Research

Regulatory Reform and Housing Finance: Putting the "Cost" Back in Benefit-Cost

ANDY WINKLER, DOUGLAS HOLTZ-EAKIN | OCTOBER 25, 2012

The American Action Forum today released a new study calculating the impact new housing regulations are having on lending, sales, and starts as well as the greater economy. The study finds that the Dodd-Frank regulations and Basel III capital standards would not only hinder qualified borrowers from access to loans, but also result in 20 percent fewer loans than otherwise would be made. Other impacts include up to a million fewer housing starts over the next three years, 3.9 million fewer jobs and a loss of 1.1 percentage points of GDP growth. Read the introduction below and follow the link to the complete study.

Introduction:

The impulse for regulatory reform in the aftermath of the U.S. housing bubble is both understandable and appropriate. The housing bubble was characterized by under-regulation (mortgage origination) and over-regulation (the housing government-sponsored enterprises' excessive affordable housing goals). Getting the regulation of housing finance right was, and remains, a policy priority.

Getting regulation right means balancing benefits and costs. Even in ordinary circumstances, this laudable goal is difficult to realize in practice. Since the bubble burst in the housing market, there has been a virtual tsunami of changes to the environment facing the mortgage finance industry. Credit standards and minimum down payments have increased, and access to credit has become a challenge for even qualified buyers. Stringency in the private sector has shifted mortgage production to the government-sponsored enterprises (GSEs) and Federal Housing Authority (FHA), where the observed standards of originations have risen as well. The net result has been a visible drag on the housing market and the economy.

However, more regulatory impacts are in the offing with the implementation of Dodd-Frank legislation and the Basel III accords. These well-intended regulations proposed to shore up weaknesses in the mortgage finance system at the behest of Congress and the international financial community may go further than desired and risk undermining long-term growth in the housing market and U.S. economy.

This paper seeks to illuminate the regulatory debate by estimating the impact of recent regulation on mortgage origination, housing construction, and macroeconomic activity. We find using conservative economic assumptions that the bottom line effects of proposed Dodd-Frank and Basel III regulations may include up to 20 percent fewer loans, resulting in 600,000 fewer home sales. In turn, the resulting tightened lending and reduced sales are estimated to cost up to 1,010,000 housing starts, 3.9 million fewer jobs, and a loss of 1.1 percentage points from GDP growth over the next three years.

Read the full study here.