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## Economics has Left the Building: Rising Emotions in the Housing Policy Debate

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I fear that we have reached the point of the crisis where policymakers no longer feel the need to be constrained by logic or reason. What have been hailed as “creative” approaches are merely *ad hoc* political expediences, addressing the symptoms of the crisis but doing nothing to resolve the underlying structural deficiencies that are the root cause of the crisis. Policymakers are funding billions of dollars in bailouts and preparing to pass laws and regulations based on what “might” happen or what “could” happen, conveniently overlooking research and analysis where necessary. Economic principles are dismissed in the press as pseudo-science.

### THE BAD FACTS

There certainly is a housing crisis. Subprime and Alt-A loans are going into delinquency and foreclosure at truly alarming rates. Some of the effects are localized so that many homes in a single neighborhood are in foreclosure.

At the same time, the economy is turning down, with jobless rates increasing and economic growth at risk. Federal Reserve Chairman Bernanke uttered the other day that the economy may be in recession. I can go on, but since this part has already received the most press, most people probably do not need convincing.

### THE GOOD FACTS

More people need to be convinced of the good facts underlying the present situation. Borrowers experiencing difficulty are at the margin, being primarily individuals that overextended themselves using complex mortgage products. The situation would be far worse if defaults were led by increased unemployment, as in other recessions, and defaults were therefore more randomized. By and large, those who borrowed within their means are fine.

Neighborhood effects exist because individuals that over-borrowed tended to clump together in marginal developments, either in newly constructed developments or in redeveloped inner-city neighborhoods. Many of those neighborhoods were built in fringe areas that posed a distant commute away from public transportation in a less-desirable suburb. During the boom, homes in those areas were valued as if they were identical to the homes in nearby, more desirable, areas. Homes in the desirable areas are maintaining value.

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As Bernanke said recently, we may very well be in recession. But we may also NOT be in recession. Furthermore, there are degrees of recession. If the recession is bad, believe me, we will know it. We are nowhere close to a Great Depression in terms of home price declines, unemployment, or economic growth. The majority of the population does not know recession (you have to be older than 60 years of age to remember living through one as an adult), so saying this is the worst economic climate in recent memory doesn't mean much. So far, this is just slow growth.

At the end of the day, there are 20 million homes owned outright and 46 million mortgages, so some 62 million homeowners are fine. People can still buy homes in the US, but people without income and savings will always have mortgage troubles (unless they rent, instead).

#### FEAR OF THE LITTLE-KNOWN AND THE UNKNOWN

To me, the problem is not the bad or the good, or even weighing the two. Respectful discussion of each can result in meaningful policy and regulations. But when the policy debate turns on tales of woe and desperation – sometimes in direct contrast to the point the storyteller is trying to make (see, for instance, 24 min 19 sec into the April 7 “On Point” NPR broadcast at [http://www.onpointradio.org/shows/2008/04/20080407\\_a\\_main.asp](http://www.onpointradio.org/shows/2008/04/20080407_a_main.asp) ) – and dismisses economics as pseudo-science (44 min 33 sec) it is difficult to have a reasoned *economic* policy debate.

Alan Greenspan once warned about the misuse of inappropriately precise point estimates. Today, misapplied imprecise statistics are being combined with fear-mongering to produce a climate of panic to buy election-year votes. For all we know, in our limitations as human beings, home prices are fine. The press likes to cite the Case-Shiller index, but two other indices, the OFHEO index and the NAR index show much less of a bubble and far more muted effects of home price appreciation/depreciation more recently. The press and the politicians ignore the OFHEO and NAR indices in selling policies to voters in an election year.

The foreclosure statistics are foreclosures that have *begun*. We do not know the relationship between foreclosures begun and foreclosures completed (there is no statistical study). Historical data only covers foreclosures *completed*, so it is difficult to make any historically accurate comparison. Furthermore, the difference between foreclosures begun and completed exists because there are opportunities in the courts to block foreclosure, for instance, in the event that a loan is predatory. A recent court ruling in Wisconsin is testing class-action status for blocking foreclosures and rescinding loans on those grounds. It seems like the judiciary, at least, is working fine.

#### CONCLUSION

Fear is the central feature of the present policy debate, but fear does not lead to efficient and effective policy choices. Policymakers are trying to spend money to fight the mortgage bogeyman and win votes in an election year. We learned in childhood, instead of going to all lengths to avoid the bogeyman turn on the light and look under the bed. Even if there is something there, it's probably not all that you fear.