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Policy Considerations on Housing, Wealth, and Inequality

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Abstract

This paper discusses policies on housing from wealth accumulation and wealth distribution perspectives, relying on new evidence and stylized facts from recent Organisation for Economic Co-operation and Development (OECD) research (Causa, Woloszko, and Leite, 2019). A key policy issue is whether and how housing-related policies affect wealth distribution. Another related issue is whether housing-related policies raise potential trade-offs between equity, inequality reduction, and other policy objectives; these other objectives include employment growth, productivity growth, and macroeconomic resilience. Informed by the stylized facts and existing evidence, this paper discusses housing-related policy reforms to promote inclusiveness and social mobility, to enhance efficiency in the allocation of labor and capital, and to strengthen macroeconomic resilience.

Introduction and Motivation

Housing is an important social indicator of development along several dimensions: access to affordable housing for different socioeconomic groups, poverty and deprivation risks, and spatial inequalities such as housing segregation in metropolitan areas. One important dimension less explored in the literature, especially on a cross-country basis, is the distributional implications of housing from a wealth perspective. Recent OECD work (Causa, Woloszko, and Leite, 2019) fills in this gap by delivering new insights on housing and wealth across OECD countries, allowing readers to draw policy implications across a range of policy objectives such as inequality, efficiency, and resilience.

Housing and wealth distribution warrants attention for several reasons. Housing is the largest asset in household portfolios. It is therefore a fundamental driver of the accumulation and the distribution of assets and wealth across the lifecycle and generations, hence contributing to wealth inequality. Assessing housing from a wealth distribution perspective is all the more important in a context where inequality has been rising, the capital share of income has increased relative to labor, and wealth inequality is much higher than income inequality, potentially undermining equality of opportunity and social mobility (OECD, 2018c).

Housing debt is also the largest liability in household portfolios. One of the reasons why housing is a major vehicle of wealth accumulation is because it can be acquired with leverage. Housing-related debt enables households with low income and few assets—such as young households—to accumulate wealth. The benefits of leverage need to be balanced against its risks—one major lesson from the 2008 financial crisis. Assessing housing from a wealth distribution perspective requires looking at housing assets and liabilities, with particular attention focused on the bottom of the income and wealth distributions.

A number of public policies affect the housing market and therefore wealth and its distribution. Such policies intend to repair market failures, pursue broader economic efficiency goals, and promote affordable quality housing for citizens. They include fiscal measures, macroprudential regulations on mortgage markets, the provision of social housing, regulations aimed at influencing rental markets and the quantity and quality of dwellings through land-use policies, urban planning, and the enforcement of competition in related activities (such as construction or real estate).

Promoting homeownership is a policy objective for many governments, whether stated explicitly or not. Public policy tends to favor ownership relative to renting and other investments, typically via the preferential tax treatment of owner-occupied housing (Andrews and Caldera Sánchez, 2011; Salvi del Pero et al., 2016).[1] The main economic argument for favoring homeownership over renting is that it may give rise to positive spillovers for society. For instance, homeownership is a vehicle for wealth accumulation, leads to better outcomes for children, and is associated with more community engagement and voting behavior. Empirical evidence does not consensually support the existence of these channels; a common problem is establishing causality, because correlation between homeownership and a variable of interest may reflect the influence of a third omitted factor and self-selection bias.

[1] Also, the vast majority of OECD countries offer financial assistance to households to support the purchase of a home (Salvi del Pero et al., 2016).

Still, the argument that homeownership provides the most stable tenure arrangement to satisfy basic household needs could justify pursuing higher homeownership as a public policy goal. Yet this policy goal can conflict with other policy goals, such as efficiency, by distorting labor and capital from their most productive use; unemployment reduction by slowing down labor adjustment in a downturn; and social mobility throughout the lifecycle and across generations by discouraging people from relocating and benefiting from new opportunities.

This paper takes stock of empirical evidence in Causa, Woloszko, and Leite (2019) to frame a policy discussion on housing and wealth distribution. Reforms affecting housing wealth and its distribution tend to be unpopular. In this context, this paper attempts to analyze housing from a wealth distribution perspective by taking into account the political economy angle. The discussion focuses on a wide range of policy areas that affect housing and its distribution, such as taxation, housing market regulations, and borrower-based macroprudential policies. These focuses enable us to draw some policy implications of housing-related reforms to promote inclusiveness and social mobility, to enhance efficiency in the allocation of labor and capital, and to strengthen macroeconomic resilience.

Stylized Facts in a Nutshell

The contribution of housing to wealth inequality varies significantly across countries, but the following facts stand out from the data:

- **Wealth inequality is much higher and much more dispersed across countries than income inequality.** On average across OECD countries, the bottom 40 percent of households receive around 20 percent of disposable income but only 3 percent of net wealth. The higher level of wealth compared to income inequality partly reflects lifecycle effects.

- **There is a strong negative cross-country association between homeownership and wealth inequality.** Low homeownership countries exhibit high wealth inequality, even when income inequality is low.

- **Housing tends to equalize the distribution of wealth from a static cross-country perspective.** This finding is because housing is the most important and most widely-owned asset in household balance sheets, representing a much higher source of wealth among middle-class households than at the top.

- **The data do not lend strong support to the argument that housing acts as a vehicle to encourage higher long-term savings.**

Access to mortgage markets enables credit-constrained households to have a better chance of owning their own home, but it entails risks:

- **Housing-related debt is the most important liability in households' portfolios, particularly for young homeowners and homeowners at the bottom of the distribution.** OECD countries exhibit stark variation in the extent to which households hold mortgage debt, ranging from almost 50 percent in the Netherlands to less than 10 percent in Slovenia.

- **Mortgage debt is both an opportunity and a risk.** Although it allows households, especially those with little initial assets, to accumulate wealth, it could expose households, especially those at the bottom of the distribution, to economic and social vulnerabilities.

Informed by the stylized facts delivered in Causa, Woloszko, and Leite (2019) and summarised here, the remainder of this paper discusses policy implications of housing reform to promote inclusiveness and social mobility, to enhance efficiency in the allocation of labor and capital, and to strengthen macroeconomic resilience.

Reforming Property Taxes to Make the Overall Tax System More Progressive and Efficient

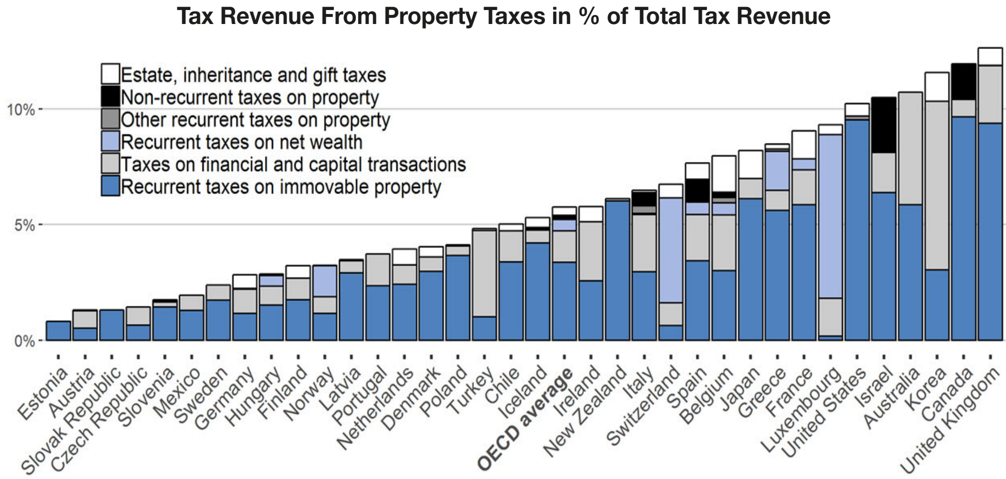
Shifting the Tax Mix Towards Property Taxes

Policy analysts and international organisations have increasingly advocated reforms to shift the tax burden toward property taxes to switch to a more growth- and equity-friendly tax system (for example, OECD, 2019a). The case for shifting towards property taxes is based on vast empirical evidence showing that greater reliance on property taxes boosts growth and tends to reduce or have neutral effects on income inequality. From an efficiency perspective, recurrent taxes on immovable property (such as taxes levied regularly on the ownership of immovable property) have been found to be the least damaging to economic growth, followed by consumption taxes, other property taxes, personal income taxes, and corporate income taxes (Brys et al., 2016, OECD, 2010). Compared with recurrent taxes on immovable property, non-recurrent taxes on immovable property, such as property transaction taxes, can have distortionary effects. For instance, they can discourage the owner of a house from moving to an area with better labor market opportunities. Transaction taxes, however, can have the advantage of discouraging speculative behavior and thereby cooling down house prices. From a distributional perspective, Akgun, Cournéde, and Fournier (2017) have recently found that greater reliance on recurrent taxes on immovable property has no effect on disposable income inequality and that greater reliance on inheritance taxes tends to reduce disposable income inequality.

