HOUSING AND LABOUR MARKET PERFORMANCE

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Introduction

1. General context and motivation

Homeownership rates have increased strongly in most developed countries since the Second World War. This increase partly resulted from a wide range of policy measures that encouraged the purchase of a house. Many positive externalities of homeownership can be thought of to legitimize these incentives. From a labour market perspective however, the effects of a high fraction of homeowners are less beneficial. The next three chapters of this dissertation analyse the outcomes of housing tenure from this particular perspective.

Oswald (1996, 1997) was among the first to elaborately study this relationship. He developed a theory that explains higher unemployment rates in some countries as the result of higher rates of homeownership. A key element in this view is that high costs of buying and selling homes make homeowners less geographically mobile than tenants. When a region is hit by an adverse labour demand shock, it is expected that homeowners are less likely to move. The higher moving cost that they experience, causes higher reservation wages for distant jobs and lowers their search intensity for these jobs. At the aggregate level, a higher number of homeowners implies lower effective labour supply in each region and each labour market segment, with higher wages and lower employment as a result.

Empirical studies reveal a remarkable difference depending on whether they investigate the relationship between homeownership and labour market outcomes at the macro or the micro level. Most macro studies, with some exceptions, support the Oswald hypothesis that higher rates of homeownership in a region or country imply inferior labour market outcomes. On the other hand, most micro studies find that homeowners have better labour market perspectives than tenants, certainly not worse. Given this apparent contradiction, we conduct three studies, analysing the topic from a variety of angles. Chapter 2 of this dissertation analyses the relationship at the aggregate level, more specifically the effect of the share of homeowners on the aggregate employment rate in Belgian districts. In Chapter 3, we focus on the main channel through which the Oswald effect runs. We explain mobility at the individual household level as a function of housing
tenure choice amongst a range of control variables. Last, we analyse the effect of homeownership on unemployment duration at the microeconomic level. We test whether homeowners have shorter or longer unemployment spells. Both micro studies also concern Belgium. A review of the three papers is given in the next section, each time discussing the research question, data sources, contributions and conclusions.

2. Research questions, results, and contributions

Chapter 2 is a direct empirical test of the Oswald hypothesis at the macro level. Controlling for a range of other regressors, we measure the effect of the fraction of homeowners on employment. To accomplish this, we use a panel of 42 Belgian districts in the period 1970-2005. The broad time range is unique and enables us to adequately estimate the effects of only slowly changing variables like the share of homeownership, the skill level, and demography. Our results confirm the Oswald hypothesis for Belgium. Estimates show that a 1 percentage point rise in the rate of ownership in a district implies a statistically significant fall in the employment rate by about 0.35 percentage points. As to the determinants of the size of the Oswald effect, we find that it falls in the fraction of high skilled in a district. This result supports the theory described by Dohmen (2005). Because of the better wage perspectives for the high skilled, moving costs will less impede the mobility of this group. We also obtain indicative results that the Oswald effect may be stronger in districts closer to a border, and in districts farther away from major cities and centres of economic activity, but these findings are not statistically significant.

Our main result in favour of Oswald’s hypothesis survives various robustness checks. Nonetheless, some of the choices that we make in this paper may require further clarification. First, unlike most of Oswald’s analyses, our benchmark model contains the employment rate as dependent variable, instead of the unemployment rate. We prefer to focus on employment for two reasons. First of all, the employment rate has become the main policy objective for labour market performance in Europe since the Lisbon Summit in 2000. In other words, the parameter of interest for policy makers has shifted since the time Oswald launched his hypothesis. Furthermore, the employment rate as performance indicator is much less vulnerable to distortions caused by policy measures (including
statistical operations) that serve to mitigate negative labour demand shocks (such as early retirement programs). In this scenario, these shocks are not fully observed by the unemployment rate.

Second, it is plausible that the size of the observed regions has an impact on the estimated effect, yet it is not clear in which direction. The larger the area, the higher the chance that zones with high homeownership rates and zones with low homeownership rates cancel each other out, concealing the effects. On the other hand, when analysing very small cross-sectional units (or in the extreme case individuals, as in the micro studies), one is not able to capture the external effects of homeownership. We have reason to believe that the size of the districts used in our research is adequate. If the external effects would transcend the borders of the districts, we would expect spatial autocorrelation. Tests reveal that this is not the case. Third, because of data constraints, Brussels itself is not included in our panel. Although Brussels is an outlier when it comes to homeownership rate, it is most unlikely that one observation would seriously alter the results. As a last sensitivity analysis, we exclude the districts neighbouring Brussels. This results in an Oswald effect that is slightly larger, which is consistent with the above described interaction of districts close to a major city.

