

## **Comment on Michael A. Stegman, Walter R. Davis, and Roberto Quercia’s “The Earned Income Tax Credit as an Instrument of Housing Policy”**

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### *Abstract*

Using the housing affordability issue to advocate for an expansion of the Earned Income Tax Credit as part of a broader working families agenda is politically shrewd. The American public strongly supports the idea that those who “work and play by the rules” (207) should be able to afford the basic essentials of life, and housing is obviously one of them.

From a policy analysis standpoint, however, there are too many unanswered questions to recommend such an expansion as a means of reducing housing cost burdens, although it may have merit on other grounds. Remarkably little is known about the causes and consequences of unaffordable housing for lower-income working families. It is puzzling, for example, why so many lower-income renters are experiencing affordability problems when the rental vacancy rate is at an all-time high. Without a solid understanding of the problem, premature efforts to fix it could have unintended consequences.

**Keywords:** Affordability; Low-income housing; Tax issues

### **Introduction**

Hitching the housing affordability wagon to the Earned Income Tax Credit (EITC) engine as part of a broader working families agenda is politically astute. The idea that, in a rich country, families that “work and play by the rules” (207) should be able to afford, at a minimum, the basic necessities of life carries a lot of force. Housing is certainly one of those necessities. And since housing absorbs such a large share of expenses for low-income families, the impact of high-cost housing could potentially extend far beyond housing itself. If housing costs too much, families are not only at risk of living in unhealthy or dangerous conditions, they may also be unable to afford other things that enable them to succeed and thrive, not merely survive.

My comments on Stegman, Davis, and Quercia’s article fall into three sections. I first look at the political feasibility of enacting an expansion

of the EITC as a means of addressing the housing affordability problem and elaborate on a couple of points raised in the article. Next, I examine the pros and cons of the proposals discussed, focusing primarily on the Dolbeare and median housing cost proposals, which seem to have the greatest policy relevance. I then turn to what is known and, perhaps more important, not known about the housing affordability problems of low-income families and whether an expanded EITC appears to be a good policy for addressing these problems in light of what we know. This last section is the most critical of using a more generous EITC to reduce the housing cost burdens of low-income working families, although the idea might well have merit on other grounds.

## Political considerations

Stegman, Davis, and Quercia contrast an expanded EITC with an enlarged Housing Choice Voucher Program as a means of addressing the affordability problems of low-income workers.<sup>1</sup> The first reason they offer in favor of the EITC is a political one, and it is probably the most important, namely, that “relative to the EITC, Congress has shown little inclination in recent years to increase support for rental assistance vouchers” (208). This point deserves sharpening. There is a substantial body of evidence that the EITC encourages work (Hotz and Scholz 2003), but there is no solid evidence on the incentive effects of vouchers on employment and earnings. This does *not* mean that negative effects have been found. Indeed, research on the incentive effects of other forms of housing assistance has not yielded conclusive evidence of either positive *or* negative effects (Shroder 2002). Since there are good reasons to suspect that vouchers would have better effects on employment and earnings than public or other forms of project-based housing assistance, it is well within the realm of possibility that they could, in fact, promote work.<sup>2</sup> However, no consistent, credible research demonstrates this, and without evidence of this sort to convince skeptics that vouchers encourage work, there would seem to be little hope of enlarging the program to serve working families.

In the current political climate, a major expansion of the EITC faces battles of its own. A possibility suggested, but soft-pedaled, by

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<sup>1</sup> The prospect of major new housing production subsidies is not even mentioned, probably because it is so dim. Vouchers are widely acknowledged to be a more effective approach for delivering housing assistance than production.

<sup>2</sup> Evidence from the experimental evaluation of the Welfare to Work Voucher Program, which was released just as this comment was going to press, suggests otherwise, however (Patterson et al. 2004).

Stegman, Davis, and Quercia is that if the EITC were sufficiently expanded, federal housing assistance could be restricted to the elderly, people with disabilities, and others who cannot be reasonably expected to work to support themselves. This could potentially elicit the backing of moderates and blunt the opposition of conservatives.