Despite their growth and equity benefits, OECD countries make little use of property taxes (exhibit 1). Overall, property taxes make up slightly more than 5 percent of tax revenues on average, ranging from less than 2 percent in Estonia, Austria, and the Slovak Republic and Slovenia, to around 10 percent in Korea, Canada, and the United Kingdom. The share of property tax revenues in the OECD average tax mix has declined over time, reflecting the widespread repeal of net wealth taxes, inheritance taxes, and gift taxes and the failure to update property values (OECD, 2018b). All in all, there is scope for shifting the tax burden toward property taxes across the OECD. Such reforms would be particularly relevant in countries where the tax mix is particularly skewed toward income relative to property, as can be seen by comparing the share of tax revenue raised from labor, capital income, social security contributions and payroll to that raised from recurrent taxes on immovable property and on estate, inheritance and gift (exhibit 2).

Exhibit 1

OECD Countries Have Ample Room to Shift the Tax Burden Towards Property Taxes

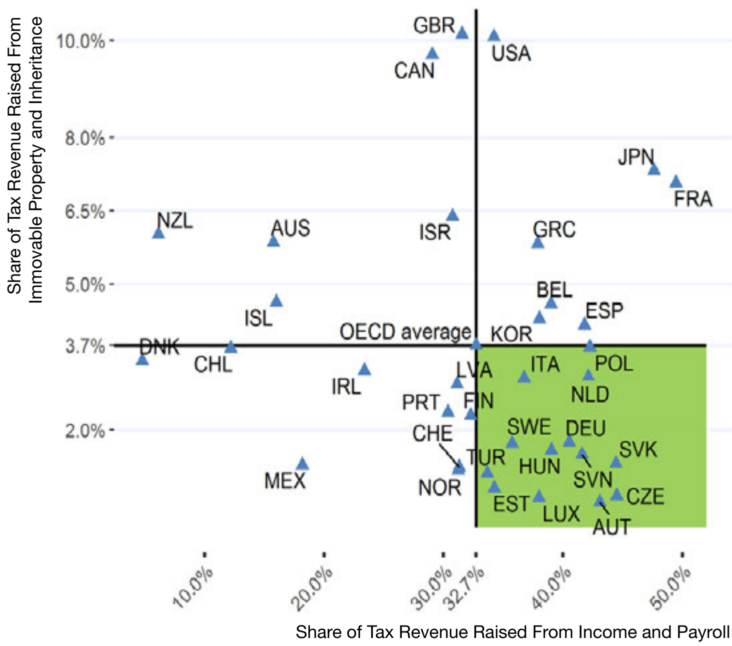


OECD = Organisation for Economic Co-operation and Development.

Source: OECD Tax Revenue Statistics

Exhibit 2

Some Countries Could Move Away from Taxing Income to Taxing Immovable Property and Inheritance



Note: Share of tax revenue raised from labor, capital income, social security contributions, and payroll (categories 1000, 2000, 3000 of OECD Tax revenue statistics); share of tax revenue raised from recurrent taxes on immovable property and on estate, inheritance and gift (categories 4100, 4300 of Organisation for Economic Co-operation and Development [OECD] Tax revenue statistics).

Source: OECD Tax Revenue Statistics

Enhancing the Efficiency and Progressivity of Immovable Property Taxation

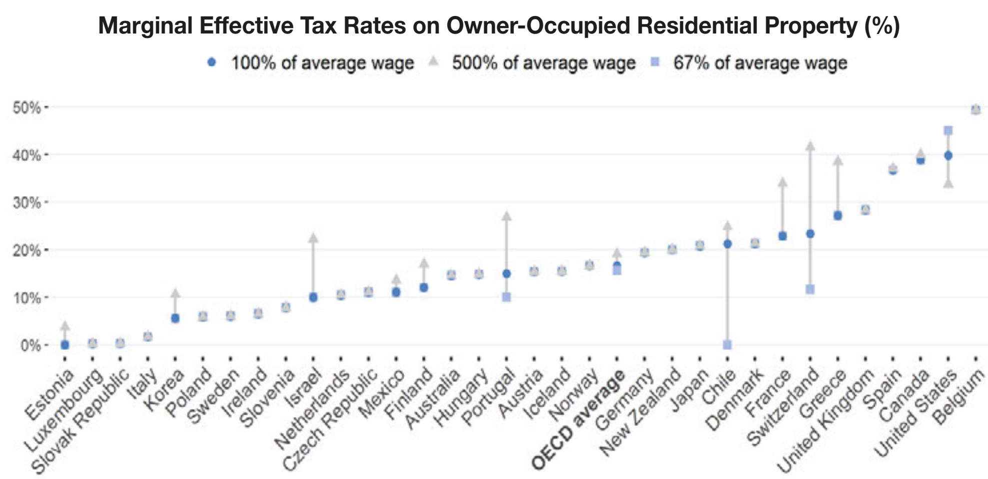
Housing taxation can be made more efficient and progressive. Owner-occupied residential property is highly tax-favored in most countries compared to other forms of household savings, with the exception of retirement plans (OECD, 2018a). This preference is due to the exemption of imputed rent and of capital gains from taxation, whereas mortgage interest is often deductible. This favorable tax treatment of owner-occupier property is economically inefficient by creating several distortions in investment decisions, capital and labor allocation, and excessive leverage (Fatica and Prammer, 2017).

Equity considerations would not justify the favorable tax treatment of owner-occupied property, because it is unlikely to benefit low-income people most. In particular, the literature has shown that mortgage interest rate deductibility has a regressive impact in most cases (Fatica and Prammer, 2017). This finding reflects the fact that high-income households are much more likely to finance their houses with mortgage debt, as documented in this paper (exhibit 3). Another argument against mortgage interest rate deductibility is that generous tax relief can be capitalized in house prices, thereby redistributing income from new entrants in the housing market to insiders (Andrews, Caldera Sánchez, and Johansson, 2011).

The presumption that the favorable tax treatment of owner-occupied housing is regressive or at least flat is confirmed by comprehensive modeling of property taxation. New estimates of marginal effective tax rates on various components of household savings and wealth show that in most countries owner-occupied property taxes are not progressive (OECD, 2018a). This finding is illustrated in exhibit 3, which provides estimated average effective tax rates on owner-occupied housing for three income levels: 67, 100, and 500 percent of the average wage. In most OECD countries, the tax rates are flat across the distribution, and in the United States, they are even higher for low-income households.

Exhibit 3

Owner-Occupied Property Taxes Could be Made More Progressive



Notes: Estimates from Organisation for Economic Co-operation and Development (OECD), 2018a. Marginal effective tax rates on owner-occupied residential property, equity-financed. Personal tax rate: 67, 100, and 500 percent of the average wage (AW). These taxes include recurrent taxes on immovable property, transaction taxes, possible taxes on income, and capital gains taxes, when applicable.

