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What to Do about Fannie and Freddie: A Primer on Housing Finance Reform

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In September 2008, the U.S. government took control of Fannie Mae and Freddie Mac, the two dominant entities in U.S. residential mortgage markets. The government placed Fannie and Freddie into a conservatorship, meant to be temporary to curtail the risk of financial contagion during the financial crisis, conserve the value of the companies, and return them to safe-and-sound condition. But as of mid-2020, the conservatorship persists. Fannie and Freddie together with other mortgage-finance institutions have been meeting several important goals over the past few years, arguably satisfying most households’ mortgage needs and, on balance, supporting financial stability. Even so, almost all policymakers, researchers, and industry advocates agree on the need to move to a system of mortgage finance in which the government plays a less direct role.

Jordan Rappaport reviews the current system of mortgage finance and analyzes the key issues policymakers face in reforming it, including what to do with Fannie and Freddie. Although policymakers have reached a rough consensus on several key issues, they disagree on the share of lending the government should backstop against widespread defaults and how many companies should have access to the backstop.

The Macroeconomic Fallout of Shutting Down the Banking System

By Qian Chen, Christoffer Koch, Gary Richardson, and Padma Sharma

During the 2008–09 financial crisis, the U.S. government arranged bailouts of major banks to prevent a suspension of bank deposits, where banks cease paying checks and refuse depositors’ requests to withdraw funds. Although these bailouts likely helped firms and households continue to make payments, they have been debated due to potential moral hazard concerns as well as the high cost to taxpayers. Assessing the costs and benefits of preventing deposit suspensions is difficult, as nationwide bank suspensions have not occurred since the Great Depression.

To circumvent this challenge, Qian Chen, Christoffer Koch, Gary Richardson, and Padma Sharma study the effects of more recent deposit suspensions at the state level (Nebraska in 1983, Ohio and Maryland in 1985, and Rhode Island in 1991). They find that the suspension in Rhode Island,
which occurred during a recession, lowered employment, gross state product, and per capital personal income. Their results suggest that interventions that prevent large deposit suspensions during recessions, such as those undertaken after 2008, are likely worth the costs. Effective interventions not only help avoid economic losses during recessions, but also prevent losses to output and employment several years into the future.

Unconventional Monetary Policy and International Interest Rate Spillovers
By Karlye Dilts Stedman

After the 2008 global financial crisis, advanced economies turned to unconventional monetary policies to provide additional monetary stimulus while short-term interest rates were constrained by their effective lower bound. However, the speed of economic recovery differed markedly among these economies, leading to differences in the timing and intensity of unconventional monetary policies across central banks. These differences may have generated “spillover effects” that undermined policy tightening in the United States after 2015.

Karlye Dilts Stedman assesses whether monetary policies from the European Central Bank, the Bank of Japan, and the Bank of England affect U.S. borrowing costs at and away from the effective lower bound. She finds evidence of spillovers from each of these central banks to the United States as well as evidence that these spillovers increased during the asynchronous withdrawal from unconventional monetary policy. Her results suggest that in the absence of international spillovers, long-term yields in the United States would have been higher than those observed at the end of 2017.

Drought Risk to the Agriculture Sector
By David Rodziewicz and Jacob Dice

Drought is a perennial and long-term risk that can negatively affect the farm economy through lower yields, loss of crops, reduced farm revenues, and lower sales for farm suppliers. As risks from climate change mount, understanding how drought will affect farmers across the country has become even more important. Drought risk can vary by region, crop type, and production method, and may disproportionately affect some farmers more than others. Although many farmers have crop insurance to protect against losses, insurance does not cover all of their crop’s value, and
even insured farmers face losses from drought. These losses can negatively affect farm finances, resulting in financial strain that may spill over into the broader agricultural economy.

David Rodziewicz and Jacob Dice analyze the relationship between county-level drought exposure and direct farmer losses (specifically, crop insurance deductibles) from 2000 to 2019. They find that farmer losses from drought vary by crop type: although losses rise steadily along with drought intensity for corn and wheat, losses spike noticeably in extreme drought for soybeans. These losses represent an economically relevant share of crop production values: farmer losses from extreme drought can reach 20 percent of production value for corn and wheat and 35 percent for soybeans.