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Are We Headed Towards Another Housing Crisis?

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Get ready for another housing boom and bust roller coaster ride. Fannie Mae and Ginnie Mae, two of the nation's largest housing finance agencies, have announced plans to reduce the down payments for home purchases from the current 5% to 3%. Fannie Mae CEO Timothy Mayopoulos broke the news on Oct. 22 to a large Las Vegas mortgage banker's conference. It was the perfect place to roll out yet another housing roulette wheel for house hungry, though credit weary, Americans.

Homebuilding is just now getting back on its legs and there is still a huge stockpile of bad subprime mortgage loans left over from the previous crisis that continue to plague banks and other lenders. So why are the regulators putting us back on the economic roller coaster?

To answer the question, we have to review the lessons taught by the Bootlegger/Baptist theory of economic regulation.

The theory goes like this: Both bootleggers and Baptists like Sunday closing laws that shutter corner liquor stores. By taking the moral high ground on the matter, the good Baptists pride themselves in getting demon rum off the streets (at least one day a week). And the bootleggers? They eliminate competition, also for one day a week. Both win—as do the politicians who have pleased two important interest groups.

The Bootlegger/Baptist theory tells us that durable regulation emerges when two very different lobby groups push for the same outcome. But they cannot be just any two different groups. One must call for doing the right thing, which helps the politicians justify their actions. And the other must be in it for the money so as to focus and possibly bankroll the endeavor. The "Bootleggers" can celebrate all the way to the bank when the "Baptists" deliver the goods.

It's obvious that people who currently lack the wherewithal to purchase a desired home will celebrate when told that a shortage of cash will no longer stop them on the way to living the American dream. Advocates for lower income people will celebrate with them, while explaining that helping lower income people is the right thing to do.

For example, Paul Leonard, California director of the Center for Responsible Lending, described the situation lower income families faced after the 2008 crash this way: “Those folks took it on the chin the hardest and have been least able to get up off of the mat. That’s a serious challenge in terms of building wealth.”

And the Bootleggers? Home builders, realtors, mortgage lenders, mayors of cities pushing for growth—all facilitated by politicians looking to put more merit badges on their jackets.

The trouble with all this, though, is that lower down payments create just the sort of incentives that led to the last housing crisis. When homeowners put less money down, by definition they have a smaller stake in the value of the home. So when monthly payments become overly burdensome, they are more likely to walk away. Banks find they have to write down more bad loans, which is all financed by the “endless” credit line provided by federal housing agencies…until it isn’t.

So will the end of the ride be as bad as the last housing roller coaster? Maybe the boom and bust will not be so staggering this time. After the bruising 2008 financial collapse, many new rules fell into place. But some of them helped make banks even bigger and even more aggressive in finding new financing opportunities. Furthermore, each of the rules can be adjusted when politicians get the urge.

In other words, conditions are ripe for Bootlegger/Baptist activity and another plunge into economic darkness. The rest of us are just along for the ride.

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