Source: OECD, 2018a

Housing should ideally be taxed in the same way as other assets by taxing imputed rental income while allowing for mortgage interest deductibility. In practice, few countries tax imputed rental income, and using recurrent property taxes as a substitute is most often not sufficient as these taxes are not large enough to offset the mortgage subsidy. In these cases, a "second best" approach is to remove the mortgage subsidy or to scale up recurrent property taxes (OECD, 2010).

Removing or reducing mortgage interest rate deductibility would increase the progressivity of the tax burden on owner-occupied property.[2] This removal should be done gradually to prevent a crash in house prices insofar as mortgage deductions tend to be capitalized in house prices (Andrews, Caldera Sánchez, and Johansson, 2011). If removing mortgage interest rate deductibility is not an option, granting the rebate as a capped tax credit (for example, a capped reduction of the tax liability), rather than a tax allowance (such as, a reduction of the taxable income) is one way to make the tax relief less regressive. A more direct way to achieve progressivity in owner-occupied property taxation is to apply a progressive recurrent tax rate schedule and introduce a tax allowance or income-tested property tax credit. Another approach is to allow deferral of the tax payment until the death of the taxpayer or sale of the property for older taxpayers, but one major drawback in this case is the risk of lock-in effects. OECD countries have used these types of measures to increase the progressivity of their property taxes (Brys et al., 2016)

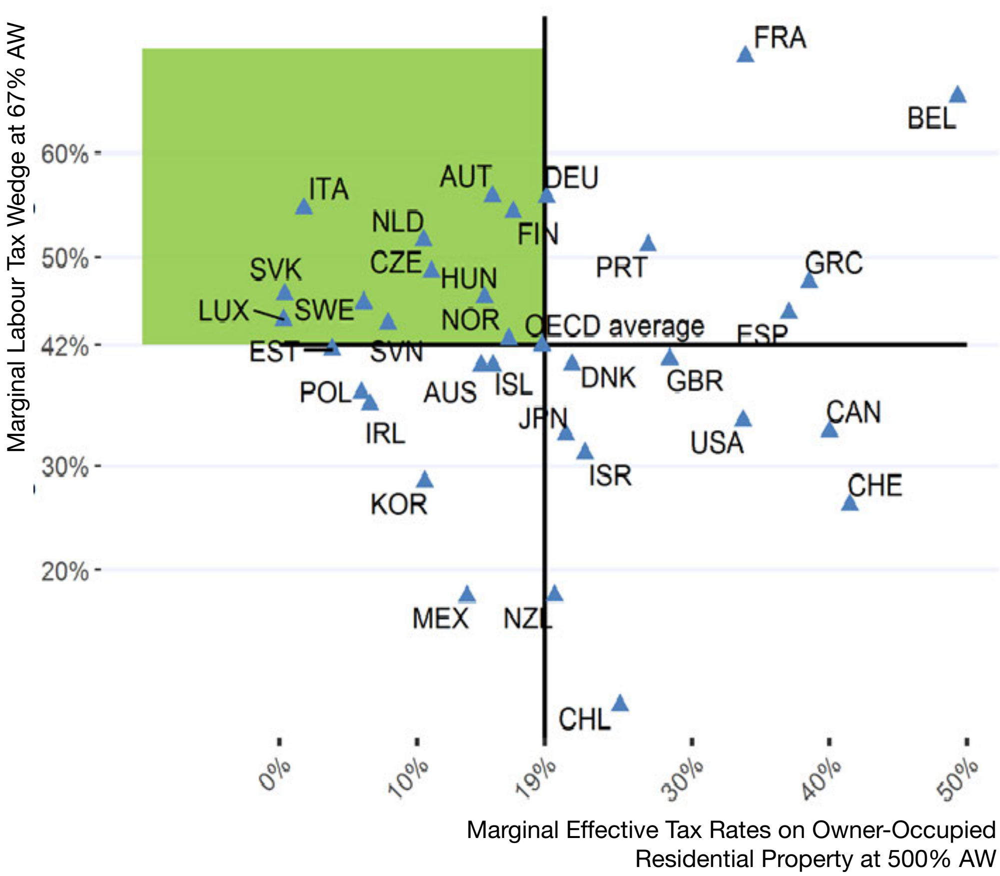
Increases in recurrent taxes on immovable property must be accompanied by regular updating of property values to market values. Denmark recently introduced a property tax reform that includes a new system for housing valuation and replaces a nominal freeze of property taxes with proportional taxation, maintaining a progressive element for the most valuable homes (OECD, 2019c). Reforms in this area can be designed to address liquidity constraints for people with low incomes and non-liquid assets, for instance, by making it possible to spread tax payments throughout the year or by introducing escrow accounts.

Going further, tax reforms to shift from labor to immovable property taxation are likely to enhance tax efficiency, progressivity, and labor market inclusiveness in countries where the taxation of low wages is relatively high and the taxation of owner-occupied property for high-income households is relatively low (exhibit 4). This likelihood implies recurrent taxes on immovable property featuring generous allowances and a progressive tax schedule, especially when homeownership is widespread.

[2] The current low interest environment may strengthen the case for removing mortgage deductibility.

Exhibit 4

Higher Progressivity in the Tax System Could be Achieved by Raising Owner-Occupied Property Taxes at High-Income Levels while Reducing Labor Taxation at Low-Income Levels



AW = average wage

Note: Marginal labor tax wedge is defined as marginal personal income tax and social security contribution rate on gross labor income. Marginal effective tax rates on owner-occupied residential property, equity-financed.

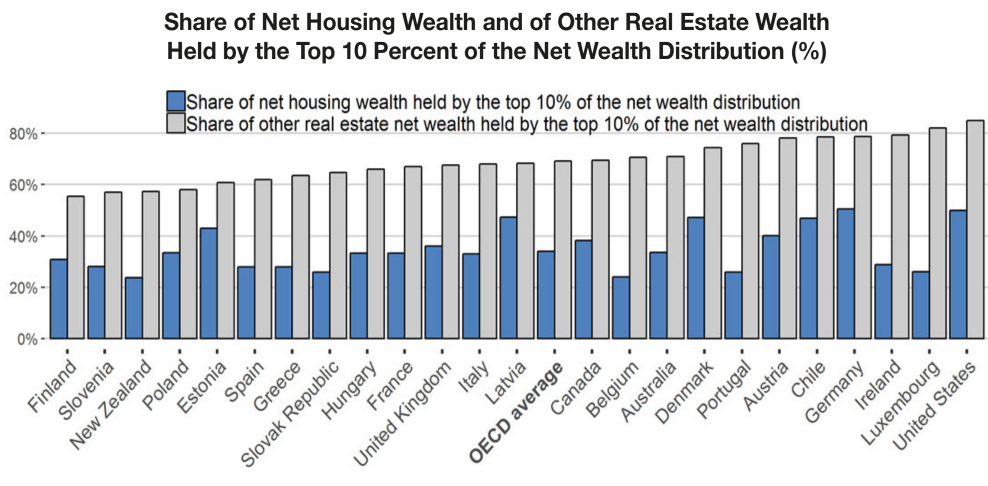
Source: Organisation for Economic Co-operation and Development (OECD) Tax Database and OECD, 2018a

There is also scope to review taxation of secondary and rented residences. Indeed, the distribution of other real estate is extremely unequal (exhibit 5), with households in the top 10 percent of the net wealth distribution owning 34 percent of net housing wealth and 69 percent of net other real estate wealth. Available tax indicators suggest that the taxation of other real estate is higher and more progressive than that of an owner-occupied residential property (OECD, 2018a). Comparing the marginal effective tax rates on an owner-occupied residential property relative to those on rented property suggest that: (1) marginal effective tax rates on rented property are significantly higher than those for primary residences because of the non-taxation of imputed rental income, as opposed to actual rental income, and because most countries apply capital gains tax to rented residential property; and (2) marginal effective tax rates on rented property tend to be progressive across the income distribution because rental income is most often taxed at progressive marginal personal income tax rates.

