Housing and Pecuniary Externalities*

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Abstract

We analyze the efficiency properties of a general equilibrium model that focuses on the interplay of housing and credit markets. In a setting with heterogeneous households and uninsurable idiosyncratic risk, we study the impact of the inherent illiquidity of housing and its collateralizable nature on optimal financial taxes. We characterize constrained efficiency by sufficient statistics and find that Pareto improvements can be achieved by taxing borrowings and savings nonuniformly, such that the capital stock and housing price are reduced. The illiquidity of houses limits how insurance can be implemented and determines that the socially efficient level of capital is below that of the laissez-faire outcome. Collateralizability, in turn, introduces a trade-off when alleviating the social costs of the two frictions at play: we find that the socially more important margin is to improve households’ insurance, instead of enlarging their credit opportunities, achieved via less capital and a lower housing price.

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