Abstract

Aggressive deregulation of the mortgage market in the early 1980s triggered innovations that greatly reduced the required home equity of U.S. households. This allowed households to cash-out a large part of accumulated equity, which equaled 71 percent of GDP in 1982. A borrowing surge followed: Household debt increased from 43 to 62 percent of GDP in the 1982-2000 period. What are the welfare implications of such a reform for borrowers and savers? This paper uses a calibrated general equilibrium model of lending from the wealthy to the middle class to evaluate these effects quantitatively.