A New Approach to Federal Housing Policy

For decades, owning a home has been viewed as a key component of the "American Dream." It's a goal to which many people aspire and one that federal policymakers have promoted, largely through subsidizing housing-related debt. Even if one supports subsidies for homeownership, there are strong reasons to question the way those subsidies are structured. In particular, it may be more desirable to subsidize home equity rather than debt, a point I will consider later in this article.

First, I think it's worth stepping back and noting that while purchasing a home is often a wise choice for many people, it's not a universally good idea. There are people for whom homeownership doesn't make sense.

Many people value mobility. For instance, they may want to be able to move from one part of the country to another to pursue their career goals, as different and perhaps better job matches become available. For them, owning a home can make such moves considerably more costly.

Moreover, even if a household prefers to stay in the same area, it may wish to either downsize to a smaller house or upsize to a larger one, depending on its circumstances. That, too, can be costly. Finding a buyer may take time — and once an agreement is made the transaction costs often are considerable.

So why do we so actively promote homeownership as a policy goal? One argument is that homeownership produces what economists call "positive externalities." People who own their own homes, the argument goes, have more of a stake in their communities than do renters. They are more likely to maintain their properties, which benefits their neighbors. And they also may even become "better citizens," participating more actively in organizations that aim to improve the safety of their neighborhoods and the quality of the local schools.

I think there is something to this argument. It makes sense in theory and I think most of us have seen it in practice. But do these benefits outweigh the costs associated with the policies that we have employed to increase homeownership? The answer to that question is less clear.

Government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac facilitated the issuance of mortgages that, upon closer scrutiny, should not have been made. Why did they, and their creditors, take on such risks? I think there can be little doubt that they were emboldened to act incautiously by the belief that they would receive federal assistance in the event that those risks would put them in financial peril. The implicit policy of protecting "too-big-to-fail" firms ultimately failed the American public and contributed to the financial crisis.

However, even if the GSEs had acted more prudentially when evaluating the subprime loan market, there is still reason to question whether the way we promote homeownership is wise, as I noted at the beginning of this article. As it stands, we effectively subsidize mortgages — that is to say, debt. I think there is a better way. We could instead encourage savings and the accumulation of home equity. One way to do this is to create tax-favored savings accounts for potential homeowners. As Charles Calomiris of Columbia University recently noted, these accounts "could be used by low- and moderate-income families to accumulate adequate down payment." Such a policy would limit the risks associated with current GSE practices and provide incentives for households to more carefully consider how much house they can afford and under what terms.

As the economy continues to recover, it is important to reconsider and correct those policies that directly contributed to the crisis, as well as fundamentally examine our long-term societal goals. Homeownership is a good thing for many people. But it is not for everyone. If we are going to promote it, we should recognize that and tailor our policies accordingly. This wouldn't mean an end to the "American Dream." Far from it. Instead, it would mean an end to policies that, in combination with other public actions, have the potential to imperil our financial system again — and our prosperity. **RF**

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