Chapter 3 focusses on residential mobility in Belgium. Using micro data, we estimate the probability of a residential move as a function of housing tenure, area characteristics and household characteristics. The Oswald hypothesis explicitly presumes that homeowners are less mobile than tenants. A longitudinal dataset covering the period 1994-2002 is derived from the Panel Survey for Belgian Households (PSBH). Likewise, we use the European Union Statistics on Income and Living Conditions (EU-SILC) to cover the more recent period 2004-2009. Because the two datasets are not directly comparable, we employ both panels separately. The wide range of socio-economic variables that is provided in the datasets allows us to control for age, family structure, educational level, nationality, income and room stress. The area characteristics are derived from Cambridge Econometrics data and data from the ‘FOD Economie’, Belgian Federal Government. These imply the provincial unemployment rate, regional dummies and a list of variables capturing housing supply.

We further subdivide tenants as tenants paying market value rent versus ‘social’ tenants paying a subsidized rent, and homeowners as outright homeowners versus homeowners with a mortgage. Both distinctions are meaningful. Because social tenants have
the possibility of losing their privileges when moving, they are expected to be less mobile than private tenants. Furthermore, having or not having a mortgage can influence residential mobility for homeowners in various ways. A mortgage can hamper mobility because of the supplementary transaction costs and the risk for lock-in effects in case of negative equity. On the other hand, Caldera Sánchez and Andrews (2011) argue that the monthly payments of mortgage holders increase the probability of moving, in order to improve their labour market perspectives, and so avoid unemployment. Our results suggest that tenants are the most mobile group, especially those paying market value rent. Homeowners with a mortgage are the least mobile. Although this is in line with most of the preceding studies, earlier results for Belgium revealed no significant difference between outright owners and mortgagees. Methodologically, in this paper we make progress on the existing literature by paying particular attention to (and dealing with) econometric issues such as unobserved heterogeneity and state dependence. However, we also obtain some indications that the strict exogeneity assumption may be violated for some regressors, implying that we cannot exclude the possibility of some bias in our estimated coefficients.

Chapter 4 studies the impact of housing tenure choice on unemployment duration. By using the EU-SILC data for Belgium, we are able to analyse household behaviour in the recent period 2003-2008. The dataset provides detailed information of a person’s activity status in each month. We use the spells of unemployment that start after a period of employment (i.e. left-censored spells are withheld). A spell can end with re-employment or with right-censoring. We use a mixed proportional hazard model to estimate the effect of housing tenure on unemployment duration, controlling for a wide range of other variables. We take into account the potential selectivity bias that may arise if a person’s unobserved characteristics affect both his unemployment duration and housing tenure. One might falsely interpret the combination of these events as a causal relationship from housing tenure to unemployment. To resolve this issue, we simultaneously estimate a mixed multinomial logit model explaining housing tenure, along the hazard model for unemployment duration. We use instrumental variables (exclusion restrictions) to econometrically identify the housing tenure effect. These are variables that influence housing tenure but do not directly affect unemployment duration. As a first instrument, we adopt the aggregate fraction of homeowners from the study of van Leuvensteijn and Koning.
(2004), in our case at the provincial level. Second, we contribute to the existing literature by adding a new instrument, i.e. the relative price of buying the house versus renting in the year of purchase or contract.

Previous research using a similar methodology found evidence for shorter unemployment spells among homeowners than tenants (Munch et al., 2006) or no significant difference between both groups (Battu et al., 2008), and therefore clearly contradicted the Oswald hypothesis. Our main contribution lies in the investigated distinction between housing tenure types, in particular the different types of homeownership. According to the theoretical search model of Rouwendal and Nijkamp (2010), homeowners have shorter unemployment durations when housing expenses are high. These housing expenses are primarily determined by whether the individual has a mortgage or not. Our results show that homeowners with a mortgage have, ceteris paribus, the shortest unemployment spells while outright owners stay unemployed the longest. Tenants take an intermediate position. When we do not make the distinction, no significant difference between owners and tenants is observed, consistent with the results of Battu et al. (2008). Our results demonstrate the relevance of the distinction that we introduce. Two important conclusions emerge from this. First, liquidity constraints and the induced reduction of consumption caused by housing costs, seem to play a more prominent role than mobility constraints. Second, our results suggest that the discrepancy between the findings of the preceding studies, might be the result of a different composition of the group of homeowners in the respective countries that were studied. More specifically, the Danish group of homeowners, studied by Munch et al. (2006) consists of a higher fraction of mortgage holders than the British group of homeowners (Battu et al., 2008) and the homeowners in our sample. The higher weight of this mortgage subgroup may shift the results to better labour market outcomes for homeowners. If data allow, further research is desirable in which liquidity constraints can be taken into account more directly.

