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The Argument Over The Subprime Mortgage Crisis

The argument over what part government should play in business has been a heated one in the U.S. since the inception of the Constitution. While some argue for a Laissez-Faire style, "hands off" government-business relationship, others seek the government to play a more active role in business. The debate is relative to current issues today, the most notable being the "sub-prime" mortgage crisis facing the American economy. As a result of this crisis, the housing market has collapsed, there are record numbers of foreclosures, and the economy faces a potential recession. Should government intervene in this crisis and subsidize homeowners facing foreclosure? The answer to this problem is yes, the Federal government should subsidize homeowners facing foreclosure due to the "sub-prime" mortgage market. While staunch laissez-fair proponents such as Milton Friedman might roll over in their grave at this idea, it is a necessary step to diminish the possibility of a recession from occurring.

In order to understand why the government should subsidize "sub-prime" homeowners, it is necessary to look at what has resulted from this crisis. As a result of rising foreclosures, the housing market has bottomed-out and the economy is on the verge of a potential recession. Financial firms, such as Lehman Brothers and Merrill Lynch, have lost about $600 billion as a result (Moses and Onaran). Approximately $739 billion in mortgages are at great risk to default over the next five years and millions of families could lose their homes as a result (Andrews). The crisis has not solely affected those involved in the housing or credit markets. The crisis has put the jobs, homes, and economic standing of innocent bystanders in serious jeopardy. The government cannot simply sit idle as people everywhere are hurting.

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The mortgage crisis is not one solved by government inaction. Lenders and borrowers, the people who created the problem and are most affected by it, can't fix it on their own. Alan Blinder argues this point by stating that borrowers and lenders can't renegotiate terms of a mortgage because in today's complex age of lending, the two parties don't even know each others names. Even banks, notorious for seeking looser government restrictions, have begged for government intervention. Bank of America recently sent a proposal to Congress calling for certain interactions that they claim would help solve the problems created as a result of the "sub-prime" mortgage crisis (Andrews). If banks are resorting to begging for government help, then it is clear prominent lenders won't be able to solve the problem on their own and certainly not individual borrowers.

Multiple government subsidizing plans to aid homeowners facing foreclosure have been proposed. The proposal with the strongest supporting precedent is government purchasing of mortgage debts from private companies. The government could then issue new loans to homeowners or adjust the old mortgages; both of which would provide relief to homeowners. Alan S. Blinder, writes that there is precedent behind this course of action. In 1933, facing huge impending foreclosures, President Franklin D. Roosevelt and Congress created the Home Owners' Loan Corporation (HOLC). HOLC proceeded to buy old mortgages from banks and issue new loans until 1951, when it was no longer needed (Blinder). As Blinder writes, "It was a heavy lift, but the incredible HOLC lifted it." Bringing back the HOLC can serve to provide homeowners with relief from their housing debts. Bank of America's aforementioned proposal to Congress called for a similar course of action. It suggested creating a corporation that would buy billions in troubled mortgages at a discount, forgive debt above the homes current market value, and use federal loan guarantees to refinance the loans at lower rates (Andrews). If these plans to reinstitute the HOLC or a similar body were implemented, homeowners facing foreclosure would have more time to pay off less debt.

Another proposed government subsidy is to eliminate the tax for a homeowner when a lender forgives some mortgage debt. This plan has been supported by both the Republicans and Democrats. This course of action has actually been implemented temporarily under The Mortgage Forgiveness Debt Relief Act of 2007. However, this tax moratorium only lasts 3 years (Rosen). Under current law, if a bank forgives a borrower for its debt due to their inability to pay, the forgiven debt becomes taxable income to the borrower at rates of 30 to 40 percent (Clemmitt). The borrower still would lack the ability to pay off this tax. The borrower goes from owing a bank to owing the government. Eliminating this tax permanently can help to decrease the tremendous amount of debt owed by consumers in this country. The temporary tax has provides over $600 million worth of relief, that number will only soar if the plan is made permanent (Rosen).

One argument against having the government intervene in the housing crisis and subsidize homeowners is that it will be essentially serve as a “bail out” for greedy borrowers. Marvin Goodfriend of the Richmond Federal Reserve Bank argues that “Bailouts are terrible because they create moral hazard—the tendency of people to make more bad choices in the future because they didn’t have to face consequences of earlier choices” (Clemmitt). Yes, some borrowers were speculators looking to make a quick buck and flip the house they bought for a profit. However, there are still approximately 2 million owner occupied homes where families face foreclosure. These borrowers were not looking to make a quick profit but merely simply looking to provide shelter for their families. In doing so, they were as Danny Schechter writes, “seduced into buying homes with so-called subprime loans (pricier than most ordinary loans) that the lender knew they could not afford.” These two million people are not looking for a “bail out” to recover lost profits; they are looking for a “bail out” to provide a roof for their families.

It has also been argued that government subsidies will end up bailing out the lenders, not homeowners. “A borrower bailout and an investor bailout are synonymous,” argues real estate agent Paul Jackson (Clemmitt). Is this necessarily a bad thing? While lenders may not necessarily “deserve” a bailout, that doesn’t mean it won’t help the mortgage crisis. Lenders like Countrywide and Lehman Brothers, who have been hurt considerably as a result of the mortgage crisis, employ thousands of employees whose jobs are in grave danger. Helping out the lenders helps keep jobs, which in turn, help to prevent a recession or economic downslide. Homeowners will still benefit regardless as a result of government subsidies. They will still have less to pay and more time to pay it with help from the government even if lenders are benefiting as well. Apparently, according to critics, only one group of people can be helped out per government action.

Critics can scream all they want about “bail outs” for the greedy but ultimately this is not what government subsidies will be. They will be economic lifesavers to victimized people and an economy in desperate need. While the government should not always intervene in the economic hardships of its citizens, this is one case where they need to. We have already seen what happens through this crisis the results of government inaction; unemployment rises, homes are lost, and threats of recession occur. Those problems will only become further inflated if a more Laissez-Faire type policy continues. The time to act is now. Any government inaction will simply be a “sub-prime” policy.

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Essay #1: The Federal Government SHOULD subsidize homeowners who are in foreclosure due to collapse of the "sub-prime" mortgage market.