Abstract

In this paper I show that when debt is used to finance asset purchases, debt subsidies redistribute wealth away from borrowers and can actually harm some of them. To analyze the incidence of mortgage subsidies, I present a competitive model where the loan-to-value (LTV) ratio adjusts when the cost of borrowing changes. This feature of the model introduces a second economic mechanism for the effect of mortgage subsidies on borrower's welfare. I analyze the effect of mortgage subsidies theoretically and quantify it using U.S. data.