

**COMMENT TO
“PROPERTY TAX REFORM
AND THE USER COST OF OWNER-OCCUPIED HOUSING IN THE EU”
BY SALVADOR BARRIOS, SERENA FATICA AND JONATHAN PYCROFT**

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1 Short summary of the paper

The paper computes the “marginal cost of homeownership” (MCH) for four EU Countries (France, Italy, Spain and the UK).

This measure, well-established in the empirical literature, is given by the following formula:

$$MCH = i + t_p + \beta + m + \delta - \pi_H,$$

where i is the prevailing interest rate, t_p is the recurrent property tax rate, β is a risk premium associated with housing investment, δ is the depreciation rate, m represents maintenance unit costs and π_H is the rate of increase of house prices.

Obviously, the higher the marginal cost of homeownership, the lower the incentive to invest in housing.¹

Tax policy affects this measure in several ways, besides recurrent real estate taxes. In particular, the MCH is reduced by two elements. First, the fraction of the house which is debt-financed (call it λ) benefits from tax relief for mortgage interest payments. Second, the remaining fraction $(1-\lambda)$ of the house, which is financed by own funds, is bought with funds which would have been invested in financial assets, and therefore taxed accordingly. Therefore, if we call t_{cap_inc} the tax rate applied to capital income and EMTR the effective marginal personal income tax rate, the marginal cost of homeownership becomes:²

$$MCH = i - \lambda EMTR - (1 - \lambda)t_{cap_inc} + t_p + \beta + m + \delta - \pi_H$$

The EMTR – and therefore the MCH – differ across different taxpayers.

The main contribution of the paper is to compute individual-specific EMTRs and MCHs for a representative sample of individuals for each of the four countries. To do this, the authors use the simulation model EUROMOD (which is in turn based on EU-SILC data for France Italy and Spain, and on FRS data for the UK).

The main results are summarized in their Table 3, which I report here for convenience. From the table emerges that Italy has the highest MCH (about 5 per cent) while UK has the lowest MCH (about 2 per cent). The other important finding is that for all countries except France the MCH decreases as a function of income (in France it is basically constant across income deciles).

2 Some comments about how the index is computed

The paper sheds light on a very interesting and hotly-debated topic, using appropriate and theory-driven tools. It is also very clear and (perhaps too) concise.

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¹ In equilibrium, it should be equal to the rent-to-price ratio.

² For simplicity’s sake, I omit other terms included in the original contribution but not relevant for the present discussion.

Country	User Cost of Housing		By Income Decile									
	Average	CoV	1	2	3	4	5	6	7	8	9	10
France	0.0309	4.25%	0.0291	0.0285	0.0309	0.0308	0.0313	0.0308	0.0317	0.0314	0.0330	0.0317
Italy	0.0486	2.14%	0.0562	0.0558	0.0536	0.0527	0.0495	0.0475	0.0456	0.0434	0.0415	0.0401
Spain	0.0424	8.31%	0.0475	0.0464	0.0459	0.0433	0.0427	0.0420	0.0407	0.0394	0.0394	0.0364
UK	0.0236	5.21%	0.0287	0.0281	0.0267	0.0254	0.0234	0.0224	0.0218	0.0216	0.0199	0.0177

2.1 Relaxing the assumptions

I would like to discuss some assumptions made by the authors in their calculations. While I understand that they are necessary to simplify things, they might be relaxed in future versions of the paper (alternatively, they might be discussed qualitatively, and the authors could explain to what extent, and in what direction, they drive the results).

The authors assume that the borrowing and lending rates coincide, and that they are the same for all individuals. The latter hypothesis appears unrealistic for two reasons: first, given the existence of transaction costs, typically the poor have access to worse investment opportunities (for example, they don't invest in stocks); second, given their worse credit standing, they are typically charged higher borrowing rates.

The same is true for the rate of appreciation of houses. My intuition is that typically (except perhaps during housing booms) the rich own houses in city centers and in other zones in which supply is generally fixed, so these houses tend to appreciate more.

2.2 Explain results more at length

Apart from relaxing some restrictive assumptions, I think the authors could give some more information about their computations.

It seems that what drives the regressivity of the MCH is the regressivity of the property tax and of the mortgage interest relief. But what features of the four tax systems should be blamed for this?

Furthermore, in some countries (e.g. in Italy) capital income is excluded from the personal income tax base, in others it may be included, so that $EMTR$ and t_{cap_inc} coincide. I don't know what are the rules in the remaining three countries, but the authors should tell us, and say whether this is relevant for their results.

3 Some comments about the index

Let me conclude with some thoughts concerning the MCH index itself.

First, one is left wondering whether the MCH is relevant from the positive point of view. Do cross-country differences in the index explain differences in households' choices and housing prices? I think the authors can check whether, everything else equal, households with lower MCHs are more likely to own a house (and/or to own larger houses). Furthermore, it would be interesting to extend the analysis to at least another point in time, to see whether reductions (resp. increases) of the MCH induce an increase in homeownership or in house prices (this would also increase the robustness of the results, as the authors' data come from a very peculiar period of subdued house price dynamics and pronounced economic downturn).

A related concern is about the use of the index for policy exercises. Indeed, the MCH is computed for given (expected) price dynamics. However, clearly the MCH and its tax components are itself drivers of house prices; doesn't this represent a classical example of the Lucas critique, and therefore limits the policy usefulness of the index?

From a normative viewpoint, I wonder what are the normative foundations of the MCH index. Said differently: should public policies target the MCH? Is it a sufficient statistics of a country's housing policy? Related to this, I would suggest the authors to look at some contributions in the fields of urban economics and local public finance³, which argue that homeownership can be seen as a policy goal in itself as homeowners tend to behave as better citizens. In some countries, cultural preferences could drive the policy choices.

Finally, what is left unexplained is the MCH regressivity. While we all know that the degree of progressivity should be seen as an attribute of the tax-benefit system as a whole, studying the political economy reasons behind the political power of rich homeowners could be a very interesting topic for further research.

³ See, e.g., FischeI, W.A. (2001), *The Homevoter Hypothesis*, Harvard University Press, Cambridge (MA).

