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President Obama, What about Tomorrow?

by Sheldon Richman

The Obama administration's \$275 billion bailout for mortgage lenders and troubled borrowers once again shows that "tomorrow-be-damned" thinking still rules the White House. President Obama has clearly dumped the Clinton administration's theme song, "Don't Stop Thinking about Tomorrow." (Not that Clinton or his successor took the lyric to heart.)

Under the plan, the federal government will spend money it doesn't have to encourage banks to refinance mortgages for people who can't afford their current loans. The plan also calls for giving more money to Fannie Mae and Freddie Mac to make it easier for people to get new mortgages. These government-guaranteed agencies were put under government control last year when they appeared to be insolvent.

Obama and his economic advisors are putting short-term expediency over longer-term consequences. That is always a dangerous strategy. This can be seen clearly in Obama's wish to see bankruptcy law changed so judges can amend the terms of mortgages to lower distressed borrowers' monthly payments. If that happens, lenders henceforth will be reluctant about lending to marginal borrowers. Why take the risk that a judge will change the loan later?

Obama says his plan is intended to stop the fall in housing prices. Therein lies the problem. Market prices are signals — information about reality. Masking or distorting prices can never be prudent. It's the equivalent of turning off the light before crossing a room full of furniture. You are bound to hurt yourself.

Housing prices have fallen precipitously over the last year, but that happened because they had previously soared to unprecedented heights on the wings of government policy. Once we understand that, we can see the folly of trying to push prices back up with government policy. If they are to do their job, prices have to be allowed to find their level according to genuine supply and demand. Obama's plan attempts to paper over past mistakes and therefore sets the table for the next economic crisis.

For more than a decade, the federal government aggressively encouraged resources to flow into housing and the financing of housing by artificially boosting demand. Beginning in the

1990s, a variety of federal agencies and guarantees sought to make homeownership available to people who were unable to obtain conventional mortgage loans because of insufficient income or poor credit records. The government was intent on removing those factors as barriers to buying a home. This effort coincided with an big influx of foreign savings, a low-interest-rate policy from the Federal Reserve, or both. As a result, mortgage loans were easily procured, boosting the demand for houses.

The resulting rise in home values, the “bubble,” gave many people the incentive to refinance their homes at the higher values in order to turn their equity into cash for consumer spending. Loans that ordinarily would have been seen as risky became attractive because expected higher home prices made later refinancing or sale at a profit appear feasible. All of this had the effect of driving demand and prices even higher.

Since this was a bubble artificially inflated by government policy, it couldn’t last. Too many resources went into housing. Too many units were built. Too many marginal loans were made. Eventually prices stopped rising and turned south. Loans that looked good in a bull housing market suddenly looked bad in a bear market.

Conventional economic and political thinking says that the only real problem is the fall in home values — therefore government should do all it can to stabilize prices and get them rising again. Hence the plan to pump money to homeowners, lenders, and the government guarantors.

But if the prices of homes were artificially inflated and the source of the economic collapse, why would we want those prices pushed back toward their previously unsustainable levels? That policy cannot bring lasting economic recovery. It is merely a typical political expedient. Obama keeps doing things the old way.

That would be bad enough. But the tab for this program will be financed by more borrowing. Obama has stopped thinking about tomorrow.

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