The Distribution of Risk and the Great Recession: Old Problems, New Crises

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- Method: Trace the developments which transformed mortgages from financial instruments which shielded borrowers and savers from risk, to concentrating risk on those least able to bear it.
- Consistent theme: risk-bearing capacity is both costly and limited. When this capacity becomes stressed, there is a persistent tendency to redistribute risk towards end users of the system – borrowers and savers – often with severe consequences.

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  - Reinterpret Great Recession as due to old persistent problems of19th century mortgage finance, which re-emerged after deregulation and privatization
  - "Garden variety" 19th century boom-bust cycle: Both predictable, and predicted

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  - Those which fund through securitization don’t allow refinances, prepayments, require high LTVs.

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- Agency problems in secondary markets
  - Boom-bust cycle in housing: all six early attempts prior to 1930 at securitization failed in similar pattern
- Snowden (1995) warning: Each of these failures, "provided evidence that private securitization structures rest on a razor's edge. There is always some limit to the amount of default risk that can be absorbed in a privately financed securitization structure, and whenever that threshold is broken the severe informational problems that are inherent in mortgage securitization appear in full force. We have seen that insiders regularly exploited their informational advantage in these situations before 1930 and, by doing so, imposed much larger losses on investors than would have resulted from default risk alone."

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  - Uses public/private competition + direct participation in market as method to set the terms of the market to shield households from risk.

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  - GSE underwriting templates would serve to regulate primary market.
  - But removal of restrictions weakened ability to "regulate through public option". Weaknesses only revealed after rapid growth of PLS market.

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    - 51% of loans in PLS market contained misrepresentation along one of 3 easy to measure dimensions (Griffin and Maturana, 2016)

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  - Capitalization per modification doubles from 2010-2014, even though delinquencies per modification remain constant.