Testimony
Before the United States Senate Committee on Banking, Housing, and Urban Affairs
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Introduction

Chairman Brown, Ranking Member Toomey, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Norbert Michel and I am Vice President and Director for the Center for Monetary and Financial Alternatives at the Cato Institute. The views I express in this testimony are my own and should not be construed as representing any official position of the Cato Institute.

Congress's wasteful spending policies, through a series of massive bills, have harmed Americans both young and old by hampering economic growth and worsening inflation. These spending policies have compounded other existing harmful policies, such as the Federal Reserve's support of the secondary mortgage market, massive federal intervention in housing markets, and state and local supply-constraints. The typical American has little to show for decades of these failed housing policies other than excessive debt, high housing costs, volatile home prices, overregulation, distorted markets, and a trail of federal bailouts.

Wasteful Government Spending

The most recent omnibus spending bill, a 2,700-page $1.5 trillion package that sailed through Congress in a matter of days, is the fifth massive spending bill passed since March 2020.[1] The bill adds nearly $100 billion to the current base spending level. These funds, regardless of the so-called trade-off between defense and non-defense spending, represent the

[1] Matthew Dickerson, "8 Ways Massive Omnibus Spending Bill Is a Mistake," The Daily Signal, March 9, 2022, https://www.dailysignal.com/2022/03/09/8-ways-massive-omnibus-spending-bill-is-a-mistake/.

latest round of higher deficit-financed government spending that will add to the increasing inflationary pressures hurting millions of Americans, including seniors and younger families.[2]

The omnibus includes thousands of earmarks that funnel billions in deficit financed spending to special-interest pork projects. These projects include subsidies for an Institute for Rural Partnerships and a Cattle Contracts Library in Vermont, a state that accounts for a miniscule share of U.S. agriculture.[3] Other examples include $3 million for a fisherman's co-op facility in Guam, $2.75 million for an innovation center in Waverly, New York, $2.5 billion to build a new museum in St. Johnsbury, Vermont, $5 million for an electric substation in Delaware, $2 million to reduce inequity in access to solar power, and $10 million to tear down an abandoned hotel in Fairbanks, Alaska.[4]

Prior to passing this omnibus, Congress added to deficit-financed spending with a $1.2 trillion infrastructure package in November 2021, the $2 trillion March 2020 Cares Act that included billions in loans and grants, the $900 billion Response and Relief Act in December 2020 that further extended the counterproductive unemployment benefit bonus, and the $1.9 trillion American Rescue Plan in March 2021.[5] All these spending packages, the sum total of which is $7.5 trillion, worsened inflation. They also exacerbated labor market problems and pandemic-related supply chain problems, thus leading to the abnormally high increases in the Consumer Price Index that Americans continue to experience.[6]

Now, on virtually the same day that the White House released its $6 trillion budget (with a $1.4 trillion deficit), the government official in charge of COVID relief announced that the Paycheck Protection Program (PPP) was the "biggest fraud in a generation," with approximately $80 billion doled out fraudulently (a figure that adds to the $170 billion previously stolen from other COVID relief programs). The latest report confirms what was already widely acknowledged, that many of these stolen funds were used to buy expensive cars and fund

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[2] Norbert J. Michel, "Inflation: A Brief Look Back, and A Path Forward," Cato at Liberty, November 9, 2021, https://www.cato.org/blog/inflation-brief-look-back-path-forward.

[3] David Ditch, "Omnibus Thread About What's in the 2,741 Page Omnibus Spending Bill As I Read It," March 9, 2022, https://twitter.com/DavidADitch/status/1501578341178089490. Also see Dickerson, "8 Ways Massive Omnibus Spending Bill Is a Mistake."

[4] Ditch, "Omnibus Thread About What's in The 2,741 Page Omnibus Spending Bill As I Read It."

[5] David Ditch, "Congress' Wasteful Spending Spree Must End With Infrastructure Bill," The Daily Signal, November 12, 2021, https://www.heritage.org/budget-and-spending/commentary/congress-wasteful-spending-spree-must-end-infrastructure-bill.

