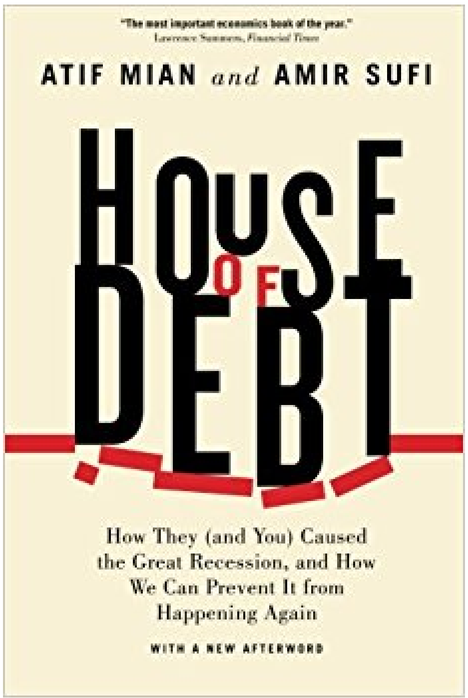
House Of Debt: How They (and You) Caused The Great Recession, And How We Can Prevent It From Happening Again



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 publicÃ¢â ¬â„¢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. Ã Â 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?

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Customer Reviews

Ã¢â ¬Å“The most important economics book of 2014; it could be the most important book to come out of the 2008 financial crisis and subsequent Great Recession. Its arguments deserve careful attention, and its publication provides an opportunity to reconsider policy choices made in 2009 and 2010 regarding mortgage debt. Ã Â House of Debt is important because it persuasively demonstrates that the conventional meta-narrative of the crisis and its aftermath, which emphasizes the breakdown of financial intermediation, is inadequate. . . . All future work on financial crises will have to reckon with the household balance sheet effects they stress. After their work, we can still believe in the necessity of financial rescues; however, we can no longer believe in their sufficiency. And after their work, we have an important new agenda of reforms to consider if future crises are to be prevented.Ã¢â ¬Â• (Lawrence Summers Financial Times)Ã¢â ¬Å“A concise and powerful account of how the great recession happened and what should be done to avoid another one. Atif Mian, an economist at Princeton University, and Amir Sufi, a finance professor at the University of Chicago, make a strong circumstantial case that household debt was the recession’s main culprit. They also find it skulking in the background of previous downturns, usually loitering in the vicinity of a housing bubble. . . . House of Debt is clear, well-argued and consistently informative. . . . Mian and Sufi’s proposal to shift much of the risk of falling home prices to lendersÃ¢â ¬â •while rewarding them for their troubleÃ¢â ¬â •is a good place to start. If we don’t put moralizing aside and analyze dispassionately what caused the last crisis, we areunlikely to prevent the next one.Ã¢â ¬Â• (Wall Street Journal)Ã¢â ¬Å“Subsequent reforms to our financial system give policymakers more tools to police housing finance, yet the continuing over-reliance on debt and a lack of good jobs leaves families at risk and exposes our economy to the whipsaw of another debt-fueled credit bubble. Mian and Sufi deserve credit of another kind for detailing how ensnared the American Dream is in this tangled web of debt financeÃ¢â ¬â •and how exposed the vast majority of us are to the broader economic consequences.Ã Â Ã¢â ¬Å“ (Atlantic)Ã¢â ¬Å“Mian and Sufi are convinced that the Great Recession could have been just another ordinary, lowercase recession if the federal government had acted more aggressively to help homeowners by reducing mortgage debts. The two men Ã¢â ¬â • economics professors who are part of a new generation of scholars whose work relies on enormous data sets Ã¢â ¬â • argue . . . that the government misunderstood the deepest recession since the 1930s. They are particularly critical of TimothyÃ Â Geithner, the former Treasury secretary, and Ben Bernanke, the former Federal Reserve chairman, for focusing on preserving the financial system without addressing what the authors regard as the underlying and more important problem of excessive household debt. They say the recovery remains painfully sluggish as a result.Ã¢â ¬Â• (Binyamin Appelbaum New York Times)Ã¢â ¬Å“Distills lessons about the crisis from their recent research into one easily digestible package.Ã¢â ¬Â• (Economist)Ã¢â ¬Å“The economists Mian and Sufi are our leading experts on the problems created by debt overhang (and the authors of an important new book on the subject, House of Debt); they looked at GeithnerÃ¢â ¬â„¢s claims about the benefits of debt relief to the economy and showed that they are absurdly low, far below anything current research suggests.Ã¢â ¬Â• (Paul Krugman New York Review of Books)Ã¢â ¬Å“Sufi and Mian have been publishing important work on this topic for the last eight years, beginning well before the 2008 crisis. Their arguments are compelling and deserve widespread attention, especially at a time when Tim Geithner and others are trying to rewrite history Ã¢â ¬â œ and when many homeowners still need help.Ã¢â ¬Â• (Richard Eskow Huffington Post)Ã¢â ¬Å“House of DebtÃ Â by Atif Mian and Amir Sufi of Princeton University and the University of Chicago, respectively, reads things a bit differently and, to my mind, more sagely. The authors contend that Geithner and colleagues erred mightily in not focusing more on homeowners. HomeownersÃ¢â ¬â„¢ post-bubble mortgage debt overhang was a much greater long-term threat to the macroeconomy than was bank failure. It was also, as I and others argued at the time, the ultimate source of bank peril itself. Rescuing homeowners would accordingly have offered a twofer, binding the wounds that the bailouts could but bandage. . . . Superior to GeithnerÃ¢â ¬â„¢s take on the crisis.Ã¢â ¬Â• (The Hill)Ã¢â ¬Å“In House of Debt, their brilliant new book . . . Mian and Sufi detail the ways in which the housing bust damaged the economic well-being low- and middle-income households across the country.Ã¢â ¬Â• (National Review)Ã¢â ¬Å“Much has been written about the boom and subsequent bust that rocked the US economy during 2007Ã¢â ¬â œ2009, but insightful and informed analysis is much rarer. This book is one of those rare gems. It offers an in-depth look at the state of housing, consumer credit, household incomes, and debt around the crisis and presents an informed discussion about its causes and consequences. The analysis of crisis resolution has resonance, not only for the United States, but for the many countries that are still entangled in severe financial difficulties.