

What are the Effects of Removing the Mortgage Interest Deductibility?

Markus Karlman

Karin Kinnerud

Kasper Kragh-Sørensen

Stockholm University, Institute for International Economic Studies

What is the Mortgage Interest Deduction?

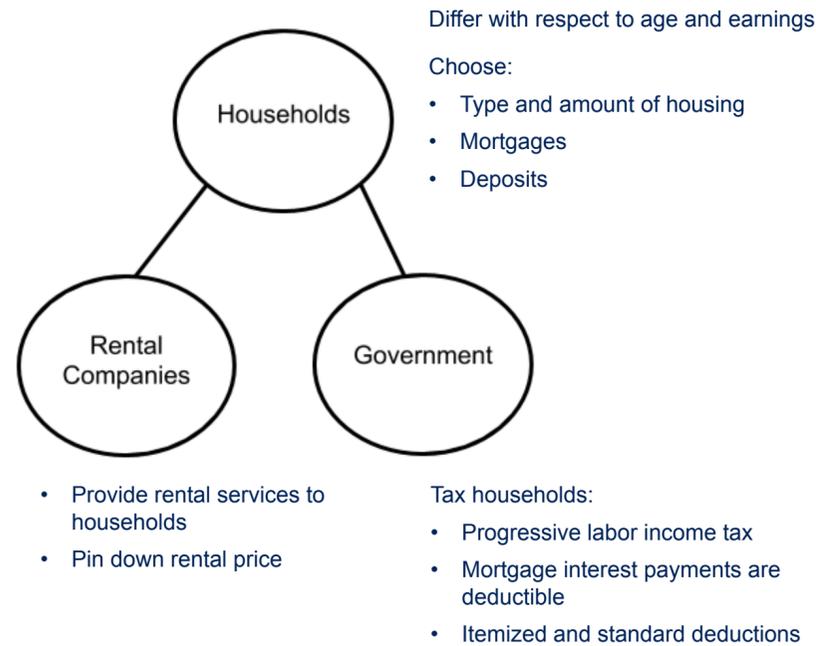
Households can deduct mortgage interest payments from their labor income. This reduces:

- Taxable labor income (in the US)
- User cost of owner-occupied housing

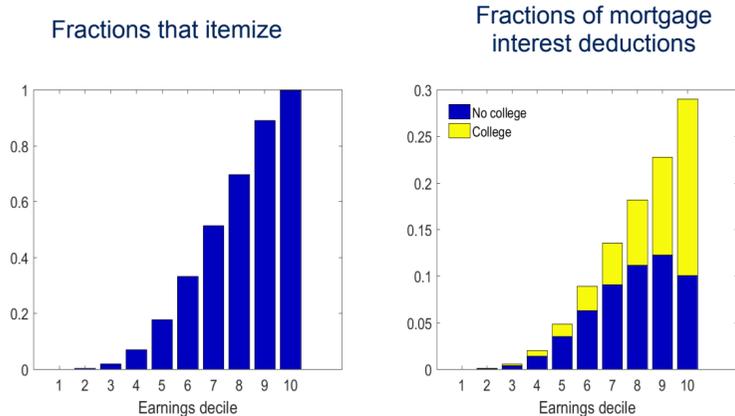
Symbol of the “American dream of homeownership”, but also:

- A significant government expenditure (USD 64 billion, in 2017)
- Highly skewed towards high-earning households