[6] Norbert J. Michel, "Inflation and the Fed: How Congress Should Approach Monetary Policy," Heritage Foundation Backgrounder No. 3624, June 1, 2021, https://www.heritage.org/sites/default/files/2021-06/BG3624.pdf; and, Norbert J. Michel, "Many Consumer Prices Are Higher: Time to Eliminate Government-Imposed Economic Roadblocks," Heritage Foundation Backgrounder No. 3650, August 20, 2021, https://www.heritage.org/sites/default/files/2021-08/BG3650.pdf. Also see Matthew Dickerson, David Ditch, and Richard Stern, "Congress Is Writing Blank Check for Big Government, Socialist Tax-and-Spend Spree," The Daily Signal, December 10, 2021, https://www.heritage.org/budget-and-spending/commentary/congress-writing-blank-check-big-government-socialist-tax-and-spend.

vacations, as well as purchase larger homes.[7] The fashion in which these spending packages were designed reflects, in part, a refusal to acknowledge the extent to which both the private sector and existing government programs satisfy existing consumer needs. The massive amounts of spending on luxury items, to say nothing of the fraudulent spending, is hardly surprising.

Excessive Government Involvement in U.S. Housing Markets

Federal policies encourage borrowing by supporting the operations of Fannie Mae, Freddie Mac, and Ginnie Mae, and by providing loan insurance through the Federal Housing Administration (FHA), the Veterans Affairs (VA) home-lending program, and the U.S. Department of Agriculture's Rural Development Program. Historically, the federal tax code has also promoted housing investment and consumption by allowing taxpayers to deduct mortgage interest and capital gains from the sale of a home from their federal income tax liability. Additionally, the Basel capital requirements have long provided financial institutions with capital relief for holding mortgage-backed-securities (MBS) rather than whole loans, while Fannie Mae and Freddie Mac have long enjoyed lower equity requirements than banks.[8]

Prior to the 2008 financial crisis, the federal government controlled a dominant share of the U.S. housing finance system, and that share has expanded. As of December 31, 2020, Fannie and Freddie (both of which remain in government conservatorship) had combined total assets of $6.6 trillion, representing approximately 42 percent of the nation's outstanding mortgage debt.[9] From 2008 to 2019, the FHA's annual market share of purchase loans ranged from 16.49 percent to 32.6 percent.[10] From 2009 to 2020, Fannie Mae and Freddie Mac's annual share of the total MBS market averaged 70 percent. Including Ginnie Mae securities,

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[7] Ken Dilanian and Laura Strickler, "'Biggest fraud in a generation': The looting of the Covid relief plan known as PPP," NBC News, March 28, 2022, https://www.nbcnews.com/politics/justice-department/biggest-fraud-generation-looting-covid-relief-program-known-ppp-n1279664.

[8] Norbert J. Michel and John Ligon, "Basel III Capital Standards Do Not Reduce the Too-Big-to-Fail Problem," Heritage Foundation Backgrounder no. 2905, April 23, 2014, http://thf_media.s3.amazonaws.com/2014/pdf/BG2905.pdf; and, Norbert J. Michel, "Strict Bank-Like Capital Rules Needed for Fannie Mae and Freddie Mac," Heritage Foundation Backgrounder no. 3474, March 9, 2020, https://www.heritage.org/sites/default/files/2020-03/BG3474.pdf.

[9] For the fiscal year ending December 31, 2020, Fannie Mae reported $4 trillion in total assets while Freddie Mac reported $2.6 trillion. See Federal National Mortgage Association, "Annual Report," December 31, 2020, p. 61, https://www.fanniemae.com/media/38271/display. p. 61; and Federal Home Loan Mortgage Corporation, "Annual Report," December 31, 2020, p. 34, http://www.freddiemac.com/investors/financials/pdf/10k_021121.pdf, p. 34. The 42 percent figures it is the author's estimate using the Federal Reserve's (now discontinued) 2019 reported total for mortgage debt outstanding ($15.8 trillion). See Board of Governors of the Federal Reserve System, "Mortgage Debt Outstanding, All holders (DISCONTINUED) [(MDOAH])," retrieved from FRED Economic Data, Federal Reserve Bank of St. Louis, October 15, 2021, https://fred.stlouisfed.org/series/MDOAH, October 15, 2021.

[10] See United States Department of Housing and Urban Development, "FHA Single Family Market Share, 2020 Q1," p. 4, https://www.hud.gov/sites/dfiles/Housing/images/FHASFMarketShare2020Q1.pdf.

those that are backed by FHA mortgages, the federal share of the MBS market averaged 92 percent per year.[11]

Yet, the evidence suggests that the expansive federal role has done little to expand homeownership. Robust mortgage financing exists in virtually every developed nation of the world without the high degree of government involvement found in the United States, but the overall U.S. homeownership rate is below average among developed nations (64.5 percent in the United States versus 68.1 percent for the Organisation for Economic Co-operation and Development (OECD) countries).[12] And even though the U.S. ownership rate has changed little since the 1960s, the volatility of home prices and home construction in the United States were among the highest in the industrialized world from 1998 to 2009.[13] Federal housing finance policies have, at the very least, magnified economic instability by inducing higher home prices.[14] Federal involvement expanded after the most recent financial crisis, for instance, and home prices have risen to 43 percent *more* than where they peaked prior to their 2007 crash.[15] The fact that prices are so far from the bottom of a housing cycle is worrisome, especially since empirical evidence links large increases in housing prices to banking crises.[16]

Although home equity frequently represents a large portion of many Americans' wealth (especially seniors), purchasing a home can be a risky investment that depends entirely on home price appreciation, an attribute fundamentally in conflict with housing becoming more affordable.[17] Federal policy should not encourage home ownership as part of an investment strategy, just as it should remain neutral in terms of which stocks Americans should purchase.

