Overview

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I would like to begin by saying that one has to be very appreciative of the enormous amount of work that went into this contract and the high quality level that was maintained, given the fantastic time constraints that we imposed on our contractors. However, Harris Friedman and I won't really know whether we spent the taxpayers' money wisely until we go back and run it through the Office of Management and Budget's management-by-objective system and count the number of good ideas per dollar. But, I suspect that the outcome will be somewhere in the range of Dwight Jaffee's Alpha.

One thing that we know for certain is that we have many unresolved issues per dollar. But better to have unresolved issues than to be unaware of their existence.

One thing that was said a number of times is that if capital markets were perfect, we wouldn't be here at all. Various mortgage forms would have already evolved and the issue would be moot. *And,* in fact, markets aren't so imperfect that we aren't already getting these new mortgage instruments. They have already started: we see the development of the short-run balloon note; we saw the California developments with variable rate mortgages in the last few days and these may be only the first of a flood of new kinds of instruments. Of course, I may be wrong; economists (especially housing economists) have been wrong a great deal this year. At a minimum we're guaranteed an experiment to see if American consumers like these new mortgage forms, either because they're relatively smart, as Franco suspects, or because they're relatively dumb, as Saul Klaman seemed to suggest yesterday. But the real policy issue is not whether we'll have them or not, but whether the various levels of government should alter their laws, regulations, and subsidy programs, to favor them or at least be neutral towards them. I don't think there's anyone here who claims that we should bar such innovations by fiat; nor do I think there's anyone here who would suggest that we should bias our regulations in favor of them. Rather, we should make those changes which would allow them to develop in a neutral context.

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One of the problems we face in a policy framework is whether any particular new instrument would add to the efficiency of the marketplace. Again, I think there's pretty firm agreement here that the efficiency of markets will be enhanced by giving the consumer a choice between more mortgage instruments. Much of the discussion, however, involves endogenous political responses that arise when you have different mortgage forms. For example, there has been considerable discussion about the political response in various countries whenever a particular type of mortgage has created serious problems for consumers. On the other hand, there hasn't been too much discussion of the political responses within the United States over the last year, when our markets have been in trouble for reasons which include, but are clearly not limited to, the level payment mortgage. I don't think there's been widespread realization of the extent of Federal Government intervention last year. One can say that the mortgage market for new houses in the $40,000 range and under has effectively been nationalized, since we created an inventory of commitments that would finance the present level of sales twice over.

Political responses are hard to predict, but let's admit for the sake of argument that when you consider political factors as endogenous, we still come to the conclusion that new mortgage forms will result in a higher level of efficiency. We still must face the problem that changes which increase the efficiency of the economy also have distributional implications. If the new mortgage is a good thing for certain types of borrowers, and commands more resources, say, to the home building sector, there will be fewer resources left elsewhere in the system for consumption or investment.

One thing we know about policy-making in Washington is that when you work with the Hill, it's much easier to stop an idea than to initiate one. One could go further to say that in a political environment it isn't important who actually loses, but rather who perceives that they will lose. This conference has brought to the surface some of the people who think that they would lose from the new mortgage form. When you talk about the losers, I think you have to differentiate between the long-run losers and those who would lose in this very difficult transition phase. Looking at the long run, Steve Rhode perceives that the losers would be the non-upwardly mobile poor, especially the minorities and the elderly. I have serious doubts about this; but I think the uncertainties are great enough that no one can reach any conclusion with certainty. In regard to the truly disadvantaged, the topic is essentially irrelevant. These groups are not in the home-buying market and they are not to any great extent savers. Of course, this view oversimplifies the problem, because it doesn't consider the full range of changes that take place in an economy in response to a change in technology or institutions.

However, I'm starting to sound too much like an academic economist. I want to stress a more fundamental point, that it would be a great tragedy to avoid change just because of the low probability that it might have some adverse distributional effect.

Turning from the long-run distributional effect, I think the transitional distributional effects are quantitatively more important and somewhat troublesome. If tomorrow we remove Regulation Q and create all sorts of new mortgage forms, it's likely that Saul Klaman and Ken Thygerson could not afford to come to the next conference where we would study the results of the policy change. The discussion last night clearly delineated the Reg Q dilemma, a dilemma that affects many things, in particular the whole issue of financial reform. To go cold turkey on Reg Q would lead to many adjustment problems, a euphemism for many people going broke. On the other hand, if we opt for a five-year or ten-year phase-out, I'm very concerned that at the end of that time, there would be a request for just one more fix, to save us from what is generally called ruinous competition. Obviously, we're not going to resolve this issue here; both the Treasury and HUD have been working very hard with the interested parties on this question in connection with the whole issue of financial reform.

Let me turn to a very different issue concerning the results of the study. I suppose that some of the most dangerous and most useful results came from the simulations that Dwight Jaffee ran. I'm in accord with Professor Duesenberry that one of the most important reasons for running simulations is to uncover interrelationships that you would not think of offhand, and when these are uncovered, you can think of them, or about them, more profoundly. Unfortunately, simulations also yield hard numbers, often specified to two decimal points, and quite frankly, I am concerned about potential misuse of these results by persons unfamiliar with the underlying assumptions. Perhaps a label should be affixed saying "The use of these numbers may be dangerous to your health."

In summary, I think that we've learned enormous amounts from this exercise, and I think there's plenty more to learn. However, I think what we do in the near future very probably will be overwhelmed by the marketplace. I think there are, certainly, new mortgage forms in our future.