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Safe as Houses: Comparing Housing Finance Policies in the U.S. and Germany

In the wake of the recent financial crisis, Alexander Reisenbichler, a visiting DAAD/AICGS Research Fellow and Ph.D. Candidate at George Washington University in Washington, DC, provided a comparative look at the housing market in both the United States and Germany. His presentation was titled "Safe as houses: Comparing Housing Finance Policies in the U.S. and Germany" and was held on Thursday September 11, 2014. The presentation and the following discussion were moderated by Alexander Privitera, Director of the Business & Economics Program, at the American Institute for Contemporary Studies. During his presentation Mr. Reisenbichler compared the key policy differences for the two countries to explain the variation in the housing market on both sides of the Atlantic. Undoubtedly, this is an important topic, because the US housing market has the ability to not just bring the US economy to a grinding halt, but also to have major impacts on the global economy as a whole, as we witnessed in the aftermath of the 2007 market crash.

Taxation

The housing market is a key sector of the US free market economy, and at the same time – and possibly contradictory to popular belief - US housing policy acts as one of the largest social programs in the United States. US housing policy has been a policy tool since 1913 and originated in the Revenue Act of 1913. Unintended consequences of this policy led to significant government support in the structure of housing policy. The Reagan administration (during the Tax Reform Act of 1986) even declared housing tax breaks as sacred in the tax code. To date, the US federal government provides close to $150 billion in tax breaks to home owners and Mae and Freddie Mac, the so called government sponsored mortgage giants, currently guarantee up to $5 trillion dollars in mortgage markets. $5 trillion are circulating in mortgage markets, comprising 30% of the US GDP. "This is surprising" claimed Mr. Reisenbichler, "because the common wisdom is of course that the US is the land of the free market, from which we would not expect so much government intervention in the housing sector".

By contrast, the German market has no tax incentives nor subsidies and virtually no guarantee from mortgage markets and central banks for homeowners. Germans were able to deduct home mortgage interest from their taxes up until 1987, however former Chancellor Helmut Kohl, in a coalition with the FDP, got rid of mortgage interest reductions in the interest of a free economy. The implications of this have been significant. Germany has a homeownership rate hovering at just about 40%. Homeownership rates in the US however are well over 70%.

Mortgage Market Guarantees and Housing Prices

US mortgage market is rather liberal in terms of lending, whereas the German mortgage market is much more conservative and has very strict standards. "This is because the government in the US takes on much more risk through government-backed guarantees", claimed Mr. Reisenbichler. Government-backed guarantees are a means to stimulate lending by guaranteeing payments to banks which in turn can create more loans in the market. The liberal lending system has led to much more mortgage-debts in the US, where by contrast in Germany mortgage-debts have been decreasing during the past ten years. In Germany the housing market is mostly financed through bank deposits and a fi-

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nancing mechanism through covered bonds ("Pfandbriefe"), originating even as early as the late 1700s. The government does not provide any guarantees for these "Pfandbriefe" and only covers up to 60% of each loan's value. Banks in Germany are legally obligated to retain a significant amount of covered bonds in their balance sheets.

Lastly, increasing housing prices are a priority in the United States. "The housing sector is profoundly interlinked with other sectors of the economy and creates a "virtuous circle" if housing is doing well" Mr. Reisenbichler stated. When in fact housing prices increases are largely celebrated in the United States, they are viewed with great skepticism in Germany, as they translate into rising rental costs. The fact that most Germans rent is currently a significant political concern during the Grand Coalition and started the debate about the so called "rent control" ("Mietpreisbremse"). Rental prices have to comply with the so called "Mieterspiegel", which is a neighborhood rental price index.

World Savings Day vs. Black Friday

In the discussion following the presentation, Christian Ossig, from the Institute of International Finance provided in part an explanation to the differences by stating that the differences come down to varieties in capitalism. Germany is a bank based system, whereas the US is a market based system. This translates into differing saving patterns, where in Germany saving means having a bank balance sheet and in the US saving means investing in financial products, in which the housing market is included. Furthermore, Mr. Ossig pointed to the differences in pension funds. Americans invest in real estate to save for retirement and by contrast, Germans contribute to a state-subsidized social security system to save for retirement. Therefore, in Mr. Ossig's reasoning, by subsidizing the housing market, the US government is circuitously subsidizing retirement.

In a rather humorous moment, he also incongruously suggested that the underlying differences in the housing markets might be culturally ingrained. The fact that Germans are rather risk averse "already starts with the age of three or four, when children bring their piggybank to a savings bank ("Sparkasse") and get rewarded for that on World Savings Day, whereas Americans have Black Friday."