Illimani Patiño Giraldo.

House of Debt. Atif Mian and Amir Sufi. University of Chicago Press. Paperback $15.00

The mainstream stream of thought in economics and most of the political establishment in the United States have focused on the role of credit shortage when explaining and addressing the backlashes of the Great Recession that led to four million forecloses and eight million job losses. This perspective implicated the prioritization of bailouts and capital injections for financial institutions, policies that were expected to boost back the economy. Scholars Atif Mian and Amir Sufi problematize this approach by radically shifting the spotlight towards the role of household debt as the substantial cause of the crisis and the main burden that impeded its efficient resolution, a perspective that discloses a novel view of how financial crisis can be prevented.

Atif Mian and Amir Sufi are currently professors at Princeton and University of Chicago respectively. Thanks to the contributions made in in this piece, both academics have been praised as some of the most important young scholars shaping the future global view on economics by institutions such as the IMF and the American Finance Association. The two started researching the role of debt in enhancing macroeconomic instability since to 2006, when they meet for the first time after earning their PHD at MIT. Taken advantage of extensive data from the financial crises and its aftermath, they wrote this book between 2012 and 2013, and finally published it in 2014. The piece has been praised by one of the most meaningful contributions to the understanding of the role of household financialization and macroeconomics stability by senior economists from a variety of ideological stances such as Joseph Stiglitz, Paul Krugman, and Lawrence Summers.

The central hypothesis of the book is that accumulation of debt by US households was the main factor leading to recession. In the period between 2000 and 2007, the household debt twofold after the spread of cheap mortgages. Millions of American indebted themselves following the cheap credit available after decades of financial deregulation that led to an increase on securitization and the consequent rise in financial derivatives. Financial institutions started to pile large chunks of mortgages -many of them subprime- with the acquiesce of credit agencies and sold them to investors. As more risky mortgages were issued and more houses were bought, the price of the houses soared creating a bubble that burst in 2008, freezing the vastly interconnected financial system. Describing this process is important to understand how the crisis started, but also to how lenders are should be accounted for a major proportion of the capital losses of the economic depression.

The majority of subprime mortgages were given to low-income households, which are also the household with a higher marginal propensity to consume. When the bubble burst, leading to a 30% house price decrease, most of this households saw a 100% decline in their net worth. The process affected the whole economy as forecloses plummeted even more house prices, affecting other 'healthy' owners'. Additionally, highly levered households cut their spending drastically, affecting the private sector who responded with a nine million job cut. The authors demonstrate that it was the high rate of household indebtedness rather than the lack of credit availability in the financial system throughout detailed national data, proving that areas of the country that were more leveraged pulled back earlier and stronger from consumption. Additionally, the government responded by injecting capital in the banking system, but this did not translate in a general recovery of the economy: the problem was not the supply of credit but the demand (consumption) that was moored by debt.

Subsequently, Mian and Sufi draw on their key policy proposal: The Shared Responsibility Mortgage (SRM). According to them, if amid the banking crisis the mortgages could had been renegotiated into more lenient terms, aggregate demand would not have shrunken so deeply, which would have benefited borrowers, lenders, and the public. Therefore, they propose a change in the nature of mortgages towards a system where it is not only borrowers – those who are generally already weaker – who have to bear the total burden of the financial shock. In the SRM system, the payment schedule is linked to her local housing price index, meaning that if the price decreases, the payments and the total amount to be paid decrease as well. To compensate lenders, they receive a higher upfront payment and a 5% capital gain in case of selling or refinancing. According to the authors, SRM would decrease inequality and prevent future crises as the financial system would have to assume the cost of the crisis and it would protect the homeowners at a very low cost for the taxpayers.

The authors demonstrate in this work a strong inductive approach that aims to observe the data and then theorize, in contrast to what they call fundamentals view of mainstream economics that rely largely in pre-existing models developed during the financial deregulation period between the 1980's and the early 2000's. From a theoretical point of view, the authors retake some of the key concerns of the neo-Keynesian school but without abandoning the neoclassical modelling and the limitations of the monetarist perspective. The last can be noticed, for example, in their emphasis on maintaining a low fiscal deficit.

This is a very meaningful contribution to the analysis of economic crises in general, thanks to the strong linkage between theory and evidence throughout the extensive use of available data. It does not only criticize the current state of affairs, but also provides a ‘realistic’ proposal that might be accepted by most stakeholders (potentially including the financial interests) and therefore retains a high degree of political realism. However, the proposal does not address some of the key systemic problems of the financial system, like the lack of regulation in the derivatives market, corporate compensation, or reserve requirements for banks. This is evident as the authors focus on the rise of Collateralized Debt Obligations (CDO) but not in the rise of Credit Default Swaps generally used by financial institutions to hedge the risk of default which also contributed to the triggering of the financial crisis. The question is thus if it is possible to fix the potential imbalances within the financial system without reforming it radically. From this book’s point of view, the answer yes.