William Robson

Another meltdown? It's only a matter of time

As long as Washington insists on home ownership for people who can't afford it, economic history will keep repeating its costly self

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U.S. President Barack Obama made headlines last week with his far-reaching plan to prevent another financial crisis. Yet, a less-remarked story earlier this month - the Security and Exchange Commission's fraud charges against the CEO of Countrywide, the subprime mortgage lender at the heart of the collapse - highlighted a crucial gap in the administration's blueprint.

Until his company blew up, Countrywide CEO Angelo Mozilo was a hero, with intimate ties to U.S. policy-makers bent on making homeowners of even the poorest Americans. As long as Washington obsesses with getting houses into the hands of people who cannot afford them, another meltdown is only a matter of time.

This is not to dismiss, out of hand, the President's proposals, or similarly motivated schemes from myriad academics, public officials and financial industry experts in the United States, Canada and around the world. But any cure is only as good as the diagnosis that inspires it.

Mr. Obama stressed the problem of buccaneering bankers and negligent regulators: risk managers in the private and public sectors who, sometimes willfully, ignored the dangers of highly leveraged securities and institutions. Ferreting out malfeasance and negligence matters, and exposing Mr. Mozilo as an alleged villain when populists are baying for bankers' blood has its rewards.

The Obama proposals, like those elsewhere, also address failures by bankers and regulators to take a systemic view. Even if individual banks have lots of capital and cash, plunging markets and panics can mean insolvency and illiquidity all around. Devising better measures and remedies for systemic risk is fascinating, and personally rewarding as well.

Another key theme in anti-crisis proposals is dynamic instability. If leverage ratios and other measures understate risk while bubbles are inflating, and overstate it when they burst, they need rethinking. That rethink is also intellectually engaging and gratifying for academics, experts and policy-makers alike.

All these diagnoses and cures are interesting to explore and fun to design, yet all assume that policy-makers want to, and will if they can, curb bankers' enthusiasm for excessive risk-taking. The back story to the Countrywide collapse, however, shows that U.S. political leaders have leaned, more often than not, exactly the opposite way.

U.S. promotion of home ownership goes way back. So does its principal tool: encouragement of low-quality mortgage lending. And so, not surprisingly, does a cycle of financial booms and busts.

Herbert Hoover's “Own Your Own Home” campaign sparked a mortgage binge that collapsed - like much else - in 1929 and 1930. The Home Owners' Loan Corp. of the 1930s was a default-ridden disaster. The Federal Housing Administration's urban-loan program blew up in the late 1960s and 1970s. Then, the savings and loan crisis of the 1980s - an episode that tainted recent presidential candidate John McCain - triggered a credit crunch and a slump.

In the 1990s, U.S. policy-makers prepared the way for the latest, greatest crash. The Department of Housing and Urban Development sought more lending to minorities on easier terms. In 1994, Mr. Mozilo's Countrywide was the first bank to pledge to do so. Over the decade to 2008, Countrywide

stands out as the biggest spender in the $370-million worth of mortgage-industry lobbying documented by the U.S. Center for Responsive Politics. This was the same period that government-backed mortgage insurers Fannie Mae and Freddie Mac pressed Congress for higher lending limits, which Congress readily granted.

Worse happened behind the scenes. Countrywide provided below-market-rate loans to many public figures, identified as "Friends of Angelo" in company documents: the chairs of the Senate banking and budget committees, a former Clinton administration health and human services secretary, a Bush administration secretary of housing and urban development and Obama campaign adviser James Johnson, who resigned after the Wall Street Journal reported his cut-rate loan.

The U.S. blogosphere is abuzz about the money flowing from mortgage lenders and insurers to policy-makers in exchange for supportive legislation and regulation.

The right mutters about how Barack Obama's four years in the Senate vaulted him to second place - behind fellow Democrat banking committee chairman Christopher Dodd - for donations from Fannie Mae employees and their political action committee over the decade to 2008. The left complains that most of the Troubled Asset Relief Program funds went to banks that funded, or now own, the major subprime lenders.

This muckraking appeals less to academics and regulators. It is less cerebral. For some, exposing such skulduggery would be severely career-limiting. Yet, this driver of the crisis, which other diagnoses neglect, continues in force.

The U.S. mortgage mill has slowed, but it has not stopped. Now under direct government control, Fannie Mae and Freddie Mac are definitely still in business. As pressure groups complain that foreclosures are disproportionately affecting low-income and minority Americans, Congress will reiterate its commitment to get people living in houses they cannot afford. Can we imagine Mr. Obama saying, "No"?

Our main task should be figuring out how to weather the next crisis, because we cannot stop Washington creating it.

William Robson is president of the C.D. Howe Institute.