The fact that rented property exhibits higher and more progressive taxation compared with owner-occupied property does not necessarily imply that reforms in this area are not needed. As discussed in Causa, Woloszko, and Leite (2019), the ability to debt-finance a property may open up tax-planning opportunities that benefit wealthier households the most. Real estate is also a potential asset class that can be attractive for hidden wealth. More broadly, how to tax the buy-to-let property market at the individual and corporate level is becoming a topical question, for instance, given the increasing presence of institutional investors and buyers in globalized cities that have experienced rising house prices [see chapter 3 in (IMF, 2018)]. More work needs to be done to properly document the policy features at stake, but reviewing the taxation of real estate investments—in the broader context of alternative investment vehicles—is warranted on efficiency, equity, and resilience grounds.

Exhibit 5

Household Main Residence and Other Real Estate: A Tale of Two Inequalities



Notes: Households are ranked by net wealth. Therefore, this exhibit shows the share of net housing /net other real estate wealth held by households at the top of the net wealth distribution.

Source: Organisation for Economic Co-operation and Development Wealth Distribution Database (oe.cd/wealth)

Taxing Inherited Wealth: The Role of Housing

Taxing inherited wealth is justified on equity and efficiency grounds. From an equity perspective, well-designed inheritance taxes may increase intergenerational mobility and equality of opportunity by reducing and dispersing wealth holdings at death. Indeed, wealth transfers can be viewed as a source of opportunity that is not linked to the recipient's effort and should therefore be taxed, regardless of whether the donor has already paid income tax or capital gains tax on the assets. In cases where the main residence is a significant portion of the estate's wealth, it may even not have faced income or capital gains taxes prior to the donor's death.

From an efficiency perspective, inheritance taxes tend to be less distortive than other forms of wealth taxation because, for example, their effects on savings are smaller than in the case of recurrent taxes on personal net wealth.[3] Another argument in favor of inheritance taxes is that the double taxation argument is weaker than for recurrent taxes on net wealth; there is no double taxation of the donor, and the inherited wealth is also only taxed once in the hands of the recipient. Finally, inheritance taxes are also easy to administer and comply with as they are only levied once. A recent report on net wealth taxes argues that capital income taxes alone will most likely not be enough to address wealth inequality, suggesting the need to complement capital income taxes with inheritance taxes (OECD, 2018b).

Despite the strong case for wealth transfer taxes, revenues from inheritance or estate and gift taxes are very low and have been declining over time on average in OECD from 1.1 percent of total taxation in 1965 to 0.4 percent today (OECD, 2018b). Low revenues reflect the fact that inheritance/estate and gift tax bases are often narrowed by numerous exemptions and deductions, and that avoidance opportunities are widely available. The decline in tax revenues also reflects the fact that a number of countries have either abandoned or scaled back their wealth transfer taxes. Differences, however, across countries—for instance higher revenues collected in Belgium and France—suggest that the revenue potential of these taxes could be further exploited in many countries.

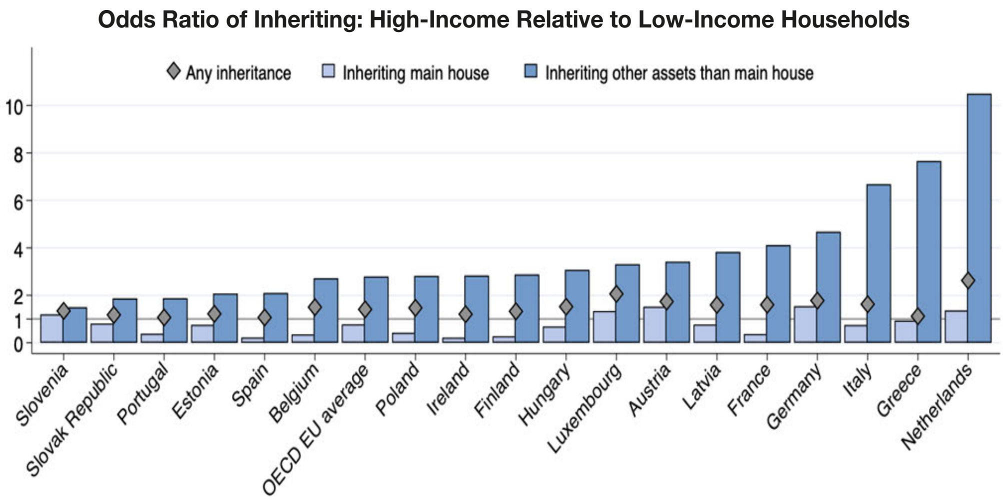
Designing efficient and fair wealth transfer taxes calls for progressive inheritance taxes. This taxation involves taxing large inheritances, but not taxing (or taxing at low rates) small inheritances received by poor taxpayers and allowing for deferred payments and installments to address liquidity constraints. One question is whether inheritance taxes should involve a favorable tax treatment when the transmitted asset is the home in which the recipient lives.[4] Such treatment could take the form of a higher exemption threshold for the home than for other assets transmitted. This treatment may be justified on distributional grounds, because low-income households tend to inherit their houses, whereas high-income households tend to inherit other assets (exhibit 6).

[3] Akgun, Cournéde, and Fournier (2017) find net wealth taxes have a negative effect, whereas inheritance taxes have no effect on long-term output.

[4] Other important questions arise in the design of inheritance taxes, such as the treatment of family-owned business. These questions are beyond the scope of this paper.

Exhibit 6

High-Income Households Have Much Higher Chances of Inheriting Other Assets Than the Main Residence



Notes: High and low incomes refer to the top and bottom income quintiles. How to read this figure: in the Netherlands, households in the top income quintile are 2.6 times more likely to receive any inheritance or gift than households in the bottom income quintile; households in the top income quintile are 1.3 times more likely to receive the main residence as inheritance or gift than households in the bottom income quintile; and households in the top income quintile are 10.5 times more likely to receive assets other than the main residence as inheritance or gifts than households in the bottom income quintile.

Source: Household Finance and Consumption Survey (HFCS)

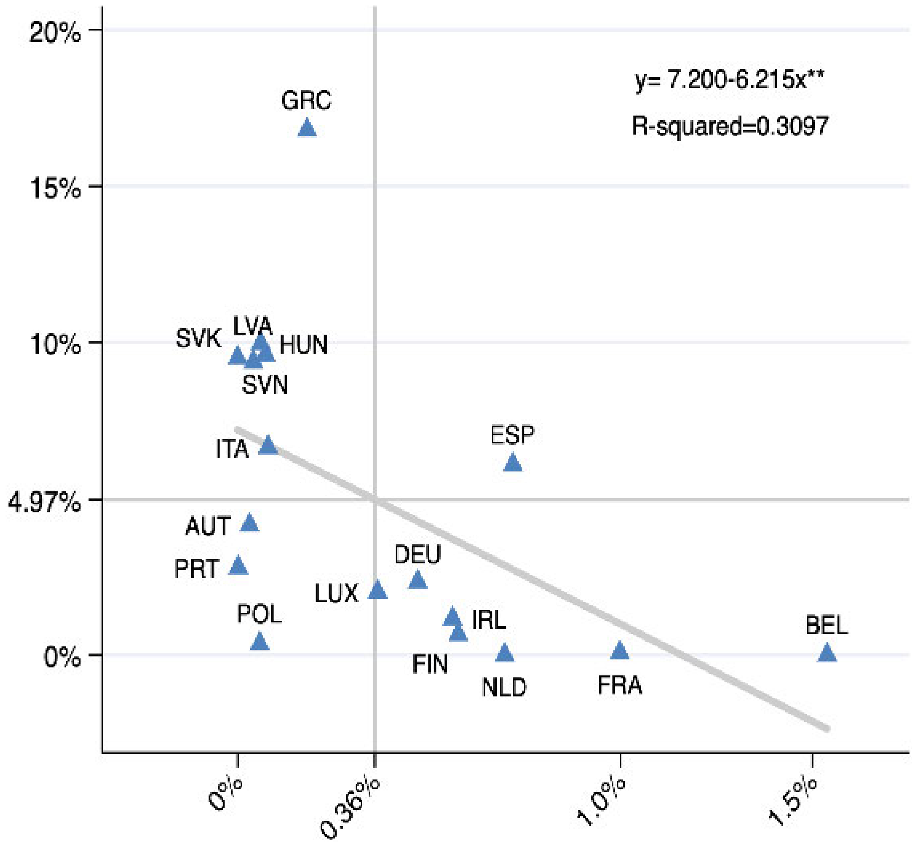
Among countries that have inheritance taxes, the main residence generally receives special treatment in the form of higher tax-exemption thresholds (in the United Kingdom, for example), preferential valuation rules (such as in France), or even full exemptions under strict rules on usage of the home (as in Ireland). The level of the general inheritance tax exemption threshold is often used to ensure that small inheritances can be passed on tax-free. In addition, there can be measures to address liquidity constraints when it comes to the payment of inheritance tax on the main residence, such as allowing tax payment deferral until the property is sold for individuals who still occupy the home or allowing tax payments in installments.