3. What it all boils down to: disentangling the apparent contradiction

Our analysis of residential mobility in Chapter 3 proves that homeowners are indeed less residentially mobile than tenants. Apparently they face a higher mobility cost which would
make them more vulnerable to unemployment, the so-called Oswald effect. However, Chapter 4 reveals no significant difference in unemployment duration between tenants and the average homeowner. Using a search-theoretic model, Munch et al. (2006) demonstrate the appearance of an alternative link between homeownership and unemployment duration, which may undermine the Oswald effect. According to this model, the effect of a higher reservation wage for distant jobs is partly counterbalanced by the effect of a lower reservation wage for local jobs. It is therefore possible that homeowners have a higher matching probability compared to tenants in the local labour market. Coulson and Fisher (2002) emphasise the importance of social networks in the search for work. Homeowners tend to invest more in their social network which improves their local job opportunities. These arguments provide theoretical grounds for the better or equal labour market performance of homeowners at the micro level. They support the results found in the empirical literature.

The question remains how the at first sight contradictory macro results in Chapter 2 and micro results in Chapter 4 can be reconciled. The answer lays in the external effects of homeownership. We sum up a number of considerations revealing that the negative effects are not necessarily concentrated within the segment of the homeowners. In these cases, being a homeowner does not directly harm the labour market outcomes of the homeowner himself. However, it generates negative effects on the labour market in general. First, as an alternative option to moving, one can commute over a longer distance to ameliorate labour market perspectives. At the individual level, reservation wages increase with commuting distance. Nevertheless, it might still be more favourable than moving if the latter induces high costs. Indeed, as argued in a recent study of Kantor et al. (2012), homeowners accept longer commutes. When the rate of homeownership is high, traffic congestion will increase commuting costs for every individual worker and raise overall production costs for firms. This may further undermine employment. Second, the overall promotion of homeownership might undermine the development of a well-functioning rental market. This might increase moving costs for tenants and hamper the efficiency of the labour market. Third, Blanchflower and Oswald (2013) refer to the possibility of zoning restrictions and NIMBY effects, enforced by the group of homeowners. This might impede business activity and consequently employment. Last, Laamanen (2013) argues that the high search intensity and
low reservation wages of homeowners for local jobs, might lead to displacement of other workers in the same region. The net effect for employment at the aggregate level depends on the ratio of the number of displaced workers to the number of homeowners who find new employment. The author provides arguments for the possibility of an increase in the unemployment rate with the fraction of homeownership, in both the short and the long run. These four negative externalities of homeownership explain the possibility that the Oswald effect is observed only at the aggregate level.

4. Policy implications

From the conclusions in the previous sections, we can deduce a number of policy recommendations that can improve labour market outcomes.

- Stop tax deductibility of mortgage payments for new mortgages;
- Decrease transaction costs for buying and selling a house;
- Implement supply-side policies to support the rental market;
- Implement active labour market policies that directly stimulate residential mobility;

Because housing policy in Belgium is a regional matter, it is convenient to concentrate on the Flemish Region throughout this discussion. Let us first target attention at a number of noteworthy characteristics of the Flemish housing policy. An extensive study of the current situation is provided by Heylen and Winters (2012). They list the various policy measures and compare their respective burden on the government’s budget. From their data, we can derive that a large extent of the budget is spent on demand-side policies, mainly encouraging homeownership. More specifically, they calculate that in 2012 the total budget to support homeowners was 5.6 times larger than the budget supporting tenants. The main expense is tax deductibility of mortgage payments which accounted for 1400 million in 2012, as opposed to 864 million for all other housing policies together. As of today, this tax deduction is a federal matter but from 2014 onwards it will be the responsibility of the regional level.

Heylen and Winters (2012) also reveal that households with higher incomes receive the highest financial support in case of property acquisition, rendering a so-called Matthew
effect. The argument of supporting homeownership as a protection against poverty is therefore not consistent with today’s policy. There are two reasons why this inequality emerges. First, it results from the nature of tax deductibility in a progressive tax system. The amount can be deducted from the highest tax bracket, resulting in a higher tax refund for high incomes\(^1\). Second, the demand-side policies supporting ownership generate a strong incentive to buy a house instead of renting. People who can afford it, will be inclined to become a homeowner regardless of their preferences. This will push up the aggregate homeownership rate. Because the lowest income households benefit more from rent subsidies, this group will be inclined to be a tenant. To sum up, both sides of the income spectrum lack tenure neutrality. Below, we extract a number of suggestions to policy makers, considering the conclusions from this dissertation. Although many other factors might inspire policy makers, our focus remains on the labour market implications of housing tenure choice.

