Republican Amnesia on the Financial Crisis

Sometimes party loyalty asks too much, even among today's rigidly unforgiving Republicans.

In December, the four Republicans on the Financial Crisis Inquiry Commission (FCIC) appeared to accept the Republican agitprop explanation, or "narrative," of the financial crisis: government regulators, under pressure from liberal Democrats like Barney Frank and Maxine Waters, bullied banks into making foolish, "politically correct" loans so poor folks could buy homes that they couldn't afford. But when the FCIC issued its final report last week, three of the four Republican commissioners flinched, apparently unwilling to sacrifice forever their scholarly reputations to the cause of partisan hackery. Instead, the three Republican commissioners argued that the financial crisis was caused by a combination of dimly understood macroeconomic forces, an unforeseeable "perfect storm."

Was this crisis preventable? "We don't know," said Republican FCIC commissioner Keith Hennessy. That argument has also been justly mocked by economics bloggers as "hoocoodanode?" ("Who could have known?"), but is far less laughable.

Only one commissioner, Peter Wallison, stuck with the Republican agitprop narrative.

Republican politicians with little scholarly reputation to protect are undeterred, of course, by the defection of three of the four Republican FCIC commissioners or by the repeated demolition of the narrative by economists.

But here's a question Republicans in Congress don't want to hear: why haven't they reminded us that they warned before the financial crisis that subprime mortgages would come to grief? And why haven't banks, happily exculpated by the narrative, reminded us that they warned at the time that they were being forced to make foolish loans that would endanger their solvency?

The answer is simple: the Republican narrative was created from scratch after the financial crisis.

During the height of subprime lending, the lending industry, conservative commentators and Republican politicians celebrated subprime mortgages as the triumph of the innovation that comes from unfettered capitalism. Subprime mortgages, they said, made homeownership possible for millions of American families who could never own their own home under the dreary, stultifying rules that Democrats like me proposed.

Robert Crouch testified at a congressional hearing on behalf of the Mortgage Bankers Association on November 5, 2003. Crouch said that "through innovations in the mortgage finance industry, and through various financing and risk enhancing tools created for the specific purpose of extending credit to our more needy communities, credit-impaired individuals now have ample opportunity to obtain loans through this 'non-prime,' or 'subprime' market." The growth of the subprime market, Crouch said, "disproportionately benefited low-income and minority borrowers, as these groups are much more likely to rely on subprime credit. One clear and visible outcome has been an increase in homeownership rates for low-income and minority borrowers."

William M. Dana testified at a congressional hearing on March 30, 2004, on behalf of the American Bankers Association. Dana said that "the ABA believes that the development of the subprime market has been a positive development for American consumers." Market innovation "has made credit available to many consumers who had previously been left out of the marketplace," he said. "The development of the subprime market has assisted those borrowers tremendously."

What Republican politicians said was so similar it was almost like bank lobbyists wrote their remarks for them.

"I need not remind my colleagues on the committee that Americans currently enjoy the highest rate of homeownership in the history of America," Congressman Jeb Hensarling said at a congressional hearing on May 24, 2005. "The benefits of free enterprise and competition have been plentiful. With the advent of subprime lending, countless families have now had their first opportunity to buy a home or perhaps be given a second chance. The American dream should never be limited to the well-off or those consumers fortunate enough to have access to prime rate loans."

Nor was there a discouraging word about subprime mortgages from conservative commentators.

The Republican narrative puts much of the blame for the financial crisis on the Community Reinvestment Act ("CRA"), a 1977 civil rights law aimed at "redlining." At the time, banks literally drew red lines on city maps around neighborhoods in which they would not lend.

But in 2000, the conservative CATO Institute published an article that said "CRA" should stand for "Community Redundancy Act." The article argued that "progress predicated on technology, financial innovation, and competition -- not CRA -- has broadened the U.S. financial marketplace," including lending in neighborhoods that had once been redlined. If a lender discriminated against a low-income neighborhood, "the profit motive would lead another lender to move in and fill the void."

It's true that Republicans were critical of Fannie Mae and Freddie Mac, the principle culprits in the Republican agitprop narrative. But Republicans' criticism was that Fannie and Freddie weren't buying enough mortgages for riskier, low-income borrowers.

Fannie and Freddie were shareholder owned corporations run for a profit, but they began as government agencies that bought mortgages from banks so banks could lend more money and more families could buy homes. Both were "privatized" in the sixties, and both did very well by doing good. In 2001, Fannie was 13 and Freddie was 18 on Fortune Magazine's list of the most profitable corporations.

But by the nineties, Fannie and Freddie did not have the business of buying mortgages to themselves. Others in the industry were also buying mortgages and selling mortgage-backed securities, also quite profitably.

The competition was bitter. Fannie's and Freddie's competitors argued that despite the subsidy from the government's implicit guarantee, Fannie and Freddie were neglecting affordable housing for low-income Americans for the sake of profits. Fannie's and Freddie's competitors urged that Fannie's and Freddie's business be largely limited to affordable housing for low-income borrowers.

Republican criticism of Fannie and Freddie was part of an internecine battle in the financial industry between Fannie and Freddie on one side, and their competitors, companies like AIG and Lehman Brothers, on the other. Fannie's and Freddie's competitors -- and their Republican allies -- argued that Fannie and Freddie had an "implicit guarantee" from the federal government that amounted to an unfair subsidy.

Peter Wallison (yes, same guy) wrote an article in the American Banker on March 3, 2006 opposing an increase in the "conforming loan" limit that was typical of the criticism of Fannie and Freddie at the time. Fannie and Freddie were already "doing less than conventional lenders in helping the underserved," Wallison said. Fannie and Freddie "only provided about 4% of credit going to minority borrowers." Rather than compete with other lenders for profitable mortgages for upper-income borrowers, "Fannie and Freddie should do a much better job of providing affordable home financing to a neglected portion of the mortgage market."

If political bullying is to blame for Fannie's and Freddie's conduct, Republicans were at least equally guilty.

The financial crisis occurred seven years and eight months into a Republican administration that let the financial industry write its own rules. A narrative of the financial crisis that absolves Republicans and the financial industry requires an acrobatic and brazen imagination.

Believing the narrative requires willful amnesia.