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[11] These figures include both single-family and multi-family MBS. Securities Industry and Financial Markets Association, "US MBS Securities: Issuance, Trading Volume, Outstanding," October 13, 2021, https://www.sifma.org/resources/research/us-mortgage-backed-securities-statistics/us-mortgage-backed-securities-statistics-sifma/; and, Ginnie Mae, *Insurance Summary*, March 2021, https://www.ginniemae.gov/data_and_reports/reporting/MonthlyIssuanceReports/Mar21_ISS.pdf.

[12] These figures represent the combined ownership rate for people who own their home outright and those who own a mortgage, for both the United States and all Organisation for Economic Co-operation and Development (OECD) countries, using 2019 data, as reported in the OECD Affordable Housing Database, October 15, 2021, available at https://www.oecd.org/housing/data/affordable-housing-database/.

[13] Dwight M. Jaffee, "Reforming the U.S. Mortgage Market Through Private Market Incentives," in Satya Thallam, ed., *House of Cards: Reforming America's Housing Finance System*, George Mason University, Mercatus Center, March 2012, pp. 23-25, http://mercatus.org/sites/default/files/House_of_Cards_March_2012.pdf (accessed March 6, 2014).

[14] Broadly, federal housing policies have caused more than their share of economic turmoil. See Alex J. Pollock and Edward J. Pinto, "Political Disasters in US Housing: The Lessons of History," *Housing Finance International*, AEI Op-Ed, September 30, 2021, https://www.aei.org/op-eds/political-disasters-in-us-housing-the-lessons-of-history/.

[15] This 43 percent figure refers to the S&P/Case-Shiller U.S. National Home Price Index. See S&P Dow Jones Indices LLC, "S&P/Case-Shiller U.S. National Home Price Index [(CSUSHPISA])," retrieved from FRED Economic Data, Federal Reserve Bank of St. Louis, October 15, 2021, https://fred.stlouisfed.org/series/CSUSHPISA.

[16] Carmen M. Reinhart and Kenneth S. Rogoff, "Is the 2007 US Sub-prime Crisis so Different? An International Historical Comparison," *American Economic Review*, 98, no. 2 (May 2008): 339–44.

[17] For *at least* the past 20 years, home prices have exhibited similar volatility to equity markets. Joe Cortright, "Why Homeownership Is Frequently A Bad Bet," *City Commentary*, July 15, 2019, https://cityobservatory.org/why-homeownership-is-frequently-a-bad-bet/. Also see Daniel Indiviglio, "Should the Government Encourage Home Ownership?," *The Atlantic*, June 17, 2010, https://www.theatlantic.com/business/archive/2010/06/should-the-

The United States has a long history of creating government programs that subsidize housing, ultimately providing incentives to borrow and invest in debt-financed purchases that raise housing prices and rental rates. Several programs were even created to replace subsidies that were phased out. For instance, the Low Income Housing Tax Credit (LIHTC) was enacted "hastily as a part of the Tax Reform Act of 1986 to replace other tax subsidies for low-income housing that were eliminated."[18] The LIHTC is one of the more inefficient federal programs, providing approximately $9 billion per year to support housing construction to benefit lower income households, studies show that "investors, developers, and financial companies gain most of the benefits."[19]

Congress and Biden Administration Further Interfere with Housing Markets While Increasing Risky Debt and Prices

Recent moves by the Biden administration demonstrate a clear commitment to implementing the same types of failed housing policies that have consistently expanded government intervention in housing markets at a great cost to millions of Americans. For instance, the Treasury and the Federal Housing Finance Agency (FHFA) announced (on September 14, 2021) that they would suspend certain conditions (added in 2021) to the Preferred Stock Purchase Agreements (PSPAs) that govern the conservatorships of Fannie Mae and Freddie Mac.[20] The PSPAs are key to protecting taxpayers against future bailouts and ensuring that Fannie and Freddie (the enterprises) do not further crowd out private capital,[21] but the administration has weakened those protections by suspending the provisions that capped the enterprises' purchases of multifamily housing loans, as well as single-family loans

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government-encourage-home-ownership/58320/; and, Daniel Indiviglio, "The Fallacy of Eternal Home Price Appreciation," *The Atlantic*, April 6, 2010, https://www.theatlantic.com/business/archive/2010/04/the-fallacy-of-eternal-home-price-appreciation/38546/.

