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Mortgage Bubble Blamed, Ludicrously, on the Government

The bullshit train just keeps rolling on.

In the ongoing effort to rewrite history and deflect blame from Wall Street for the financial crisis, former U.S. Treasury official and current American Enterprise Institute swine Peter Wallison has issued a lengthy analysis of the mortgage bubble that, surprise, surprise, lays the blame for the crash at the feet of government efforts to expand home ownership to "those who normally would not qualify."

The *Washington Times* piece about the Wallison study includes the following coda near the top. The emphasis here is mine: "*Without waiting for the evidence*, many in the political class, particularly those on the left, bought into the argument that the financial crisis was caused by greed."

I'm going to come back to that remarkable line written by senior Cato Institute fellow Richard Rahn, who's just jumped to the very top of my shit list, in a second. But just quickly, the argument goes on to summarize the conclusions in Wallison's study, which is described as a "stronger and more empirically-based" argument, having been done by one of what Rahn calls the "somewhat more sophisticated observers" who didn't just rush to blame the whole thing on greed without waiting for the evidence.

The essence of Wallison's argument is that the crisis was caused by the fact that the government in the late 1990s started forcing Fannie Mae and Freddie Mac to acquire increasing numbers of "affordable" housing loans.

Which is true. The Clinton administration did issue a mandate instructing Fannie and Freddie to purchase a larger portfolio of low-income housing loans. But this had nothing, or very little, to do with the mortgage bubble. What's fascinating about this AEI stance is the evolution of the right-wing argument: the first effort to explain the mortgage crisis involved, of all things, the Community Reinvestment Act of 1977, the anti-redlining law that required banks to issue a certain percentage of home loans to the people who made up the bulk of their depositors. That propaganda effort was only mildly successful for the screamingly obvious reason that the law in question was passed in the seventies, across

thirty years of crisis-free American history. That, plus the fact that the CRA had absolutely no real impact on the sudden explosion of subprime home loans in the early part of the last decade, made this a propaganda non-starter.

So now they're coming back with this, pegging the whole mess not to greed but to Clintonian policies involving Fannie and Freddie. Note that although they could have done so, the AEI is not criticizing Clinton for the things he was actually guilty of, like repealing the Glass-Steagall Act and signing off on the Commodity Futures Modernization Act (which deregulated the types of derivatives that made the mortgage-backed securities boom possible) in 2000.

No, the criticism here is not really partisan; it's designed more to put class and race at the middle of the crash discussion, pitching the financial crisis as the result of a botched socialistic scheme to put "those who normally would not qualify," i.e. poor white trash and poor black and Hispanic people, in fancy homes.

Here is why this argument is bullshit, and I'm not the only one saying so.

The reason there was a sudden rush to lend out homes to subprime borrowers was not because of Fannie and Freddie, but because the banks had discovered fancy new derivative tools like CDOs and CMOs that allowed them to chop up bundles of home loans and turn them into AAA-rated securities. Countrywide was not trolling the streets looking for jobless indigents to lend mansions to (this literally happened, by the way) because the government was forcing them to. It was because big banks like Goldman and JP Morgan Chase and Bank of America were letting them know that they had a virtually limitless market for mortgage-backed securities, thanks to the new derivative tools that allowed them to sell billions of subprime MBS as AAA-rated investments to suckers like German land-banks and Icelandic trade unions and the like.

Every time the AEI or some other stooge comes out with one of these "But the government made us lend this shit!" arguments, we need to stand up and repeat: no, sirs, it did not. This was not a government program to put people in homes. This was an international fraud scheme to disguise crappy American home loans as AAA-rated safe investments so that they could then be hawked to foreigners and insurance companies and pension funds. The fact that a whole bunch of people who probably didn't deserve credit ended up owning mortgages and buying homes was actually an incidental side-effect, a kind of collateral damage, to the underlying fraud scheme. Not about greed, Richard Hahn? This crisis was about banks bundling subprime mortgages and selling it off as AAA-rated gold to pension funds.

That means a bunch of jackasses on Wall Street with $1000 suits and slicked-back hair were passing the word to Countrywide lenders that they needed masses of crap loans that they could then turn into investment-grade paper and sell it all off to, say, the state pension fund of Indiana.

That way, thousands of Indianan toll booth operators and teachers and prison guards and janitors who'd been working their whole lives and saving up nest eggs were made into customers of this toxic crap these bankers knew would blow up eventually. Indiana's pension fund lost $5 billion during the crisis. Virtually every state in the union suffered similar fates. Why? Because a bunch of used-car salesmen on Wall Street sold them fleets of lemons with no engines under the hoods.

I don't know what Richard Rahn would call making your yearly bonus goal by robbing some janitor in Indiana out of his pension. As a flack for the Cato Institute, I'm sure he would call it good business. But in my mind, if that's not greed, I don't know what the hell is.

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This has to be repeated: Fannie and Freddie did not invent this scheme to turn subprime crap into AAA-rated gold. They were not the ones who were mismarking dicey home loans; that was the fault of the ratings agencies, who did so because they wanted to retain relationships with the big banks. Here's what Fannie and Freddie did do; they followed the market and bought lots of these loans after the banks had already collected them and chopped them up and mismarked them. As Barry Ritholz points out, they were essentially just another in a long line of dumb banks that jumped ass-first into the MBS market once it started to bubble up.

There's certainly a legitimate debate about government housing policy and whether or not it makes sense to have the Government-Sponsored Entities like Fannie and Freddie putting so much of our capital at risk to help low-income borrowers get houses. It may very well be that the Clintonian dictums went too far and were ultimately unsustainable. But that is an entirely separate issue, very different from the question of what caused the mortgage bubble and, by extension, the crash.

Plain and simple, the mortgage bubble was caused by the unregulated mass-marketing of mismarked, or fraudulently marked, subprime mortgages to customers who had no idea or only a very dim idea of what they were buying. This was high-tech fraud and stealing, and not just greed but unconscionable, criminal greed on a grand scale.

As for Richard Rahn talking about observers in the "political class" who blamed the crash on greed "without waiting for the evidence," let me just ask this: on the literary totem pole, what could possibly be lower than a flack for an industry-fattened think tank taking a paycheck to defend greed? I guess there are all sorts of creatures in God's kingdom, but man, are some of them ugly.

p.s. Thanks to reader Sean Ausmus for calling the Rahn piece to my attention.

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