Ã¢â ¬Â• (Carmen Reinhart, Harvard University)Ã¢â ¬Å“Atif Mian and Amir Sufi, our leading experts on the macroeconomic effects of private debt, have a new blog [www.houseofdebt.org]Ã¢â ¬â • and it has instantly become must reading.Ã¢â ¬Â• (Paul Krugman New York Times)Ã¢â ¬Å“House of Debt is a very important book, reaching beyond surface explanations of the Great Recession to identify the fundamental causeÃ¢â ¬â •excessive private debt built up in the pre-crisis boom years. It combines meticulous empirical research with an ability to see the big picture. Its message needs to be heeded and its proposals for reform seriously considered if we are to avoid repeating in future the mistakes of the past.Ã¢â ¬Â• (Lord Adair Turner, former chair, Financial Services Authority)Ã¢â ¬Å“Mian and Sufi have produced some of the most important and compelling research on the impact of debt on consumer behavior during the recent housing bubble and bust.Ã Â This excellent new book presents and expands this research in a rigorous, yet engaging and accessible way.Ã¢â ¬Â• (Christina D. Romer, former chair of the Council of Economic Advisers)Ã¢â ¬Å“This is a profoundly important book that makes a huge range of serious empirical evidence on the financial crisis accessible to a broad readership. Ã Â A compendium of Mian and SufiÃ¢â ¬â„¢s own celebrated work would already be a spectacular contribution, but this book is so much more.Ã Â Although the authors present all views in a balanced, scholarly way, their quiet insistence that we should have moved faster to write down household mortgages is well-reasoned and compelling.Ã¢â ¬Â• (Kenneth Rogoff, Harvard University)Ã¢â ¬Å“The country needed a bailoutÃ¢â ¬â •the government just chose the wrong one. ThatÃ¢â ¬â„¢s the case economists Atif Mian and Amir Sufi made this year in a book aiming to rewrite the story of the recessionÃ¢â ¬â •and what our politicians should have done about it. If theyÃ¢â ¬â„¢re right, future crises may be handled entirely differently.Ã¢â ¬Â• (Politico)Ã¢â ¬Å“One of the most important insights about the state of the European economy right now comes from postcode data in the US. In their magnificent book House of Debt, Mian and Sufi find that what is outwardly disguised as a credit crunch is in reality a fall in demand for loans. Their analysis lends credence to the idea of a balance sheet recession: the notion that indebted households and corporations do not care about cheap interest rates but just want to offload debt. When that happens, monetary policy becomes ineffective.Ã¢â ¬Â• (Financial Times)Ã¢â ¬Å“Most books about economics are hard going, ploddingly earnest and pretty impenetrable. This one is not. It is one of those rare pieces of work that actually contains more than one Ã¢â ¬Å“wowÃ¢â ¬Â• moment.Ã Â . . . Mian and Sufi are empirical economists. They are both clever. . . . But where they differ from most of their peers is that they are prepared to dig down into the data, often to the individual postcode level, to see just what the impact of a particular policy decision was and, as important, which way causality flows.Ã¢â ¬Â• (Financial World)Ã¢â ¬Å“Perhaps the most important single lesson of the crisis is that beyond some point the growth in debt adds to the fragility of the economy more than it adds to either personal welfare or aggregate demand. Atif Mian and Amir Sufi argue this persuasively in House of Debt.Ã¢â ¬Â• (Martin Wolf Financial Times)Ã¢â ¬Å“A perceptive book, House of Debt, by Atif Mian and Amir Sufi, makes a strong case that the excessive level of borrowing by middle-class and even poor Americans was a fundamental cause of deep recession. Once unemployment started o rise, Americans had less buying power because they were strangled by mortgage and other debt.Ã¢â ¬Â• (New York Review of Books)Ã¢â ¬Å“It is all too easy to get wrapped up in the glamour and squalor of financial maneuvers. One forgets that the financial system is useful only to the extent that it makes the everyday economy of production, employment, consumption and capital formation work better, and avoids doing harm. Mian and Sufi do not make this mistake. Their principles and their very ingenious research keep the focus where it belongs. They tell a powerful story about excessive debt that any reader can understand, they nail it down with careful use of data, and they have serious ideas about how to make the system better and safer. It is a splendid book.Ã¢â ¬Â• (Robert M. Solow)Ã¢â ¬Å“In this readable book, Mian and Sufi pose questions pertaining to the 2008 financial crisis and subsequent great recession: Why did the housing bubble vary in severity?Ã Â Ã Â Why did unemployment increase where housing prices were stable?Ã Â Can a reoccurrence of this financial crisis be prevented?Ã Â . . . . Recommended.Ã¢â ¬Â• (Choice)Ã¢â ¬Å“Many books have been written trying to explain the housing crash and the subsequent mortgage meltdown. This book, however, adds clarity to a murky topic. It offers new insight into housing debt, consumer spending, and how mortgage debtÃ¢â ¬â •if abusedÃ¢â ¬â •can lead to disastrous results. Moreover, their proposal to shift mortgage risk to lenders is an interesting concept.Ã¢â ¬Â• (Housing News Report)Ã¢â ¬Å“Mian and Sufi argue that Ã¢â ¬Ëœeconomic disasters are almost always preceded by a large increase in household debt.Ã¢â ¬â„¢ It is debatable whether this is a universal truth. But it is certainly true of the financial crisis of 2007-08. The authors argue, persuasively, for a shift from traditional debt towards contracts that share losses between the suppliers and users of finance.Ã¢â ¬Â• (Financial Times)