[18] Edgar O. Olsen, "Housing Programs For Low Income Households," NBER Working Paper No. 8208, p. 7, https://www.nber.org/system/files/working_papers/w8208/w8208.pdf.

[19] Chris Edwards and Vanessa Brown Calder, "Low-Income Housing Tax Credit: Costly, Complex, and Corruption-Prone," Cato Tax and Budget Bulletin No. 79, November 13, 2017, https://www.cato.org/tax-budget-bulletin/low-income-housing-tax-credit-costly-complex-corruption-prone. For more on reforming local zoning and land-use restrictions to increase housing supply, see Vanessa Brown Calder, "Zoning, Land-Use Planning, and Housing Affordability," Cato Policy Analysis No. 823, October 18, 2017, https://www.cato.org/policy-analysis/zoning-land-use-planning-housing-affordability.

[20] Federal Housing Finance Agency, "FHFA and Treasury Suspending Certain Portions of the 2021 Preferred Stock Purchase Agreements," *News Release*, September 14, 2021, https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-and-Treasury-Suspending-Certain-Portions-of-the-2021-Preferred-Stock-Purchase-Agreements.aspx.

[21] Joel Griffith and Norbert Michel, "Revising the Preferred Stock Purchase Agreements of Fannie Mae and Freddie Mac May Be the Biggest GSE Bailout Yet," Heritage Foundation Backgrounder no. 3448, November 4, 2019, https://www.heritage.org/sites/default/files/2019-11/BG3448.pdf.

"with higher risk characteristics," second homes, and investment properties.[22] These last two provisions have little to do with helping people become homeowners, and they represent a naked give away to special interests that lobby to maximize real estate lending. Uncapping the enterprises' multifamily loan purchases is also a giveaway to corporate rent seekers and will likely do little, if anything, to increase the amount of housing that would otherwise go unbuilt.

Harmful Programs Included in President Biden's Budget

President Biden's newest budget includes the continuation and expansion of multiple harmful housing policies that tend to artificially increase the cost of housing for millions of Americans. The following list provides several examples of such policies proposed in the budget.[23]

- The budget provides $32.1 billion for the Housing Choice Voucher Program, an increase of $6.4 billion. This change will magnify upward pressure on housing cost. The larger the rental subsidy program becomes, in terms of number of renters and size of the subsidy, the more upward pressure the program will have on rental rates and, ultimately, housing prices.[24]

- The budget includes $2 billion for the HOME Investment Partnerships Program, an increase of $600 million from 2021. This program is a federal block grant program created by the Cranston-Gonzalez National Affordable Housing Act of 1990, and it has a troubling track record of fraud even at its previous level of funding.[25] Moreover, the program already funds duplicative programs, including down payment assistance plans.[26]

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[22] Federal Housing Finance Agency, "FHFA and Treasury Suspending Certain Portions of the 2021 Preferred Stock Purchase Agreements," *News Release*, September 14, 2021, https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-and-Treasury-Suspending-Certain-Portions-of-the-2021-Preferred-Stock-Purchase-Agreements.aspx.

[23] All references in this list refer to the requests for the Department of Housing and Urban Development in the Budget of the U.S. Government, Fiscal Year 2023, https://www.whitehouse.gov/wp-content/uploads/2022/03/budget_fy2023.pdf.

[24] For a more general view of how housing vouchers can lead to higher rental rates, see Robert Collinson and Peter Ganong, "How Do Changes in Housing Voucher Design Affect Rent and Neighborhood Quality?," *American Economic Journal: Economic Policy*, 2018, Vol. 10, no. 2, pp. 62-89, https://www.aeaweb.org/articles?id=10.1257/pol.20150176. A similar policy problem exists with military housing allowances in severely supply-restricted areas, such as the Hawaiian Islands. See Eric Pape, "Living Hawaii: How Military Policies Drive Up Rents on Oahu," *Honolulu Civil Beat*, June 17, 2015, https://www.civilbeat.org/2015/06/living-hawaii-how-military-policies-drive-up-rents-on-oahu/.

[25] Joint Hearing entitled "Fraud in the HUD HOME Program," House Financial Services Committee, November 02, 2011, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=401964.