In 2001, about half of households assisted by the U.S. Department of Housing and Urban Development (HUD) were headed by a nonelderly, nondisabled adult, and most of them probably worked. Indeed, in their annual rent recertification interview, about half of them reported income from work.<sup>3</sup> This is surely an underestimate, given the disincentive to report income inherent in receiving housing assistance. A more generous EITC might further enhance the ability of this group to pay for housing in the private market.

Sharper targeting of federal housing aid to the elderly and disabled populations would probably improve the image of such assistance in the public eye. It would also alleviate the lack of horizontal equity inherent in current programs where, through a unknown combination of luck and skill, some low-income families receive assistance, while other equally, if not more, disadvantaged families do not.

### **Pros and cons of the Dolbeare and median housing cost proposals**

Stegman, Davis, and Quercia consider three different ways in which the EITC could be expanded to alleviate affordability problems for low-income families. One of these—the Coyne proposal—involves a modest expansion and would not significantly affect the cost burdens of low-income households. Therefore, I will focus on the Dolbeare and median housing cost proposals, which are more explicitly connected to housing policy.

Both of these proposals have their strengths and weaknesses. The Dolbeare proposal is tightly targeted to families with housing affordability problems, but would be costly to administer. It would also be more of a benefit to families with a stronger preference for housing consumption. For example, a family that spent more of its income to live in a larger or better unit would benefit more under the Dolbeare proposal than an equally poor family that spent less on housing and more on, say, education, medical care, or food.

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<sup>3</sup> This is an author's estimate using HUD administrative data.

Stegman, Davis, and Quercia's median housing cost proposal, by contrast, would be simple to administer, but would miss an important aspect of the housing affordability problem: its geography. The price of housing varies far more from place to place than other major consumption items, and it seems plausible that families living in high-priced markets have more affordability problems than comparable families living elsewhere. Discussions of where to set poverty thresholds have long recognized the possibility that local variations in the cost of living, primarily driven by housing, could affect living standards, and most federal housing programs either implicitly or explicitly take local housing prices into account in allocating funds. Dolbeare (2001) notes that "a major advantage" of her approach "is that it would be responsive to the wide differences in housing costs from one locality to another" (125).

It is surprising to note that there is little empirical research on the seemingly obvious connection between local differences in housing prices and affordability. To my knowledge, only Harkness, Newman, and Lipman (2002) have explored the link. We found that not only are low- to moderate-income working families living in high-priced markets more likely to be severely cost burdened, but that there also appears to be a kinked effect, with the incidence of such burdens rising even more sharply when the two-bedroom fair market rent hits roughly \$700.<sup>4</sup>

These results, if borne out by further empirical analysis, suggest that a nationally uniform EITC may be less valuable in real terms to those living in higher-priced markets.<sup>5</sup> For example, a \$500 EITC will go a lot further in helping families reduce their cost burdens in a place where a decent unit rents for \$400 a month instead of \$800 a month.

It may be worthwhile to consider a merger of the Dolbeare and median housing cost proposals that would base EITC levels on local, not national, housing prices. This would be somewhat more complex to administer than Stegman, Davis, and Quercia's proposal, but considerably simpler than the Dolbeare proposal, because rent payments need not be verified. An advantage over the former would be that greater aid would be allocated to the higher-priced markets, where affordability problems appear to be the greatest.

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<sup>4</sup> In this study, low- to moderate-income working families were defined as those with annual earnings between the equivalent of a full-time minimum wage and 120 percent of the area median, adjusted for family size.

<sup>5</sup> This may partially explain the counterintuitive result reported by Stegman, Davis, and Quercia of lower EITC participation rates in higher-priced markets.

This “blended” proposal is not, as will presently become clear, an approach that I necessarily advocate. From a policy analysis perspective, there are too many unanswered questions about the housing affordability issues of low-income working families. My central point, rather, is that if an expansion of the EITC were to be seriously considered for addressing housing cost burdens, the uneven geographic distribution of these burdens might be something to consider.

