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Shining a light on the cause of the Great Recession

Peter Wallison places blame where it belongs — redistributionist policy

By Richard W. Rahn

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What do you think was the primary cause of the Great Recession — too little government regulation or dictates by the government to banks and other mortgage lenders, requiring them to lend to the unqualified?

Peter J. Wallison, former general counsel of the U.S. Treasury Department and White House counsel to President Reagan, who was also a member of the congressionally authorized Financial Crisis Inquiry Commission, has just published a book, "Hidden in Plain Sight," in which he clearly documents what caused the financial crisis and why it is likely to happen again. For this act of detailed scholarship and truth-telling, he has come under fierce attack by many of those who were, in part, responsible for the crisis.

The Wallison narrative is straightforward. Traditionally, community banks made mortgage loans to customers and then kept and serviced the loans. The banks obviously wished to be repaid, so they only lent to those they considered good credit risks and who were able to make a reasonable down payment on the house, around 20 percent.

Expanded homeownership has been considered a social good, and measures to increase homeownership have been strongly encouraged by homebuilders, realtors, bankers and the political class. In order to increase the pool of lendable funds, many decades ago Congress set up Fannie Mae, and subsequently Freddie Mac, to buy mortgages from banks, thus enabling the banks to make more mortgage loans. For many years, Fannie and Freddie would only buy high-quality mortgages.

All seemed to be going well, but then "community activists" started complaining that low-income and minority consumers had much lower rates of homeownership and this was "unfair." As a result, in 1992 Congress started passing "affordable housing goals" and over the years continued to increase those goals. The banks were told to make an increasing percentage of their loans to buyers who would not normally qualify, and Fannie and Freddie were in turn pressured or required to buy more and more of these nontraditional or subprime mortgages. Down payment requirements became easier and easier, and finally, in many cases, zero. Credit and employment history requirements became less and less strict, finally leading to the “no-doc” loan.

The Federal Reserve provided the necessary money expansion to accommodate all of the new mortgages. The community banks liked it because of the fat fees and the fact they could dump the bad paper on Freddie and Fannie, which in turn put many of these bad loans into mortgage-backed securities that they and the big banks sold on the world financial markets. The buyers believed there was little risk because U.S. housing prices “only went up” and the U.S. government would stand behind all of the new debt.

All of this money fueled the great housing bubble from the late 1990s to 2008 when everything came crashing down. Too many people had bought more house than they could afford, and when prices started to drop, millions owed more than their houses were worth (i.e., they were underwater). Fannie and Freddie, the big banks and many financial institutions around the world were stuck with trillions of dollars of bad mortgages, which impaired their credit ratings and caused them to pull back lending or go into bankruptcy.

This narrative is accurate, but because it implicitly indicts all of those politicians and others, notably the executives at Fannie and Freddie who built the house of cards, Mr. Wallison has been attacked. Most Democrats could not admit that their scheme to give poor people more housing than they could afford was a fraud and failure — and needed to find a nongovernment scapegoat. The Republicans who went along, failed to do proper oversight and put their heads in the sand needed other explanations. The scapegoats became the greedy Wall Street bankers and “the perfect storm.” There may be much to dislike about Wall Street bankers, but they did not suddenly become more greedy or corrupt — evidenced by none of them having gone to jail.

Mr. Wallison is a problem for the political class, much like the boy who said the emperor had no clothes. He cannot be dismissed as a know-nothing lightweight. So his character must be impugned since the facts are on his side. The reviews on Amazon.com are amazing. As of this writing, 63 gave Mr. Wallison a “1”, 43 gave him a “5,” and there were no “3s.” Many in the organized attack called him a “liar” with no supporting evidence. Mr. Wallison, on the other hand, has hundreds of references in his book, many to official documents and memos to support his arguments.

Peter Wallison has endured many fights and knew what he was getting himself into when he took on the task of demolishing the false narrative being spun by the president and many in Congress about what caused the financial crisis. Buy this book — because it clearly documents not only what caused the crisis, but the lengths to which many of our leaders will go to cover up their policy misdeeds — and it is a good read.

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