[26] Department Of Housing And Urban Development, Office Of Community Planning And Development, Home Investment Partnerships Program, Summary Of Resources, https://www.hud.gov/sites/dfiles/CFO/documents/20_2022CJ-HOME.pdf.

- To complement other housing programs, the budget also contains a total of $50 billion in mandatory funding and additional LIHTCs to increase affordable housing development. The LIHTC program has already been shown to be inefficient and ineffective at lowering housing costs, merely serving to pass along any intended cost reductions to special interest groups that include investors, developers, and financial firms.

- The budget includes $3.8 billion for the Community Development Block Grant (CDBG) program to help communities "modernize infrastructure, invest in economic development, create parks and other public amenities, and provide social services." The CDBG program is notorious for funneling federal tax dollars to "a variety of activities that cater to high income preferences rather than low-income needs," partly because the term community development is so broad and ambiguous. Much like earmarks, the program has funded projects that are difficult to defend as helping low-income households. The projects range, for example, from expanding a brewing company in North Tonawanda, New York ($500,000), restoring an historic hotel in Boyne City, Michigan ($1 million), and providing salaries ($15,000) to teach children to sail and kayak in Lawrence, Massachusetts.[27]

Federal Reserve Bond Buying Program Puts Upward Pressure on Housing Prices

Although the Federal Reserve deserves credit for not overreacting to rising inflation as the recovery from the pandemic-related government shutdowns began, it has continued at least one long-term policy shift that has likely added to upward pressure on housing costs. As part of its response to the 2008 financial crisis, the Fed started purchasing large quantities of GSE (and Ginnie-Mae) mortgage-backed securities (MBS). Prior to the 2008 crisis, the Fed held virtually zero MBS. Between 2010 and 2022, however, the Fed has never reported holding less than $827 billion in MBS.

The Fed has slowed its purchases and allowed MBS to runoff its balance sheet at various times since the 2008 crisis, but it went from holding $1.4 trillion in MBS in March 2020 to $2.7 trillion in March 2022.[28] Between March 2020 and January 2022 (the latest date available), national home prices increased (steadily) more than 30 percent and the CPI increased 9.2

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[27] Vanessa Brown Calder, "Community Development Block Grant Spending Is Poorly Targeted to Poor," Cato at Liberty, March 8, 2019, https://www.cato.org/blog/community-development-block-grant-spending-poorly-targeted-poor; and, Vanessa Brown Calder, "Community Development Block Grant Spending is Poorly Targeted, Part II," Cato at Liberty, March 19, 2019, https://www.cato.org/blog/community-development-block-grant-funding-poorly-targeted.

[28] Board of Governors of the Federal Reserve System (US), Assets: Securities Held Outright: Mortgage-Backed Securities: Wednesday Level [WSHOMCB], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/WSHOMCB, March 30, 2022.

percent.[29] As of this writing, the Fed planned to purchase another $21.5 billion in agency MBS between March 28, 2022 and April 13, 2022.[30] The Fed should have ceased these MBS purchases and normalized its operations long before the pandemic, but it failed to do so. Currently, there is no monetary policy justification for continuing these purchases or continuing to support, in any way, the MBS market.

Conclusion

Between March 2020 and March 2022, Congress has increased the federal deficit with more than $7.5 trillion through its spending bills. These wasteful spending policies have harmed Americans both young and old by hampering economic growth and worsening inflation. They have also compounded other existing harmful policies, such as the Federal Reserve's support of the secondary mortgage market, massive federal intervention in housing markets, and state and local supply-constraints. Rather than focus on underlying economic and social problems, and removing regulatory barriers that restrict housing supply, Congress has consistently increased demand by making it easier to obtain home mortgages. The typical American has little to show for decades of these failed housing policies other than excessive debt, high housing costs, volatile home prices, overregulation, distorted markets, and a trail of federal bailouts.

There appears to be no momentum in Congress to reverse these trends. In fact, the new Biden administration policies will implement the same types of failed housing policies of the past. Collectively, these policies will further expand government intervention in housing markets at a great cost to millions of Americans. They will put even more upward pressure on prices and rental rates, waste taxpayers' money, and ultimately make housing less affordable.

Thank you for the opportunity to provide this information, and I welcome any questions that you may have.

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[29] S&P Dow Jones Indices LLC, S&P/Case-Shiller U.S. National Home Price Index [CSUSHPINSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CSUSHPINSA, March 29, 2022; and, U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items in U.S. City Average [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPIAUCSL, March 30, 2022.

[30] Federal Reserve Bank of New York, Tentative Outright Agency Mortgage-Backed Securities Operation Schedule, March 28, 2022, https://www.newyorkfed.org/medialibrary/media/markets/ambs/AMBS-Schedule-032822.pdf.