

Mortgage Interventions and Economic Growth
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Our assignment for this session was to “treat the experience of the Great Recession as a laboratory for evaluating the effects of specific interventions that took place at that time on economic performance.” I will briefly reflect on some of the lessons I drew from my time as Assistant Secretary for Economic Policy at the Treasury Department, where I worked on several of the key interventions. Some of the points will overlap with findings from the academic literature but some will not—because they are more practically oriented or just more speculative.

In particular, I will describe what I think are the big take-aways as well as some unanswered questions regarding the GSE conservatorship, the Home Affordable Modification Program, the Home Affordable Refinance Program, and the Hardest Hit Fund.

The GSE Conservatorship

Starting with the GSE conservatorship, the most important lesson I drew from the episode is that an explicit and broad government backstop can stop the mortgage market from going down. In terms of economic growth, it is widely accepted that the downturn in housing markets and the economy more broadly would have been worse if the government had not stepped in.

A second lesson—and this is one that should be taken to heart by people working on the future housing finance system—us that the government will indeed intervene in these sorts of situations. The government is simply not going to stand by and watch the housing market go down. As a result, it is much better to explicitly build this role for the government into the new housing finance system rather than have the government do it on a seat-of-the-pants basis when the need arises. I think this point is one of the most powerful arguments for why we cannot fully privatize the housing finance system.

A third lesson—and I am moving even further into political economy here—is that the politics are such that it appears to be extraordinarily difficult to extract ourselves from the current situation. In particular, the fact that there are so many politically powerful stakeholders with varied interests is proving to be a real obstacle to passing legislation that substantively overhauls the housing finance system. I hope I am wrong about this, but we may be stuck with the conservatorship (probably with some modifications to the arrangement) for some time.

The good news would be that I do not think the status quo is materially constraining economic growth—at least in the near term—or creating significant macro risk. On the growth question, having so much government involvement is probably bad for efficiency and innovation but I do not think this is a first-order issue right now. As for macro risk, the government is directly backstopping the mortgage market so that will probably reduce volatility. Of course, good

arguments can be made that we do not want the taxpayer bearing all this risk. In this regard, one positive development is that the GSEs are now selling off a considerable amount of the non-catastrophic risk through their credit-risk transfer programs.

There are also some unanswered questions about the conservatorship where more research would be constructive. To start, it would be good to have more thinking on what exactly are the deleterious effects of the conservatorship. For example, it is not uncommon to hear that we need to do comprehensive housing finance reform to address the problem that mortgage credit is still tight for higher-risk borrowers. Another example would be the speculation that the conservatorship has been a key obstacle to the revival of the private-label mortgage backed securities market. In both cases, the exact linkages are not all that clear (and, in the latter case, the need for a private-label mortgage-backed securities market in our financial system is also not exactly clear). I think it would help us motivate the need for comprehensive housing reform to have a crisper story about what we are fixing.

More thinking would also be constructive regarding the question of what we should do if we end up with the status quo or something like the status quo for an extended period. If the government continues to play such a big role, how do we avoid, for example, having our mainstream housing finance system starting to struggle with the efficiency issues that have plagued the FHA? I said earlier that I did not think the effects of the current situation on economic growth were first order right now, but they could become larger over time. And, a number of people have raised questions today about how the GSEs credit risk transfer programs would weather a downswing in the housing market—presumably the GSEs and their regulator are thinking about this question, but it would be good to have the research community do more thinking as well.

The Home Affordable Modification Program

Let me turn now to the Home Affordable Modification Program (HAMP), which facilitated the modification of mortgage loans for distressed borrowers.

In terms of take-aways, I think the issue is not so much whether it was constructive for the economy—it seems to be well-accepted that the program helped keep struggling borrowers in their homes and thus mitigated the effects of the housing bust. Rather, the key issue is whether it could have been yet more constructive. In other words, I think the biggest lessons related to how you should design these programs.

