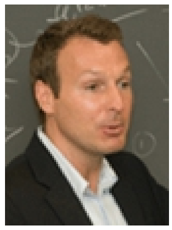
In the lead up to the financial crash of 2007, federal housing policy made a mockery of society's 'subprime virtues'

The effects of the subprime mortgage crisis which began in 2007 are still being felt today, with the U.S. now only slowly returning to pre-crisis growth levels. **Richard Avramenko** and **Richard Boyd** *write that our society is based on what they term 'subprime virtues', such as moderation, truth-telling, frugality and commitment, and that federal housing policy in the lead up to the crisis encouraged nearly the opposite behavior. They argue that modest reforms towards better housing policies, such as mortgage tax credits and stricter penalties for mortgage fraud would go some way towards fostering society's 'subprime virtues'.*



The so-called "subprime mortgage crisis" has led to intense scrutiny of American housing policy, mortgage finance, and even the goods of homeownership. Some critics allege that the housing bubble and ensuing financial crisis were consequences of misguided state intervention, whereas others contend that the sources of the crisis lay in the pathologies of unregulated markets. Still others point to international debt burdens and capital flows as the root cause. Regardless of its ultimate sources, and despite the seemingly endless hand-wringing and finger-pointing by pundits and policy-makers, the events of 2007-2009 have primarily been viewed through the economic lens of cost-benefit analysis. How much did the economic crisis cost, and who ought to pay for it? This is unfortunate because mortgage and housing policy—like all public policy—has a moral dimension that can be easily overlooked.

Over the past three decades the effects of public policy on moral character have been of great interest to political scientists. Ever since Theda Skocpol revealed the link between Civil War pensions and the development of the modern welfare state, scholars have gone to lengths to demonstrate that as politics creates policy, policy in turn transforms the political landscape from which it came. Social Security and Medicare, as Andrea Campbell illustrated, gave rise to a new constituency of seniors ready defend their entitlements. Likewise, Suzanne Mettler documented how the G.I. Bill created the "Greatest Generation"—a generation with unparalleled levels of civic engagement. Of course, not all policy creates better citizens, as Joe Soss (et al.) have shown with regard to poverty governance. Drug testing for welfare, they have argued, diminishes recipients' civic engagement and other aspects of good citizenship. Whether policies further or thwart civic engagement, it has become a truism that policies do, in fact, have moral implications and can foster particular sets of citizen dispositions and capabilities.

What, then, of housing and mortgage policy? Not only is housing and mortgage policy inevitably normative, it can also be pivotal in fostering a particular set of citizen virtues. We recognize that this position may be controversial. Is it appropriate, for example, to use state power to pursue a particular vision of the good life? And if so, who is to say what constitutes the good life, or what virtues are constitutive of good citizenship? To the first question, we answer unequivocally—all policies have normative consequences, whether we like it or not. To the second, we affirm what we call the *subprime virtues*: truth-telling, promise-keeping, frugality, moderation, commitment, foresight, and judgment. These basic virtues are absolute prerequisites for any decent society, and a survey of all the major moral traditions—be it the Western philosophical tradition, the religious traditions of Christianity, Islam, Judaism, Buddhism, Hinduism, and so on—points to a near-universal agreement on these virtues.

We call these virtues "subprime" to emphasize their minimal character. For the most part, they are passive virtues. Rather than demanding active heroism from people, like mustering the courage to charge a machinegun installation, they ask only that people refrain from doing harms. Not breaking a promise, not squandering one's income like a profligate, neither lying, nor acting imprudently in one's financial life—these are not especially demanding. But they are nonetheless essential for economic success and a tolerable civic life. Yet even these remedial virtues were cast into doubt by the financial recklessness and institutionalized lying, greed, and speculation that characterized the heady days of the housing bubble. We argue that these virtues were not just accidental casualties of the housing mania, but indeed they were directly undermined by federal housing, mortgage, and tax policies that sought to make every American a homeowner regardless of whether they possessed the requisite habits and moral character.

Whereas the moderate, frugal citizen lives within her means, eschews debt, and saves responsibly for a rainy day, federal housing policy made a mockery of these subprime virtues. Frugality and moderation were hallmarks of suckers. Truth-telling on mortgage applications became a rarity. For a time, at least, rampant speculation, flipping, and leveraging one's investment to the hilt were "virtuous" behaviors. Even moderate souls not carried away by the sirens' song of speculation were encouraged to buy larger and more expensive homes than they could afford. The proliferation of home equity lines of credit lured risk-averse retirees into financing other forms of consumer spending. When policy conspicuously rewards such vices, a moral transvaluation of values can never be far behind.

If the disastrous policies of the past contributed to undermining the subprime virtues, our argument has a more optimistic flip-side: better housing policies might foster the subprime virtues. To this end, some modest reforms of the federal tax code are in order. For example, the deductibility of mortgage interest ought to be revisited, with deductions phased out as income or the price of the home increases. The mortgage interest deduction should be replaced with a mortgage tax credit. Instead of subsidizing a quick, tax-free profit for home-flippers, capital gains on profits from the sale of a home ought to be taxed at the regular capital gains rate, unless the homeowner has lived there for a considerable length of time. Rather than being able to deduct moving expenses, long-time homeowners should be able to file for a "Staying Put" tax credit. With respect to the government sponsored enterprises, Fannie Mae and Freddie Mac should enforce stricter underwriting guidelines for down payments, sterling credit, and waiting periods for re-qualification after selective defaults or deeds-in-lieu of foreclosure. And finally, with regard to the corporate world and mortgage finance, strict penalties for mortgage fraud or for those involved in selling mortgages or financial products that fail to meet their representations and warranties ought to be the order of the day. Policies such as these would go a long way toward creating more responsible homeowners, better neighbors, better citizens, and ultimately, a more stable financial system.

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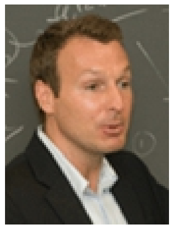

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