

Taxing Homeowners Who Won't Borrow

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Abstract

Taxes on land and property have long been viewed as highly efficient because they minimally distort incentives, but standard theories assume homeowners are willing and able to borrow against their housing wealth. Using linked administrative data and quasi-experimental variation in property taxes, I show that because households choose not to borrow, property taxes exacerbate consumption volatility, financial distress, and displacement. Moreover, property taxes increase foreclosures and decrease home investment, implying negative externalities. A household survey indicates that these responses are generated by preference-based debt aversion, rather than by financial or information constraints. While debt aversion increases housing wealth accumulation, it also increases the welfare costs of property taxes, lowering optimal property tax rates.