One lesson from academic work (including work by my former Treasury colleague Tess Scharlemann and her coauthor Steven Shore) is that addressing liquidity issues was more important than addressing negative equity issues when it came to preventing defaults. The implication, then, is that doing interest rate reductions should take priority over principal write-downs.¹

A second lesson has to do with take-up of the program. The program (or at least the first wave of the program) had to have a tough screen to limit moral hazard because the modifications were so

¹ See Scharlemann, Therese C. and Stephen H. Shore (2017) “The Effect of Mortgage Payment Size on Default and Prepayment: Evidence from HAMP Resets.”

valuable and, given the substantial subsidies, the taxpayers' interests had to be protected. This tough screen really limited participation. An alternative approach would have been to offer people less valuable modifications—for example by reducing mortgage payments by extending the term of the loans instead of reducing mortgage payments through a government subsidy. Doing so would have allowed for a less tough screen, which, in turn, might have gotten the key benefit of the program (lower mortgage payments) to more people more quickly. Of course, there would be trade-offs to the alternative, but it seems worth considering if we face a similar situation in the future.

There has also been some interesting research around the heterogeneity of HAMP servicer performance, but I will let the other panelists speak to this issue.

One unanswered question about HAMP that I would like to see some more research on would be the effects of the program on economic dynamism. I said before that HAMP mitigated the economic downturn, but some people have argued that it slowed the recovery because it kept people from losing their homes and thus raised the cost of moving elsewhere to get a job. On the other hand, other people have argued that it facilitated moving because mortgage payments dropped enough such that they could be covered by payments from renters, allowing homeowners to avoid a costly default and the negative consequences for rental or ownership prospects going forward. Especially in light of the concerns about the longer-term downtrend in dynamism and its effects on broader economic performance, it would be good to see more research on HAMP and mobility.

Home Affordable Refinance Program

Let me offer a couple of take-aways on the Home Affordable Refinance Program (HARP) program. This program facilitated GSE borrowers who were current on their low- or negative-equity loans refinancing into lower-rate loans.

First, although I do not need to tell this crowd, the goals of the program were much broader than foreclosure prevention. The program likely did keep some borrowers who would have eventually fallen behind on their original payments from losing their homes, but the program was mainly about putting more cash in people's wallets and, in turn, providing stimulus to the economy. In other words, the program was principally an instrument for enhancing the countercyclical effects of monetary policy. And, there is some empirical evidence suggesting the program helped spur spending.²

Second, the program illustrated another key benefit of having entities like the GSEs, as, on their own, private-lenders are generally reluctant to do rate-reduction modifications on performing loans.

The Hardest Hit Fund

² See "[Mortgage Refinancing, Consumer Spending, and Competition: Evidence from the Home Affordable Refinancing Program](#)" by Agarwal, Sumit, Gene Amromin, Itzhak Ben-David, Souphala Chomsisengphet, Tomasz Piskorski, Amit Seru, and Vincent Yao.

I will wrap up with a couple of quick thoughts on the Hardest Hit Fund. This fund provided money to states that were struggling with particularly high unemployment rates or particularly large home price declines to use flexibly to address economic challenges.

Regarding take-aways, one general observation is that when Treasury went to allocate the additional \$2 billion that was authorized by the Bipartisan Budget Act of 2015, it was noted that some states, including some hard-hit states, had not used all of their money from earlier allocations. We do not know exactly why this was so, but the practical take-away is that even though it seemed so appealing to allow states to customize their response, the federal government may not achieve its intended goals by putting control in the hands of the states.

In terms of take-aways related to economic growth, it is hard to make generalizations because the funding was deployed in such different ways in different states. However, because the amounts of money were fairly small relative to the size of the U.S. economy, it seems fair to say that the effects on growth overall were small.

Still, we are left with interesting unanswered questions about the efficacy of the different approaches tried, including such variations as applying the funding toward blight reduction. So, the program leaves us with opportunities to more about the tools we might use in the event of another crisis. The Hardest-Hit initiatives have, to date, been under-researched, partly because Treasury did not require the states to collect data surrounding their efforts. But, it would be constructive for researchers to think about whether there are creative ways that we might explore their effects.