William J. McDonough

Opening Remarks

I am delighted to welcome you to the Federal Reserve Bank of New York. Today's conference, "Policies to Promote Affordable Housing," has been organized by this Bank and the Furman Center for Real Estate and Urban Policy of New York University. I would also like to recognize Ronay Menschel's leadership in the development of today's program. Ronay is Chairman of Phipps Houses, a major provider of low- and moderate-income housing, and a member of the Board of Directors of this Bank.

As the title of the conference suggests, today we intend to advance our understanding of the issue of affordable housing: the cost burdens that housing places on low- and moderate-income households, the policies that are designed to lower the cost of housing for these households, and the policies that—in pursuit of some other worthy goal—may have exacerbated the lack of affordable housing. Many of the papers presented today will discuss the issue from a national perspective, but we will also focus on the unique conditions of New York City and the surrounding metropolitan area.

To help set the stage for today's discussion, let me provide a broad overview of what we know about affordable housing, or the lack thereof. We have been involved in this issue for some time through the work of our Office of Regional and Community Affairs, headed by Elizabeth Rodriguez-Jackson, and through past conferences, internal research, and the volunteer activities of our staff.

First, it is noteworthy that the words "housing quality" are not included in the title of this conference. An analysis of longer term trends at the national level, presented at a conference held here in May of 1999, indicated that relatively few housing units in the United States meet the criteria of "severely physically inadequate" or "overcrowded." By this, we mean that, with the growth of the U.S. economy over the post–World War II period, most housing units in the United States are safe and provide the basic comforts of life. Of course, what is deemed to be physically adequate would not necessarily appeal to the people in this room. Housing quality problems have not been completely eliminated, but we have certainly made great strides in this area relative to where we were in 1950.

Again at the national level, housing affordability has improved for the population as a whole over the past decade. The proportion of household income devoted to housing costs increased from the mid-1970s to the mid-1980s, a period of relatively high inflation and high nominal interest rates. It then declined from the mid-1980s through the mid-1990s as inflation and interest rates declined, ending the 1990s at roughly the same level it held in the early 1970s. Indeed, buying a home has become vastly more affordable over the past decade, with the result being that the rate of homeownership climbed to a record 68 percent by the second half of 2001. Because homeownership makes people stakeholders, builds

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wealth, and enhances social cohesion, increasing the homeownership rate has long been a goal of U.S. domestic policy. The rise in the homeownership rate is even more noteworthy in that many of these new homeowners are minorities with moderate incomes.

Nonetheless, for those in the lowest income quintile, housing affordability has not improved over the past decade. For the nation as a whole, housing costs for this group rose from around 40 percent of income in the mid-1970s to around 60 percent by the mid-1980s and have stayed at roughly that level since then. Those who can least afford it must pay what I regard as an unconscionable share of their income for what must surely be basic shelter. It is part of a broader problem that the incomes of these families have risen at rates well below average.

This is not an abstract statistical issue. There is growing evidence that poor housing outcomes are associated with poor outcomes in other aspects of life, such as health, education, and the incidence of crime. As we have seen time and again, the problems of poorer communities very quickly become everyone's problems.

Because the New York area is such an attractive place to live and conduct business, the housing affordability problem here extends much further up the income distribution. Over the period from 1997 through 2001, employment in this area grew at a compound annual rate of 2.1 percent, the fastest growth of any five-year period for which we have reliable data. According to the 2000 census, the population of New York City has surpassed its previous peak, in 1970. But because the area is already so densely populated and new construction is so expensive, even middle-income professionals struggle to pay the rent or the mortgage while still being able to afford life's other necessities. Imagine the difficulties of those on the first rungs of the income ladder.

Our understanding of the appropriate role for government in alleviating the unduly high housing cost burdens faced by low- and moderate-income households has evolved dramatically over the past fifty years. Government construction or financing of high-density housing in general did not work and in some cases produced disastrous results. In the worst cases, such housing was isolated from employment opportunities as well as health and social services. More recently, this housing has begun to be replaced by lower density homes that are developed as part of a broader community plan and that, in many cases, offer ownership opportunities.

While the lessons learned have been hard ones, it is now widely recognized that tax incentives and subsidies can be effective in encouraging economic development, provided they are appropriately structured. At the macro level, we use tax policy to encourage many things, including homeownership, research and development, and historic preservation. Local governments provide tax rebates, build or improve roads, and make other infrastructure investments using bonding authority to make their regions more enticing to companies. Providing tax incentives and subsidies to make housing more affordable and thereby keep communities growing and vibrant is an equally important role for government at all levels. Moreover, it is the right thing to do. Our job is to discover the most effective and efficient designs for these incentives. Today's conference is part of that process.

Now, you might ask why the central bank—the institution charged with setting monetary policy and maintaining financial stability—is involved in this issue. One reason is that it matters to us as people. I have been active in this area for a long time, both in my native Chicago and here in New York. I am a firm believer that disparities in the distribution of wealth and income threaten the social fabric of the United States. It is in every citizen's self-interest to address the inequalities that exist in our society and to strive to eliminate the permanent underclass.

Furthermore, the Federal Reserve is concerned with economic growth in all sectors of the economy. Growth of the national economy is nothing more than the sum total of growth in the nation's numerous local economies. At the Federal Reserve Bank of New York, we work with the private, nonprofit, and government sectors to furnish information about new ideas and models to help address local issues. We bring together key players in neutral forums and act as a catalyst for the exchange of ideas.

Your attendance today is evidence of your commitment, interest, and willingness to help your fellow citizens and improve our local communities. It is my sincere hope that this conference will further advance our understanding of how best to achieve these honorable goals. As you all know well, there is no magic formula. But we must ensure that there is concrete hope and economic opportunity for all in order for our society to prosper. The fundamental strength of our economy offers a unique opportunity to bring disadvantaged people and communities into the social and economic mainstream.