### **What do we know about housing affordability?**

Much of the recent concern about affordability stems from statistics showing a long-term rise in the housing cost burdens borne by low-income households, with the most recent data suggesting that these burdens have become shockingly high. I have three basic observations to make:

1. To the extent that housing cost burdens, per se, are a problem for low-income working families, an expanded EITC will not necessarily reduce them.
2. An expanded EITC may actually harm low-income families with little or no earnings.
3. High housing cost burdens are not necessarily a problem.

#### *Will an expanded EITC reduce cost burdens?*

Some solid evidence suggests that the fraction of income that renters in the lowest, and possibly the two lowest, national income quintiles spend on housing has increased over the past several decades (Goodman 2001; Quigley and Raphael 2003). At the same time, the quality of housing occupied by these renters has improved, and the proportion living in crowded conditions has dropped. The cost burdens of higher-income renters have remained stable, and the costs of homeownership have remained flat.

Why then have cost burdens increased for lower-income renters? Either falling incomes or rising housing costs could be responsible. Studies on the topic agree that the primary factor is the latter (Goodman 2001; Quigley and Raphael 2003). The real incomes of those in the lowest fifth of the income distribution, the group that has seen the largest long-term increase in housing cost burdens, have not fallen and may

have gained slightly (Jones and Weinburg 2000, table 3). So why have housing costs risen?

The basic issue seems to be that the supply of low-rent units is not keeping pace with demand. Many factors could play a role. Construction costs, which have lagged inflation, do not appear to be responsible. Demographic factors, such as shrinking household size and the growth of the immigrant population, may be raising demand, but the question of why supply has not kept pace remains. Increasing urbanization and population density are other possibilities. However, studies have converged on stricter housing quality standards and land use regulation, such as zoning, as the most important factors (Glaeser and Gyourko 2003; Goodman 2001; Quigley and Raphael 2003). Stricter quality standards and the demolition of thousands of low-priced units through urban renewal shrink the bottom end of the rental market, while at the same time land use restrictions reduce the supply.

If supply restrictions are really at the root of the problem, what would be the impact of expanding the EITC? It is possible that low-income working families could paradoxically end up bearing *higher* housing cost burdens, but still be better off. If the supply of housing is constrained, an expanded EITC could result in more money chasing after the same limited supply of dwellings and raising their price. Although the increased profitability of these investments might lead to some additional supply, the response would most likely be inadequate. Thus, lower-income families would most probably have to pay more for their housing. EITC recipients in working families might, therefore, have *higher* housing cost burdens, but still be better off, since even after paying for higher-priced housing, they might have more money than they did before to spend on other goods.

*Could low-income families with little or no earnings be harmed?*

More ominously, however, other low-income groups with little or no earnings—including the elderly, those with disabilities, and welfare-dependent single mothers—could be adversely affected. These low-income families that did not qualify for the EITC or qualified only for minimal benefits (in the phase-in range) could be hurt, since the cost of housing could rise for them as well, but they would not have the additional income to pay for it.

Under the Dolbeare proposal, outcomes might be even less favorable. Families spending less than 50 percent of their income on housing

would not qualify for the supplemental credit. Paradoxically, these families attempting to economize on housing could end up being most hurt by the higher housing prices caused by giving supplemental credits to those paying more of their income for housing.

### *Are high housing cost burdens necessarily bad?*

An issue raised by these scenarios is the problem of defining “affordable” as a housing cost burden of less than 30 percent or any fixed fraction of income. Depending on income and the price of housing relative to other goods, a family with a high housing cost burden could actually be better off in terms of material consumption than a family with a low burden. Because of this complication, we do not know whether the long-term rise in the housing cost burdens of low-income renters has actually made them worse off.

If, with rising incomes, the price of housing increased relative to the price of other goods, as Consumer Price Index data suggest that it has, housing could possibly absorb a greater share of the income of low-income households without reducing their consumption of other goods. My point here is not that we should be unconcerned about the economic straits of low-income households, but rather that standard housing affordability measures may produce misleading signals for policy.

