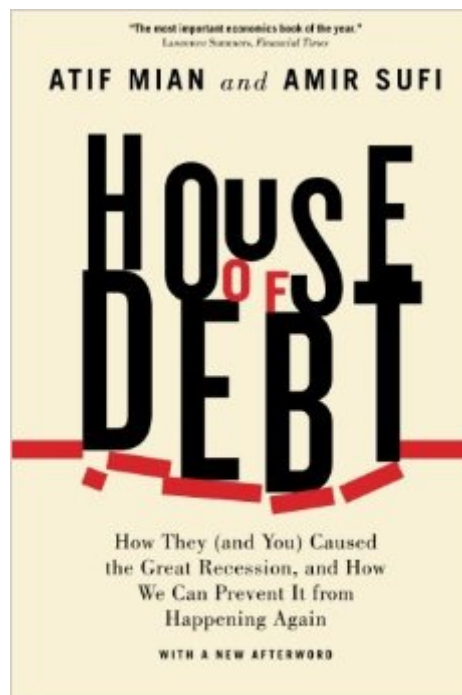


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# House Of Debt: How They (and You) Caused The Great Recession, And How We Can Prevent It From Happening Again



## Synopsis

The Great American Recession resulted in the loss of eight million jobs between 2007 and 2009. More than four million homes were lost to foreclosures. Is it a coincidence that the United States witnessed a dramatic rise in household debt in the years before the recession—that the total amount of debt for American households doubled between 2000 and 2007 to \$14 trillion? Definitely not. Armed with clear and powerful evidence, Atif Mian and Amir Sufi reveal in *House of Debt* how the Great Recession and Great Depression, as well as the current economic malaise in Europe, were caused by a large run-up in household debt followed by a significantly large drop in household spending. Though the banking crisis captured the public's attention, Mian and Sufi argue strongly with actual data that current policy is too heavily biased toward protecting banks and creditors. Increasing the flow of credit, they show, is disastrously counterproductive when the fundamental problem is too much debt. As their research shows, excessive household debt leads to foreclosures, causing individuals to spend less and save more. Less spending means less demand for goods, followed by declines in production and huge job losses. How do we end such a cycle? With a direct attack on debt, say Mian and Sufi. More aggressive debt forgiveness after the crash helps, but as they illustrate, we can be rid of painful bubble-and-bust episodes only if the financial system moves away from its reliance on inflexible debt contracts. As an example, they propose new mortgage contracts that are built on the principle of risk-sharing, a concept that would have prevented the housing bubble from emerging in the first place. Thoroughly grounded in compelling economic evidence, *House of Debt* offers convincing answers to some of the most important questions facing the modern economy today: Why do severe recessions happen? Could we have prevented the Great Recession and its consequences? And what actions are needed to prevent such crises going forward?

## Book Information

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## Customer Reviews

In this very short and extremely readable book two young professors prove with mathematical rigor (and in plain English) that the recent "Great Recession" was caused by the overindebtedness of America's poorest homeowners. It is truly incredible how much economics they pack into this 187 page book and how much of it you can absorb without stretching yourself. Brief summary of the argument: 1. Always quoting relevant research, but never attempting to talk over your head, they start by explaining how the poorest 20% of homeowners on average lost their entire net worth in the crisis, all while the richest 20% came out unscathed. How come? Simple: 1. The top 20% mainly hold financial assets that were protected by the Fed 2. The top 20% are indirectly the guys holding on to the mortgages that the poorest 20% are still paying or alternatively the US government guaranteed by taking over the obligations of Fannie and Freddie. All the recent talk about inequality? Go no further. The authors have it covered by page 40. Next! 2. They then explain that the poorest 20% have a marginal propensity to consume that is a large multiple of that of the richest 20%, an effect that also works in reverse and explains most of the fall in consumption (and thus aggregate demand) in the economy once their home equity had wiped out their lifetime savings. Yes, I'm confusing wealth effects with income effects here, but only for the sake of brevity. The authors do not! In short, the way you lose your house is you lose your income first (for example, divorce cuts it in half or illness in the family keeps you from working), next you miss payments, then you lose the house, which represented all your wealth to cap it all off. Alternatively, it's all set off when your monthly payment rockets up.

The authors present a short and pithy argument that household debt, particularly mortgage debt, grew excessively in the years leading up to the financial crisis of 2008, and show correlations between the growth of mortgage and other household debt in various communities, on the one hand, and drops in employment and household spending in the same overly levered communities, on the other. Chapters 1-7 present this theory and the supporting evidence. I came to this book holding this belief to begin with, so not surprisingly, I find the thesis persuasive. In my review of the book "Guaranteed to Fail" on this website back in 2011, I wrote: "From 1986 to 1995, the annual growth in US residential mortgage debt averaged less than \$200 billion per year; considering

inflation and population growth, the rate of growth relative to demand declined significantly over that period. In 1995, when mortgage growth was only \$150 billion, the then administration launched its "National Homeownership Strategy" to expand home ownership in which [GSE] financing played a major role. By 1998, mortgage growth more than doubled, past \$300 billion; by 2001 it was over \$500 billion, and in 2005, it exceeded \$1 trillion. In other words, annual mortgage growth went up more than 600% in that decade.

I found the early chapters of the book to be well written and insightful. Essentially, the authors documented the rapid expansion of private debt to unsustainable levels, as the public chased home appreciation, caused by easy credit. The authors went on to avert that the collapse in housing prices had a greater adverse effect on the wealth and spending habits of the poorer cohorts of our society. They asserted further that the efforts of the government and the FED to mitigate the effects of the Great Recession were ineffective since they did not address the major cause, that being, the over leveraged private sector. They assigned most of the blame to lenders while leveling much milder criticism on the government, FED, Fannie and Freddie, and the American public. The final third of the book described the authors' solution to the problem. The authors assert that creditors did not absorb their fair share of the losses as a result of the collapse of housing. Their solution was a new mortgage contract they named a "shared-responsibility mortgage" (SRM) which essentially places the lender in a partial equity position. The lender could absorb future losses through reduction of mortgage principal if the underlining property fell in value and additional profits if the home appreciates. All the subtracting would result from changes in various indices that the authors claim can be developed. The additions would be recognized at the time of sale. (What happens if the owner does not sell his home? Is he presented with a bill by the mortgage holder at the time the mortgage is paid off? What happens if the owner dies does the note holder have a claim against the estate)? The authors were heavy on the positive macroeconomic effects of such a program and light on detail.

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