



# **RENTAL MARKETS AND WEALTH INEQUALITY IN THE EURO-AREA**

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# What does the paper do?

- **Key research question:** What is the relationship between homeownership and wealth inequality across Eurozone countries?
- **Inputs:**
  - *HFCS data from the first wave (excluding Cyprus and Malta)*
  - Cyprus and Malta might be uninteresting for financial portfolio but not for real estate!
  - Nevertheless, impressive decompositions of GE measures of inequality focusing primarily at the middle and bottom of the distribution rather than at the top
  - ***A 3-period model with various simplifications***
  - Why not save some of the 65 main pages and jump in directly to the real thing?
  - ***A general equilibrium model of housing and consumption choice, incorporating a rental market, choice to own or rent, background labor income risk, different education levels, and detail of tax and pension systems.***
  - ***Calibration to match the homeownership rate in Germany***
  - ***Counterfactual exercises, where Germany is successively assigned different degrees of frictions in the rental market and generates different homeownership rates and associated wealth inequality measures***
  - Shortcut to considering different countries, as they do not find that tax or pension systems are particularly relevant for the observed relationship between homeownership rate and degree of inequality

# There is a lot to admire

- Excellent use of HFCS data
- Interesting decompositions of net wealth inequality across renters/homeowners, within the groups, and also across countries
- Development and solution of a general equilibrium housing model with rental markets and background income risk focusing on the role of rental market frictions modeled in a parsimonious way (one parameter)
  - *A (GE)<sup>2</sup> model!*
- Clear focus of the theoretical and the empirical work on this key parameter, despite comparison across so many different countries
- Thought-provoking stylized facts and policy implications that need to be considered further

# Key takeaways from the paper

- There is an **inverse relationship between homeownership rates and measured wealth inequality** in Eurozone countries
- This relationship **comes from the middle and lower part of the wealth distribution** and is linked to the much greater degree of wealth inequality observed among renters compared to the degree of wealth inequality among homeowners.
- The key factor generating higher homeownership can be captured in a model through **a wedge between the value of shelter services obtained by renters and that offered by landlords** (owned real estate).
  - *The precise nature of this wedge is not clear yet*
  - *Policy implications can be surprising:*
  - **Measures to reduce the wedge** and make the rental market more efficient would reduce homeownership and increase wealth inequality
  - **Higher wealth inequality** (e.g. in Germany) can be defended as a consequence of having greater efficiency in the provision of rental services

# Points to think about: The wedge

- The margin **could be introduced in preferences** or in the budget constraint to capture relative service flows of rented versus owned housing
  - *Key question: what creates the difference in service flows of shelter depending on the mode of access to the house?*
- Once we know this source of the wedge, we can start thinking about policy implications:
  - *Is it a friction that would normally need to be corrected, creating a conflict with the objective of less wealth inequality?*
  - *Or a feature of the economy that assigns value to owning the house of residence beyond its flow of shelter services, making it less clear that it should be eliminated or reduced?*
- **How costly would it be to provide such extra services** through public means, for example?

# Points to think about: Wealth Inequality

- Is wealth inequality measured correctly?
- Numerous issues, but here focus on the wedge:
  - *Ownership of the house results from the need to overcome the wedge in provision of shelter services*
  - *Thus, **owned real estate is not equally valuable** to households in terms of shelter services across high- and low-wedge countries*
  - *Yet it counts the same in computing wealth inequality indices and comparing them across countries or even within groups*
  - *Can we adjust for the relative shadow value of housing?*

# Points to think about: Surrogate wealth

- Suppose that the international difference in the wedge arises because of **lower pension entitlement** in some countries relative to others (e.g., Germans offer higher pensions compared to Greeks)
  - *For Greeks, in this case, the house is partly a source of housing services and partly **a substitute for higher pension wealth***
  - *Pension wealth is **surrogate wealth** (not measured in the survey)*
  - *German renters have **access to this pension wealth without owning a house**. A German renter is wealthier than a comparable Greek renter.*
  - *Renters are also closer to homeowners in Germany than in Greece, as pension wealth does not require the purchase of a house.*
- **Increasing these entitlements** could reduce the willingness of people to accumulate (housing) wealth, but it might even reduce the extent of wealth inequality when such surrogate assets are taken into account.
- **Key challenge:** public versus “home-made” provision of pension or other benefits
  - *Some of these points are being pursued in Cerletti, Faia, Haliassos (in progress) in the context of a different housing model with rental markets*

# Other points to think about

- The finding that **housing does not matter for inequality at the upper end** of the wealth distribution mirrors Biliias, Georgarakos, Haliassos (RIW 2017) for the US. There, however, stock wealth inequality matters a lot for overall net wealth inequality, partly because of the much greater popularity of stocks in the US compared to Europe (Christelis, Georgarakos, Haliassos, REStat 2013)
- Germany is exceptional in the way it treats **tax deductibility of mortgage interest** among those who rent out.
  - *Yet, this is not important for the model and the data, even though the model does not allow people to rent and rent out at the same time?*
  - *Incidentally: the model allows for RB&B!*
- The wedge induces homeownership among the previous generation, too, and **a greater tendency to leave bequests**.
  - *How are bequests treated and how would they influence the predictions of the model for wealth accumulation and consumption over the life cycle?*



# Other points to think about

- As the authors acknowledge, **the level of wealth inequality** is not well matched.
  - *Moreover, “There is no real variation in wealth inequality among positive wealth holders in different countries. All of the variation in inequality across countries in the model is generated by the fraction of households with zero wealth.”*
  - *Problematic? How can we understand the sources of this? Could it have something to do with the size of the wedge discouraging sizeable accumulation of housing assets?*
- Are differences in **measured net wealth levels** matched?
  - *Figure 24: Net wealth over the lifecycle is virtually independent of the wedge.*
  - *How do we then understand differences in net wealth levels across countries?*