Exhibit 7

Across European Countries, Housing Inheritance is Negatively Correlated with Inheritance Tax Revenues (1 of 2)

Inheritance/Gifts of Housing and Non-Housing Assets and Tax Revenue Raised From Inheritance and Gift Taxes

Panel A. Proportion of Households Having Received Their House as Inheritance or Gift in Age Group <35 and Tax Revenue Raised From Inheritance and Gift Taxes

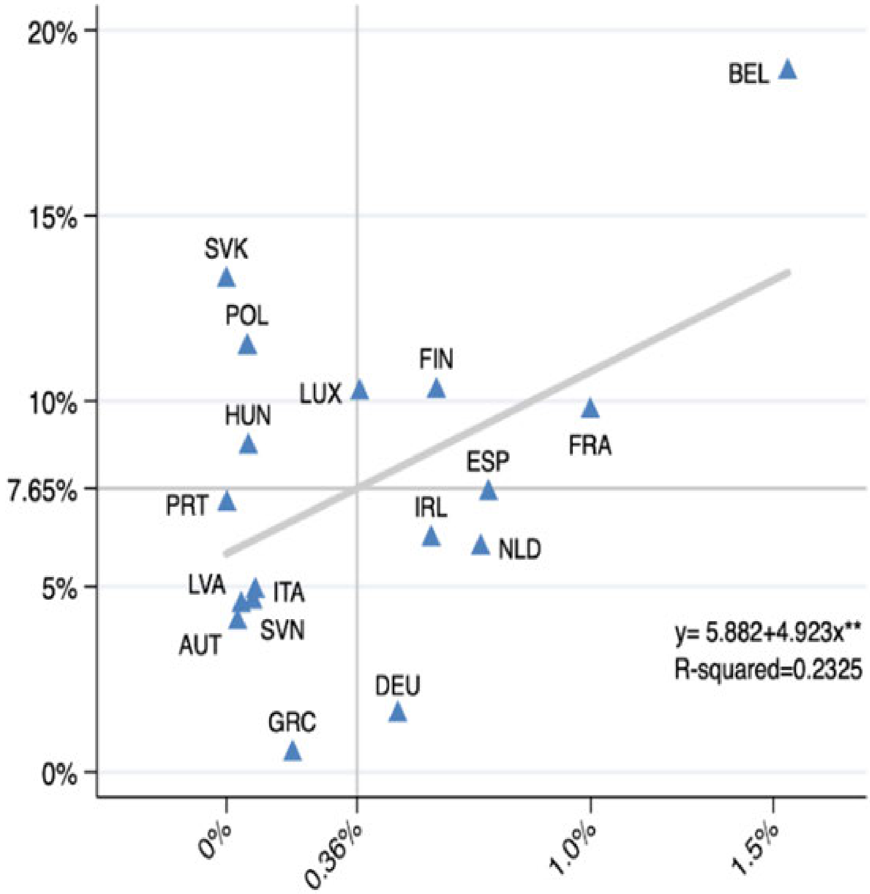


Tax Revenue Raised From Inheritance and Gift Taxes (%) of Total Tax Revenue)

Exhibit 7

Across European Countries, Housing Inheritance is Negatively Correlated with Inheritance Tax Revenues (2 of 2)

Panel B. Proportion of Households Having Received Assets Other Than Their House as Inheritance or Gift in Age Group <35 and Tax Revenue Raised From Inheritance and Gift Taxes



Tax Revenue Raised From Inheritance and Gift Taxes (%) of Total Tax Revenue)

Note: Tax revenue from estate, inheritance, and gift taxes, average over the period 2009-2014.
Source: Household Finance and Consumption Survey and Organisation for Economic Co-operation and Development Tax Revenue database

Full exemption of the main residence from inheritance taxes is likely to have regressive effects by allowing rich households to transmit expensive houses for free. It may also open up tax planning opportunities (such as providing incentives to hold more wealth in housing in anticipation of favorable inheritance tax treatment). Moreover, it risks locking-in recipients in their house, thereby reducing residential mobility. Indeed, the data indicate that households that have received their houses as inheritances or gifts tend to be less mobile than those that have acquired them.[5] Finally, this exemption will narrow the tax base and reduce revenues from inheritance taxes on houses (OECD, 2018b). In fact, across European countries, inheritance tax revenue is negatively correlated with inheritance of the main residence and positively correlated with inheritance of other assets (exhibit 7).

Political Economy Considerations in Housing Taxation

Political economy considerations affect the design and implementation of housing taxation. One reason why OECD countries make little use of immovable property taxes, and even less of inheritance taxes, is because those taxes are highly unpopular, and distributional concerns are major reform obstacles. To start with, this paper has shown that housing is the chief asset of the middle class.[6] In virtually all OECD countries, the median voter is a homeowner. Concern is often raised that property taxes impose an unfair burden on middle-income families because middle-income families tend to hold a high proportion of their wealth in the family home, whereas top earners may hold a significant proportion of their wealth in more liquid assets that are not subject to property taxes. Concern is also raised about the impact of inheritance taxes on asset-rich but cash-poor households, especially in the case where the house is being inherited; a substantial tax bill combined with a low income may result in a property needing to be sold to pay the tax. These concerns are not unjustified:

- Although being a homeowner drastically reduces the risk of being asset poor, it does not affect the risk of being income poor (exhibit 8).[7] Going further, in a number of OECD countries, especially high-ownership ones such as Eastern European countries, Spain, and Japan, homeowners are over-represented among the income-poor (exhibit 9).
- Housing is transmitted from one generation to the other, and in most European countries, more than one in five low-income homeowners has inherited their houses (exhibit 10).

[5] Not shown to save space. However, causality is hard to infer, as lack of mobility could reflect other confounding factors such as low education.