Model Framework



Our model replicates skewness in MID claims



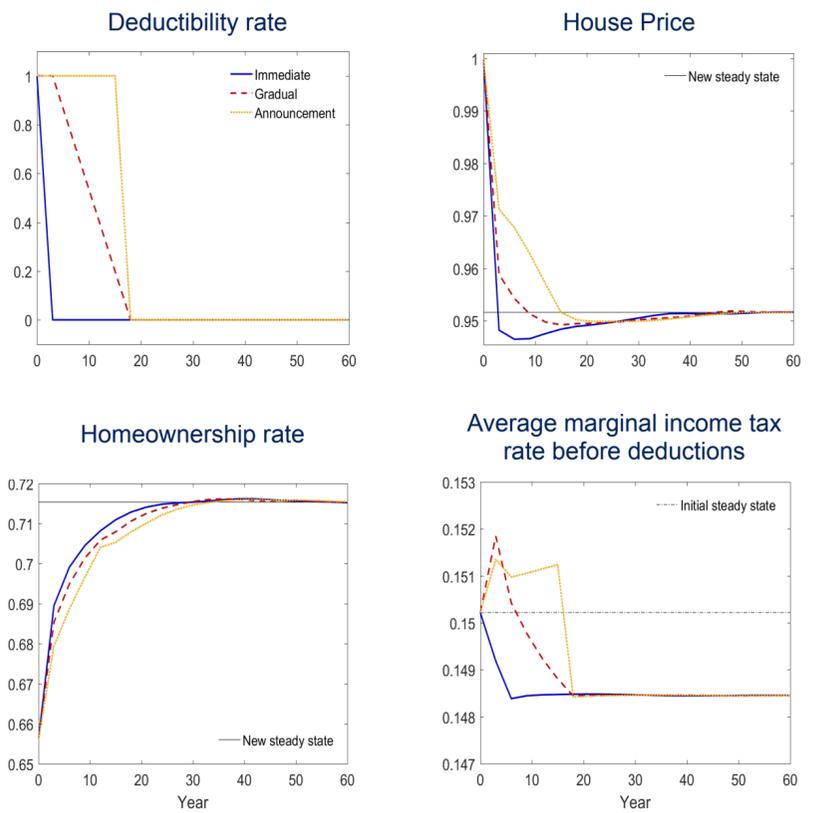
Results

What are the Long-Run Effects of Removing the MID?

- Removing the MID reduces the tax level and housing demand of high-earning households.
- The fall in housing demand lowers house prices
- Lower taxes and house prices increase: homeownership and welfare (97 % better off)

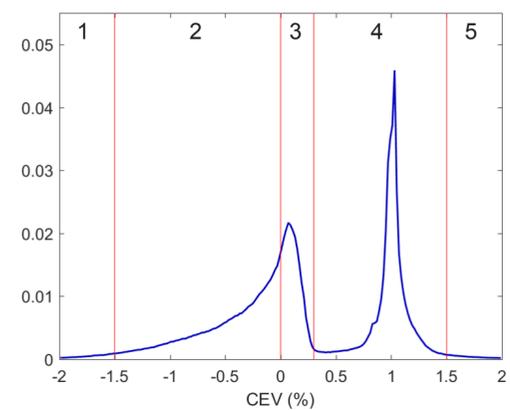
	MID	No MID	Difference (%)
House price	1	0.952	-4.8
Rental price	0.236	0.230	-2.3
Homeownership rate	0.66	0.72	9.0
Fraction ever-owner	0.81	0.85	4.6
Mean owned house size	68.97	65.37	-5.2
Mean LTV	0.48	0.47	-2.2
Mean marginal tax rate	0.1502	0.1485	-1.14

How do Short-Run Dynamics Depend on the Timing of Policies?



Who are the Winners and Losers in the Short Run?

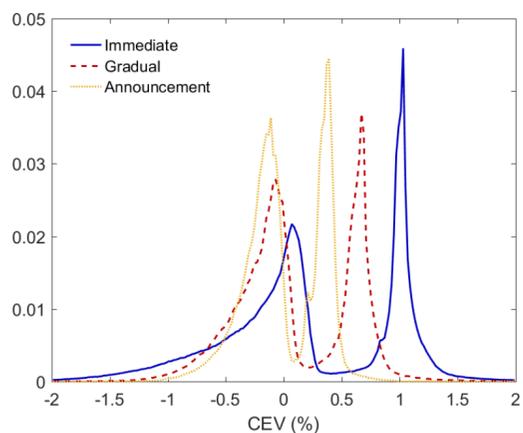
The distribution of welfare effects under the immediate removal policy



Group:	1	2	3	4	5
Homeownership rate	1	0.99	0.97	0.01	0
Itemization rate	0.97	0.71	0.39	0.01	0
Age	37	44	48	36	56
Permanent earnings	61	40	35	18	6
House size	120	75	60	60	-
LTV	0.76	0.56	0.37	0.10	-

How does Welfare Depend on the Timing of Policies?

Distributions of short-run welfare effects, across policies



Policy:	Immediate	Gradual	Announcement
Avg. welfare gain (CEV %)	0.22	0.10	-0.00
Fraction in favor	0.60	0.47	0.42

Main Findings

A policymaker faces a difficult trade-off:

- Most households prefer and are in favor of an immediate removal...
- ...but this comes at the cost of significant welfare losses for homeowners with large mortgages and high earnings
- More gradual policies can mitigate these severe negative losses...
- ...but such policies have less positive average welfare effects and do not receive majority support