We learned that the perceived Oswald effect in macroeconomic empirical work, is most likely the result of the negative external effects caused by homeowners. In our opinion, there are two major remedies to mitigate the Oswald effect. On the one hand, one can lower the rate of homeowners and on the other hand, one can remove the underlying determinant, the restricted geographical mobility of homeowners.

First, how and to what extent can the rate of homeownership be reduced to a more moderate fraction? For example, policy makers can facilitate supply in qualitative rental housing using subsidies and regulation. However, as long as the incentives to become a homeowner are sustained, the effect might be limited for the simple reason that owners of rental houses may sell them. The rental house may then turn into an owner-occupied house. A more effective path is restoring tenure neutrality. Without doubt, the most conspicuous market distortion is the tax deductibility of mortgage payments. We recommend to eliminate this disproportional stimulus for becoming a homeowner. For two reasons, we advise to retain the benefits granted for existing mortgages, at least to some level or for a certain amount of time. First, the households that bought a house have taken into account the current and future benefits they are entitled to, while making a budget. The unexpected

\(^1\) Since 2012, this is much less the case since a reform was implemented in which the percentage of tax deduction has been fixed at 45%, irrespective of the highest tax bracket.
loss of these benefits might disrupt the household’s budget. Second, the elimination of the tax deductibility is likely to have a negative impact on house prices. Because the Belgian housing market (as in many other countries) is characterized by an inelastic supply\(^2\), we can expect that demand-side policies will, to a large extent, be absorbed by fluctuations in the price, especially in the short run. Although this might seem beneficial for future buyers, it is very harmful for current mortgage holders. The negative equity causes so-called lock-in effects. These imply a strong restraint on mobility of this group of homeowners. Also on a larger scale, a strong decline in the average house price can be detrimental for an economy. Therefore, caution is needed. Achieving tenure neutrality is an indispensable objective. Nevertheless, it will only slowly affect the aggregate rate of homeownership.

Second, how can we increase residential mobility? Higher mobility is not only desirable from a labour market perspective but also to achieve a more efficient matching of housing according to household (life cycle related) needs. First, governments can directly encourage mobility by financially compensating the costs that the unemployed experience when moving closer to a new employer. This type of subsidizing can be a complementary tool in the context of activation programs. Within housing policy today, a similar subsidy exists when a household moves to a more adequate residence. It may be useful to implement it for moves to a more adequate labour market as well. Second, a more straightforward policy instrument to stimulate mobility, is directly decreasing the cost of mobility. In 2002, the government of the Flemish region introduced the portability of the transaction taxes. In particular, if an owner-occupier buys a new residence, the transaction taxes paid for the initial residence are deducted from the new transaction taxes. A useful policy measure, because moving costs for the typically immobile homeowners decrease. We recommend to increase the maximum portability and further ease its conditions. Today, the rights expire after two years which is an incentive to remain a homeowner. It is in conflict with tenure neutrality. Additionally, we would recommend reducing overall transfer taxes, which further decreases mobility costs. This will generate the appropriate mobility incentives, as has been empirically proven by van Ommeren and van Leuvensteijn (2005), in the case of the Netherlands.

\(^2\) For estimates of the responsiveness of new housing supply to prices in Belgium and other OECD countries, we refer to Caldera Sánchez and Johansson (2011).
Housing policy attracts a lot of attention from the public opinion. This is not surprising because housing expenses take a large part of the household’s budget. Moreover, owning a house is often a very substantial part of the household’s total wealth. Changes in housing policy are therefore a very sensitive subject matter for the vast majority. From the four policy recommendations, two are likely to have a large impact on household’s behaviour: eliminating tax deductibility of mortgage payments and reducing transaction costs. We believe that these two measures are complementary for four reasons. First, only lowering transaction costs would further encourage homeownership. This effect will be outweighed by the dissuasive effect of the ceased tax deductibility. Second, the expected drop in house prices caused by the latter, will be counterbalanced to some extent by the first. As described above, a very strong correction in house prices is harmful for mortgage holders. Furthermore, it can impair the economic system. Third, both policy measures are compatible for the government’s budget. As shown above, the tax deduction is a heavy burden on the budget. Ending it will generate room to cut transaction taxes and imply other measures improving the quality and sustainability of the housing stock. Last, the momentum is just right. As the tax deductibility for mortgage payments becomes a regional matter, it offers the Flemish Government the opportunity to rethink its housing policy. Choices have to be made because budget constraints force the policy makers to do so. Ceasing the tax deductibility will require political decisiveness. Cutting transaction costs may support its political feasibility.

References