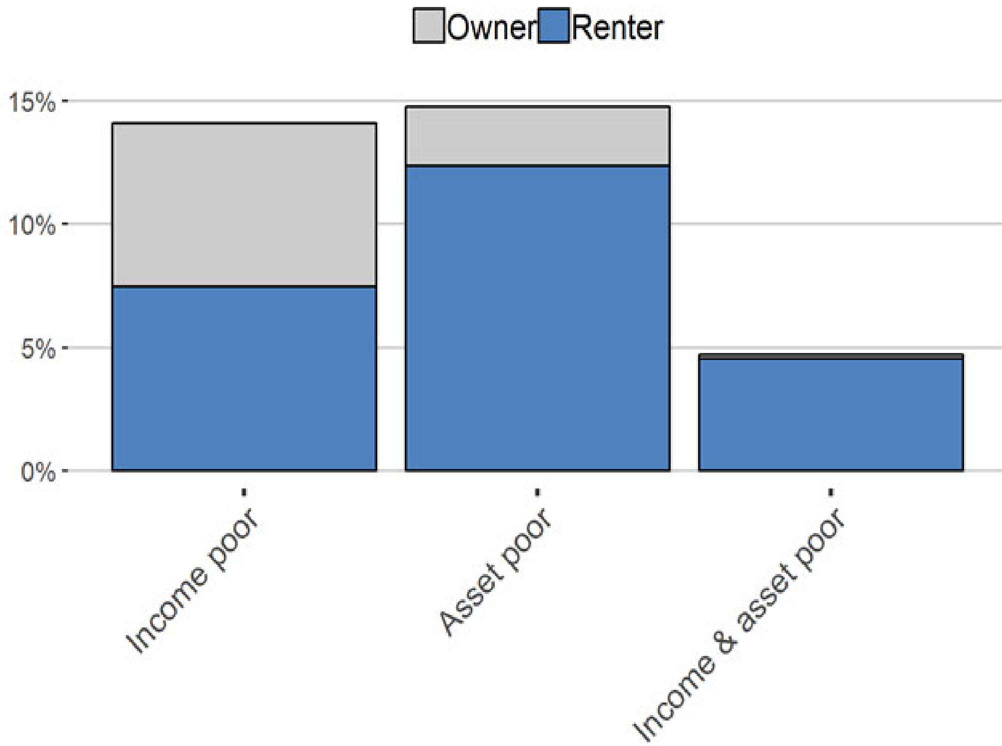
[6] For a discussion on housing and the middle class see for example (Wolff, 2017).

[7] One potential limitation and explanation of this finding is that the income poverty measure used here does not include imputed rents. This definition of income poverty is in line with standard practice due to the difficulty of properly estimating imputed rents in a comparable way across countries.

Exhibit 8

Being a Homeowner Reduces the Risk of Being Asset-Poor but Not the Risk of Being Income Poor

Share of Individuals That Are Income Poor, Asset Poor and Income and Asset Poor, OECD Average

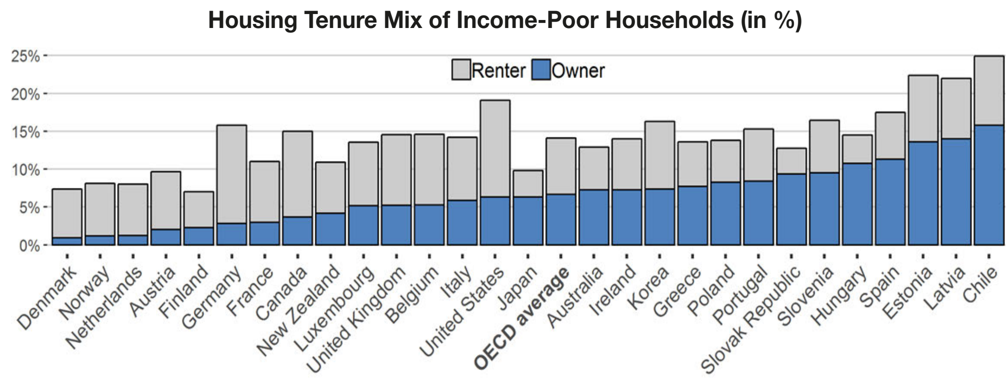


Notes: For the purpose of poverty measurement, both income and wealth are equalized so that the unit of analysis is the individual. (1) income-poor individuals are defined as those with equivalized annual income below the income poverty line (50 percent of median); (2) asset-poor individuals are defined as those with equivalized net worth insufficient to cover 3 months of the income poverty line; and (3) income and asset poor individuals as those with equivalized net worth insufficient to cover 3 months of the income poverty line and with equivalized annual disposable income below the income poverty line. Different wealth concepts and reference periods can be used to derive asset poverty measures, which has an impact on the estimated poverty levels. For instance, when net wealth is used, measures of asset-based poverty are around two-thirds lower than those based on the liquid financial wealth concept. As expected, the share of the population identified as asset poor increases with longer reference periods, although the relative ranking of countries is insensitive to the reference period used. See Balestra and Tonkin (2018) for details.

Source: Organisation for Economic Co-operation and Development Wealth Distribution Database (oe.cd/wealth)

Exhibit 9

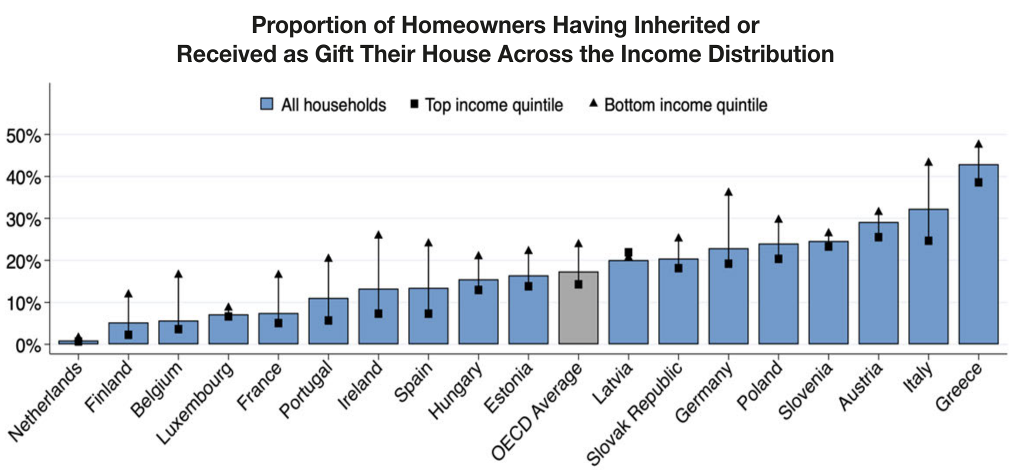
Homeowners are Over-Represented Among the Income Poor in Some OECD Countries



Note: How to read this figure: in Chile, 25 percent of individuals are income-poor, out of which 15 percent are homeowners and 10 percent are renters.
Source: Organisation for Economic Co-operation and Development (OECD) Wealth Distribution Database (oe.cd/wealth)

Exhibit 10

In Most European Countries, More than One in Five Low-Income Homeowners Have Inherited Their Houses



Note: How to read this figure: in Germany, 23 percent of homeowners have inherited their house, 36 percent of homeowners in the bottom income quintile and 19 percent of homeowners in the top income quintile have inherited their house.
Source: Household Finance and Consumption Survey

Still, as discussed, housing taxation reforms can be designed in a way that addresses these obstacles, ultimately producing a more efficient and more progressive tax system. No approach is one-size-fits-all, and tax reform will depend on country-specific context, challenges, and social preferences.

Housing Policy Reforms to Promote Resilience and Labor Mobility

Reducing Household-Level Vulnerabilities Through Prudential Regulation

This paper has shown that access to mortgage debt allows households with little assets a chance to own their own home and to accumulate wealth, but it can expose households at the bottom of the distribution to financial vulnerabilities. This section discusses preliminary policy implications focusing on borrower-based prudential policies alongside their potential differential effects across the distribution (see Alam et al. [2019] for recent evidence on the effects of loan-targeted instruments on aggregate household credit and consumption).

The implementation of borrower-based prudential regulation may raise distributional concerns. As shown in this paper, borrowers with high loan-to-value ratios are concentrated at the bottom of the wealth distribution, and borrowers with high loan-to-income ratios at the bottom of the income distribution. Subsequently, caps on loan-to-value and debt-to-income may exclude low-income and low-wealth households from the mortgage market. The downpayment constraint resulting from more restrictive caps will be particularly binding for first-time buyers and liquidity-constrained households, such as younger and low-income households (see, for example Ortalo-Magne and Rady, 2006). Recent analysis by Kelly, Le Blanc, and Lydon (2019) on the effect of tightening credit standards on the distribution of borrowers shows that European countries that experienced a boom-and-bust in the housing market saw the composition of buyers shifting from young and low-income to old and high-income households after 2010.