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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 where 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. The complexity of these products would be well beyond the ken of the vast majority of the American public, who couldn't understand the workings of a simple ARM, according to the media. I can not image the required regulations, new federal agencies, political demagoguery, and potential fraud by lenders and homeowners of such a complex product.The debt orgy that we experienced in the first decade of this century would not have happened a generation ago. Prior to the GSE's and securitization, lender's where much more prudent dispensing credit since they anticipated holding the mortgage until redemption. A far simpler solution would be to require lenders to maintain an significant stake in any mortgage orginated by their institution. Adam Smith and Nassim Taleb would understand!

This book was a useful read for me because it laid out the relationship between excessive mortgage debt, the collapse in demand and the depth of the great recession. They also make some interesting assertions about the impact of collapsing house prices on wealth inequality; the minor role played in the recession of a systemic threat to the banking system (as opposed to a liquidity crsis); and therefore the umipactful wealth transfer from taxpayers to bankers, and bank shareholders and lenders. In general, such assertions are interesting but sloppy. As happens so often in these popularizing books, the writers spin a coherent logic but forget that logic and the real world are two different animals. As a result, empirical tests seem very thin. Countervailing explanations are not fairly considered before rejection. For example, isn't it possible that the taxpayer bailouts of the banking industry saved the banking system? Can't that explain the lack of impact on recession? I wouldn't say they are absolutely wrong so much as they don't give the lay person the tools to fairly evaluate their assertions. Finally, their preventitive for a future housing price based recession adresses the moral hazard of mortgage forgiveness. But other than that it seems wholly unrealistic. They fail to address any issues relating to regulatory capture and excessive regulation.

The book main message is simple : global investors' insatiable demand for super save funds far outpaced the supply of these funds. In response, the financial industry used ``tranching'' as a way to create an endless supply of these funds. Bankers were lending to anyone they can without regard to their capacity to pay back. The great recession started when lenders started defaulting on loans they could ill afford to start with.Mian and Sufi show that the reduction in housing equity caused a sever reduction in consumer spending which in turn lead to the worst economic crisis since the great depression.The authors explain their argument in easily accessible terms. They also provide references to excellent empirical work that gives more details and often have replication files and data.Other than being an authoritative source on the causes of great recession, this book can serve as an excellent introduction to empirical macroeconomics.

What an amazing read! The basic premise is that household debt is the culprit behind so many of the recessions and economic downturn that we've seen last century. And the research supports it.The formula is simple: as households incur more debts, the whole economy gets closer to a downturn. While the sub-prime mortgages really hurt us, so many of the middle class who own only 20 to 30% of their homes were painfully affected. The ones who are able to withstand such downturns are ones who own most of their capital (like 80% of their homes and other properties).The solution is simple:- From a consumer standpoint, try to avoid debt. If you have to, make sure you not only afford it, but also have buffer so you're not stretched.- From a system standpoint, new options have to exist where it's more focused on equity and less on debt.All in all, it was one of the best books that I read about the economic meltdown of 2008.

Although there is a lot of good information about debt in this book, the authors' basic premise that traditional 20% down mortgages were responsible for homeowners losing so much in the housing crises is ridiculous to anyone who lived in the midst of it (I lived in the San Francisco area). The problem was that next to no one was getting this kind of mortgage during that time period. If buyers had had to put 20% of their own money down, the crisis would not have spun out of control to begin with. There is no need to add more complication to mortgages as they suggest. Just require that buyers actually qualify for the loan and that they have some skin in the game.