may be social costs associated with homeownership, especially for low-income people. Homeownership often makes it more difficult for people to move from one place to another — mobility that might be especially valuable to those in search of better jobs. Renting may make it easier for them to relocate for a position that more closely suits their skills. Also, low-income households have more difficulty weathering sudden drops in income and large unexpected expenditures, which could lead to foreclosure. As William Rohe, Shannon Van Zandt, and George McCarthy of the University of North Carolina's Center for Urban and Regional Studies have noted, “While breaking a lease on a rental unit is problematic, the stress and trauma caused by defaulting on a mortgage is much more serious.”

Overall, then, I think we should be cautious about pursuing policies that aim to increase homeownership. For some people, owning a home is clearly a good decision, which will benefit them and their neighbors. But for other people, renting may make more sense — again, for both the renters and society generally. I don't see a strong reason to tilt the playing field in favor of one choice or the other, especially when the public benefits and costs of encouraging homeownership are so uncertain.

A handwritten signature in black ink, appearing to read 'J. M. Lacker', written in a cursive style.

JEFFREY M. LACKER  
PRESIDENT  
FEDERAL RESERVE BANK OF RICHMOND