However, distributional concerns associated with the implementation of borrower-based macroprudential policies are likely to disappear over a longer term horizon. Excessive expansions of mortgage credit can trigger higher house price increases, which reduce housing affordability and thus price out low-income households from the market. By curbing the joint increase of credit volume and house prices during leverage cycle booms, macroprudential caps may enhance housing affordability (Glick and Lansing, 2010; Kohl, 2018; Mian and Sufi, 2009).

The policy implication is that macroprudential policies can enhance micro-resilience, especially for those households most vulnerable to price and income shocks. Although associated credit constraints may prevent young households from accumulating wealth through homeownership, long-term positive gains are likely to outweigh short-term costs, and therefore such instruments can improve welfare by (1) preventing young households from prematurely investing in housing, hence reducing vulnerability to price and income shocks, ultimately allowing better consumption smoothing (Xiong and Mavropoulos, 2018); and (2) more generally, contributing to housing affordability by curbing leverage-induced increases in house prices. The effectiveness of such instruments will ultimately depend on specific policy design: more data and work are needed to properly evaluate the micro distributional effects of macroprudential instruments.

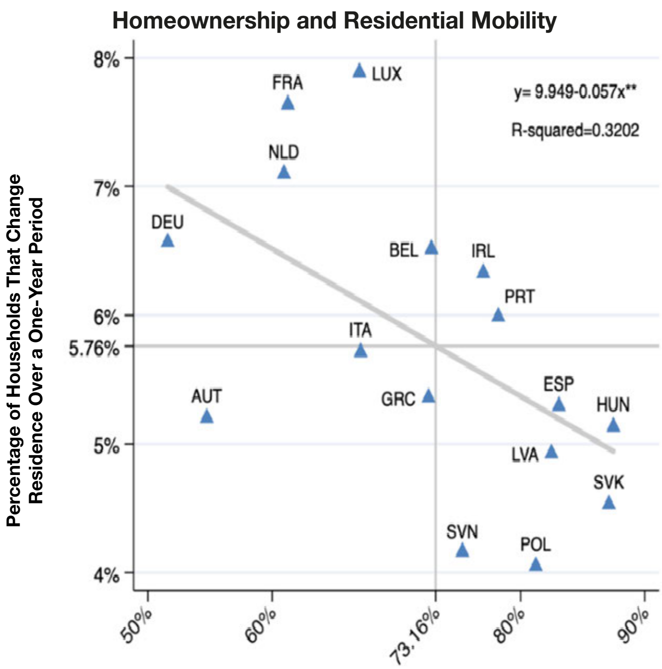
Promoting Residential Mobility by Reducing Relocation Costs

The ease of moving residence geographically has positive efficiency implications by enhancing the functioning of the labor market through the job-matching process and therefore the efficient allocation of human resources. It can also have positive inclusiveness implications, especially from a dynamic perspective. Moving can be an opportunity for people from disadvantaged areas and backgrounds to find better jobs and achieve a better quality of life, and available evidence tends to support this argument (Chetty, Hendren, and Katz, 2016).

Ideally, housing markets and policies affecting them should not hinder residential mobility. The data used in this paper allow for shedding some light on this topical issue. Keeping in mind that the data do not distinguish residential turnover within the same geographical area from geographical mobility, the evidence is that of a strong negative cross-country association between homeownership and households' mobility (exhibit 11).[8] In the average European country, 6 percent of households change their residence over a 1-year period. Such mobility is low in high-ownership countries in the East and South of Europe, compared with low-ownership countries in the middle and North of Europe, where households move twice as often.

Exhibit 11

Across European Countries, High Homeownership is Associated with Low Residential Mobility



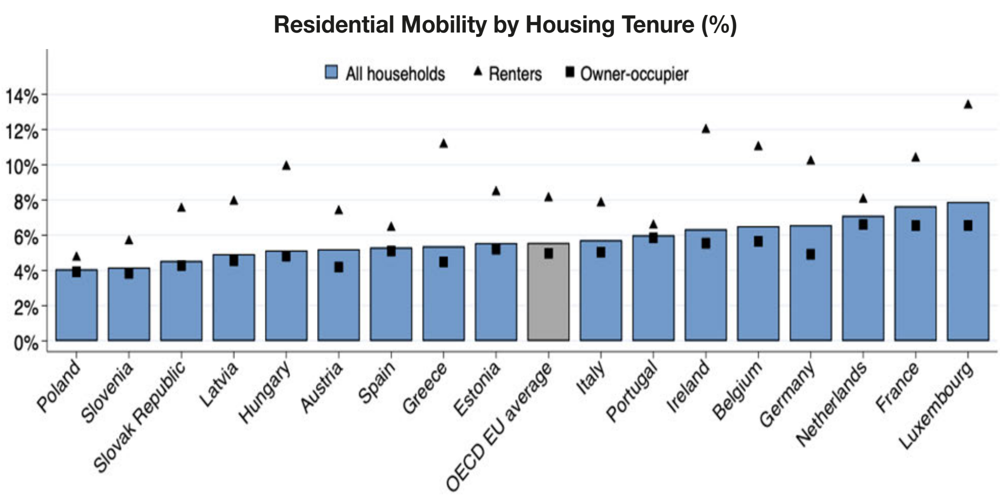
Notes: Residential mobility is defined as the proportion of households that change their main residence over a 1-year period. Restricted to age group 35–64.
Source: Household Finance and Consumption Survey

[8] The sample is restricted to the age group 35–64 to reduce the impact of differences in demography, notably in the share of older households. That said, country rankings are unaffected by using the whole sample.

The negative association between homeownership and residential mobility directly reflects cross-country differences in the housing tenure mix to the extent that homeowners tend to be less mobile than private renters (exhibit 12).[9] A common conjecture is that mobility is lower among owner-occupiers than renters; owners face higher transaction costs of moving homes and therefore spend a longer time in their residence to spread the costs over a longer time period. Causation cannot be easily established, and differences in mobility across tenure types could also reflect self-selection into various tenures. For example, some households may have a preference for stability and be more likely to choose owner occupancy. The negative association between homeownership and residential mobility can also reflect that when the tenure mix is skewed toward owner-occupancy, the size of the rental market, and therefore turnover in the rental market, is limited, which reduces mobility among renters. Indeed, the lowest level of mobility among renters is observed in high homeownership countries such as Eastern European countries, Portugal, and Spain. One crude implication from the negative association between homeownership and residential mobility would be that there is a trade-off between promoting homeownership and encouraging residential mobility.

Exhibit 12

Owner-Occupied Households Tend to be Less Mobile Than Renters



Notes: Residential mobility is defined as the proportion of households that change their main residence over a 1-year period. Restricted to age group 35-64.
Source: Household Finance and Consumption Survey

Reducing policy-driven residential mobility costs can help mitigate the trade-off between promoting homeownership and encouraging labor mobility. One relevant area is property transaction costs. For instance, stamp duties and registration taxes are typical transaction costs in buying and selling a property—together with real estate agent fees and legal fees, which are also influenced by government regulations. Data from Global Property Guide's in-house research published online[10] and used in World Bank (2018) suggest that such transaction costs differ

[9] This finding is in line with a number of papers such as Causa and Pichelmann (2020) and Caldera Sánchez and Andrews, (2011).

[10] https://www.globalpropertyguide.com/home

considerably across OECD countries: they are comparatively high in Belgium, France, Italy, and Greece and comparatively low in the Nordic and Anglo-Saxon countries—in line with replies to the 2009 OECD questionnaire on housing. High transaction costs may discourage property transactions and thus curb the liquidity of housing markets, with potentially negative repercussions for residential mobility. Empirical evidence has indeed shown that high transaction costs tend to reduce residential mobility (Caldera Sánchez and Andrews, 2011; Causa and Pichelmann, 2020; World Bank, 2018).

