
Government Intervention Is Needed to Solve the Housing Crisis? It Just Ain't So!

BY STEVEN HORWITZ

In his March 18, 2008, column in the *New York Times*, David Brooks addresses the ongoing problems in the housing industry and concludes that “In normal times, the free market works well. But in a crisis like this one, few are willing to sit back and let the market find its own equilibrium.”

Instead, Brooks calls for a variety of government interventions to address the problems he sees, even as he recognizes that government contributed to those problems. Consistently throughout the column he fails to be as skeptical about regulators as he is about market participants, although the regulators are the cause of the problem and the key to his proposed solution. It simply “just ain’t so” that additional regulations are necessary to deal with these problems; in fact, they are likely to exacerbate them.

Brooks begins with a typical litany of potential problems arising from the fall in housing prices. Millions of people are expected to default on mortgages in the next few years, with millions of others owing more than their houses are worth. Furthermore, he worries that uncertainties about mortgage-backed securities will create ongoing problems for the banking system for the foreseeable future. And as for who’s to blame for the situation, Brooks points to “out of control” mortgage brokers, regulators who were “asleep,” and homebuyers who thought themselves entitled to huge houses as well as ever-rising property values.

Brooks then asks, rhetorically, “Shouldn’t people be held responsible for their stupidity and greed?” His answer, unfortunately, is “not really.”

One point worth noting in the hand-wringing over the housing crisis is that it is not a universal phenomenon. Yes, it’s very much true that housing prices have taken a big tumble in a number of major metropolitan areas, but more so in hot markets like Las Vegas and south Florida, as well as the affluent suburbs of other cities. The fact that many of these places are in “blue” states, where opinion-makers tend to live, might explain why it has received so much media attention.

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However, in the rest of the United States the effects are not so great. And where I live, near the Canadian border in New York state, the local newspaper indicated that housing prices in the tri-county area are up over one year ago. Moreover, reports from areas with high foreclosure rates suggest that some number of the houses falling in value in hot areas were bought to be “flipped,” that is, sold quickly for

a profit, rather than lived in as primary residences. The number of people losing their primary residences is much lower than the total in mortgage default.

However, let’s grant Brooks the fact that there is a crisis at hand. Why then not have individuals take responsibility for their own bad choices? He argues that such responsibility, while important, has its limits. Specifically, he cites research in behavioral economics that shows how we “are powerfully and unconsciously influenced by the ideas and assumptions that float

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around in the social ether.” In his view “financial elites” offered “delicious loans to consumers” that they apparently were powerless to resist because they were unable to see the real risks involved. Therefore, they are to be rescued from their own short-sightedness.

This argument is dangerous in two ways. First, am I then to be saved from myself every time I walk into a restaurant that dangles a delicious serving of Buffalo wings before me at a price I am apparently powerless to resist, only to discover later that I’ve gained weight and caused my cholesterol to rise? What about that ultra-soft toilet paper I buy that turns out to be not as soft as I expected? As F. A. Hayek argued decades ago when similar arguments were made by people like John Kenneth Galbraith, the fact that our opinions and beliefs are very much shaped by the cultural environment and not consciously or rationally chosen does not mean that specific sellers can somehow “deliberately determine the wants of particular consumers.” The results of behavioral economics do not suggest we are victims of malevolent sellers, whether of food or mortgages.

But suppose Brooks is right that we are being overwhelmingly influenced by the ideas in the social ether. *Why is this not equally true of those whom he would empower to save us from ourselves, if not Brooks himself?* Do we suddenly become all-knowledgeable and able to resist that social ether when we move from consumer to regulator? Perhaps Brooks himself interprets the housing crisis the way he does because of similar unconscious, and erroneous, influences. Whatever the truth of the results of behavioral economics, they do not by themselves provide a case for government regulation of human behavior because, like the fact that people are generally self-regarding, the claim that people are unconsciously influenced applies to regulators as well. How can we be sure they will do any better than the same people will in the marketplace?

Perhaps most disturbingly, Brooks dismisses the most trenchant criticism of some sort of bailout by invoking the language of crisis. The danger of a bailout of home-

owners or mortgage holders is that it creates “moral hazard” for the future. Moral hazard refers to the propensity to engage in more of a risky behavior when you know you are insured against a bad outcome. A bailout today suggests that all parties can count on such bailouts in the future, reducing the costs of engaging in the same sort of risky behavior down the road. In fact, it was former Federal Reserve chairman Alan Greenspan’s promise several years ago that the Fed would cushion against bursting asset bubbles that some commentators blame for encouraging the risky loans in the housing market. Brooks recognizes that this is a concern, but then says that’s a worry for “normal times” In a crisis, concerns like this go “on the back burner.”

Dangerous Precedents

What is so disturbing about this argument is that it is *precisely* during crises that precedents get set and powers are given to government that never are given back. As the work of Robert Higgs has documented, very rarely do the temporary powers given to the state to address a specific crisis ever get completely removed when the crisis passes. It is all too easy for the politics of a crisis to slowly transform into the politics of “normal times.” In the current situation, regulators are not even bothering to pretend that their “need” for new powers is a “temporary necessity.” The current proposal to give the Fed broad new regulatory oversight will be a permanent increase in the power of the state. To the extent the causes and consequences of the problems in the housing market have been misinterpreted and power-hungry politicians and regulators see an opportunity to swoop in, more “solutions” such as this one are sure to follow.

Those who propose intervention to bail out homeowners and mortgage providers not only fail to see that it was prior intervention (among other things, the promised bailout) that helped to create the current crisis, but they also fail to recognize that the precedent created by a bailout makes it more likely that one will occur in the future.