A couple of other observations further complicate the question of whether housing affordability has really become a more serious problem. One is that, in tandem with the apparent long-term rise in the housing cost burden of low-income renters, rental vacancy rates have increased. Indeed, the latest data (U.S. Bureau of the Census 2004) indicate that this rate was at an all-time high in 2003. Why rents have not fallen despite historically high vacancy rates remains a puzzle (Belsky and Goodman 1996). A second question is why crowding is so rare. Although living in crowded conditions is obviously undesirable, it would seem to be one strategy that lower-income renters might use to reduce their cost burden. Yet data suggest that there is slightly *less* crowding among renters in the lowest-income quintile than among higher-income renters.<sup>6</sup>

<sup>6</sup> In 1999, 4.3 percent of renter households (468,000 of 10,793,000) in the lowest national income quintile were crowded, compared with 5.2 percent of higher-income renters (1,206,000 of 23,249,000) (Joint Center for Housing Studies 2003, table A-10). Similar results may be obtained for 1997. Incidentally, the escalating vacancy rates and the lack of crowding also undermine findings that rising housing cost burdens stem from supply constraints.

Further uncertainties abound regarding the affordability problems of low- to moderate-income working families, the group that would most benefit from an expanded EITC. Some evidence suggests that severe housing cost burdens are temporary for most of them (Harkness, Newman, and Lipman 2002). Fluctuations in income possibly associated with job losses, marital breakups, and other disruptive life events seem to be the primary factor for these transitional cases. Beyond these sketchy results, however, to my knowledge, there is no research on what precipitates episodes of severe housing cost burdens for working families, how long they last, and what families do to manage them.<sup>7</sup>

Finally, there is no solid empirical evidence suggesting that unaffordable housing has serious repercussions on the material or psychological well-being of adults or children in low-income working families, despite widespread concerns and strong reasons to suspect that it might.<sup>8</sup> Without convincing evidence, it is difficult to make a credible case for public concern. The geographic variation in housing affordability raises complicated questions in this regard. The primary reason why housing prices are higher (and less affordable) in some places than in others is that some places are more desirable than others. For example, economic development generally means more and better jobs—and more expensive housing. It is therefore possible that families living in places where housing is costly might be better off than similar families living where housing is cheap. Indeed, people often move to boom areas in search of economic opportunities. Should the federal government be concerned with their housing costs? Or, to put it more bluntly, should taxpayers subsidize working families and, indirectly, their employers to locate in more desirable, higher-priced areas?

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<sup>7</sup> A major problem here is that virtually all research on housing affordability relies on data from the American Housing Survey (AHS). Since the AHS is conducted on a biannual basis and tracks housing units, not households, a large fraction of cost-burdened households vanish from the AHS between survey years. For better information, it would be extremely useful to add a housing module to the Survey of Income and Program Participation, which surveys households on a quarterly basis over three or four years.

<sup>8</sup> There is some evidence for a link between housing prices and homelessness for those at the very bottom of the income distribution (O’Flaherty 1996; Quigley, Raphael, and Smolensky 2001). There is also some evidence that living in public housing has positive effects on children’s development (Currie and Yelowitz 2000; Newman and Harkness 2002), possibly because of lower housing cost burdens.

## So what should we do?

To avoid misunderstanding, I should emphasize that I am *not* claiming that housing affordability is not a problem for low-income working families. Rather, it seems to me that our comprehension of the dimensions, causes, and consequences of the problem are not yet solid enough to be sure that the policies we might devise for it are helpful and not harmful.

As a place to begin, it may be useful to model a housing affordability research program on the substantial body of rigorous, quantitative research amassed over roughly the past decade on the incidence, duration, and effects of spells of poverty. The introduction of housing affordability into that research stream would be a natural extension, since the effects of low family income are likely to depend on geographic variations in the cost of living, which are driven largely by housing prices.

Beyond this fundamental research designed to help us understand how many families experience periods of unaffordable housing, how long these periods last, and what impact they have, research must examine the critical question of whether affordability is a demand-side or a supply-side problem. On the one hand, if working families do not have enough income to pay for available housing, or if raising their incomes would stimulate supply, a more generous EITC might help. On the other hand, if supply constraints are the real issue, an expanded EITC might help lower-income working families, but hurt those unable to work. In this case, the affordability problem cannot be addressed without confronting housing supply constraints head-on by easing development restrictions or implementing effective regional fair-share housing policies.

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