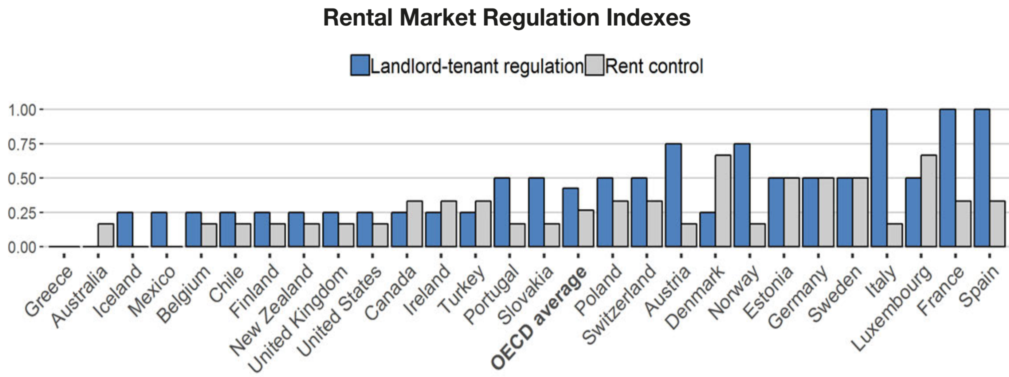
The existing literature has suggested reforms to reduce transaction costs in two areas:

- Shifting from transfer taxes and stamp duties to (progressive) recurrent taxes on residential property. Reforms in this area are likely to make the housing market more liquid and efficient, but they could also make it more volatile and therefore less resilient. Governments need to seek an appropriate balance, taking into account country-specific conditions because transaction taxes can be useful at curbing over-heated housing markets.
- Liberalising professional services to reduce notarial, legal, and real estate agency fees linked to housing transactions. This result can be achieved by reforming conveying procedures to allow for more competition among the providers of housing transaction services. For example, in some countries, the use of notaries is mandatory in real estate transactions. The case for reducing the role and cost of professional services in this area is all the more justified in the context of digitalization that allows using new technologies (such as blockchain) to secure property transactions.

Curbing excessively strict rental regulations can also increase residential, and therefore labor, mobility. Empirical evidence has shown that stricter rent controls and tenant-landlord regulations significantly reduce residential mobility by discouraging the supply of rental housing and by locking-in tenants (Caldera Sánchez and Andrews, 2011; World Bank, 2018). Recently developed indexes of rental regulations suggest that rent control is comparatively strict in countries with a relatively large rental sector such as Denmark and Germany, possibly reflecting that, in countries with large rental sectors, the demand for regulation is greater. Tenant-landlord regulation, however, is measured as comparatively strict both in countries with large (Austria and France) and small (Italy and Spain) rental sectors (exhibit 13). Reforms in the area of rental regulations need to strike a balance between landlords' and tenants' interests to create a security of tenure and avoid market segmentation between sitting and new tenants (Andrews, Caldera Sánchez, and Johansson, 2011). On the one hand, the absence of rent regulations can lead landlords to hold up tenants by unexpectedly raising rents. On the other hand, very strict rental regulations can hold up landlords' property and reduce incentives for investing in rental housing, maintenance, and upkeep.

Exhibit 13

Excessive Rental Market Regulation May Hamper Residential Mobility



Note: The index varies between 0 and 1 and increases in the level of regulation.
Sources: Kholodilin (2018), Deutsches Institut für Wirtschaftsforschung (DIW)

Reforms to land-use regulations can influence housing supply and, in turn, residential mobility. In particular, where housing supply is more responsive to demand, residential mobility is higher (Caldera Sánchez and Andrews, 2011). This finding may reflect that higher supply responsiveness reduces housing affordability differentials and price gaps across regions, potentially easing relocation. In this context, policies to increase the responsiveness of housing supply are likely to deliver more efficient and inclusive housing markets by curbing excessive house prices and making housing more affordable, reducing geographical disparities and urban sprawl, and encouraging residential mobility. Reforming land-use regulations and building restrictions is key in this respect, while balancing economic, social, and environmental aspects. Security of property rights and better quality of land administration (such as coverage of registration system, reliability of administrative infrastructure, and accessibility of information) have also been found to lead to higher residential mobility across European countries (World Bank, 2018).

Housing-related social transfers and subsidies aimed at addressing inclusiveness and redistributive concerns also influence residential mobility and require careful design to reconcile efficiency and equity objectives. Several studies have found that tenants in social housing are less mobile than private tenants, possibly reflecting the reluctance to give up their below-market rents and their generally more secure tenancies (Caldera Sánchez and Andrews, 2011; World Bank, 2018). This circumstance has been found to be particularly the case in countries where social housing is highly targeted. The causality is unclear, however, since households that are inherently less mobile to begin with—possibly due to unobserved characteristics such as cultural and or social attachment to their local area—may self-select into social housing.

Well-designed income-based portable housing allowances may be preferable to the direct provision of social housing as they do not seem to directly hinder residential mobility. Governments could also consider providing housing or rent subsidies for targeted groups, such as young people who are more likely to move, potentially making benefits conditional on job search responsibilities.

Finally, experimenting with housing vouchers to encourage low-income households to move to higher income neighborhoods is another policy option to encourage residential and social mobility (see Chetty, Hendren, and Katz [2016] for empirical evidence based on the United States). That said, housing allowances have limitations; they cannot guarantee good housing and may adversely affect rent prices. They require careful design in terms of efficiency and targeting to avoid discouraging labor market participation and ensure take-up by households in greatest need for housing (World Bank, 2018).

In this context, social housing is needed, but it should prevent residential segregation by ensuring that it is well integrated in the urban structure with appropriate access to transport sectors and public services. Urban transport planning policies are key complementary instruments, and they should aim at desegregating and connecting people in disadvantaged communities. In addition, frequent reassessment of eligibility of social housing incumbent tenants with appropriate action if eligibility has changed is important, as it frees up accommodation for needier households. Such reassessments may also help encourage residential mobility, but they should be designed to avoid possible disincentives to labor market participation among incumbent tenants.

Conclusion

Political economy considerations affect the design and implementation of housing-related reforms and often make them unpopular:

- **The median voter is a homeowner in many countries.** Besides providing shelter, homeownership is the most important source of wealth accumulation for middle-class households. For low-income households, it is often the only source of wealth transmission across generations through inheritance.

- **One often stated challenge to housing reform is the fact that homeowners can be asset-rich and income-poor.** Indeed, being a homeowner significantly reduces the risk of being asset poor, but it does not affect the risk of being income poor.

- **Public policy tends to favor homeownership relative to renting,** typically via the preferential tax treatment of owner-occupied housing relative to rented housing. Yet the case for departing from housing tenure neutrality in policy design is not clear, neither on efficiency nor on equity grounds.

  Informed by the stylized facts in Causa, Woloszko and Leite (2019) this paper discusses policy implications of housing reform to promote inclusiveness and social mobility, to enhance efficiency in the allocation of labor and capital, and strengthen macroeconomic resilience:

- **Making the overall tax system more progressive and efficient,** for instance, by (1) shifting from income to progressive recurrent taxes on immovable property and on inheritance and gifts; and (2) phasing out the regressive features associated with the preferential tax treatment of owner-occupied housing such as mortgage interest deductibility.

- **Reducing household-level financial risks associated with mortgage debt through borrower-based prudential regulation** such as loan-to-value or debt-to-income caps.
- **Promoting residential mobility by** (1) reducing housing transaction costs associated with taxation and the regulation of professional services; (2) curbing excessively strict rental regulations; and (3) reforming social housing programs with a view to avoiding lock-in effects and residential segregation and expanding well-designed portable housing allowances. These actions require complementary investments in public transportation and effective urban planning.

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