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Lies or Ignorance?

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If government agencies pressure banks to give loans to people who are poor credit risks, do you view this as a failure of capitalism or a failure of government? A number of left-wing politicians and commentators have made the assertion that the financial crisis is a result of too much deregulation under the "capitalistic" policies of President Reagan. Those who make the assertion are either ignorant of the facts or being untruthful.

First, a few basic facts: It is universally understood that the present financial meltdown began with the problems of two enormous government-sponsored enterprises (GSEs) - Fannie Mae and Freddie Mac. These two enterprises purchased mortgages from banks to allow banks to issue larger and riskier mortgages with the explicit goal of increasing homeownership.

Fannie and Freddie were allowed to have a lower percentage of capital reserves, needed in case of losses, than other purely private banks were required to keep. Fannie and Freddie both engaged in accounting practices that the courts have ruled to be improper and fraudulent. Fannie and Freddie have contributed millions of dollars to political candidates, including most members of Congress.

During the Carter administration, the Democratic Congress passed the Community Reinvestment Act (CRA), which gave federal regulators the power to pressure banks into issuing loans to high-risk households and small businesses. During the Clinton administration, the CRA was given more power to force banks to issue even riskier loans to poor households. Officials of the Bush administration and members of Congress, who tried to rein in the CRA because they saw a train wreck coming, were accused of racism by some congressional Democrats and left-wing activist groups.

The Federal Reserve engaged in a policy of excessively easy money, cutting the federal funds rate to only 1 percent in June 2003, a rate lower than inflation. Thus, banks were encouraged to provide many very low-rate adjustable mortgages that they, in turn, could offload on the GSEs. Everyone knew interest rates would eventually rise and many borrowers would then be unable to pay the mortgages. But each party in the chain thought it could pass off the bad paper to the next sucker. The result, the taxpayer becomes the ultimate sucker.

Financial regulators are supposed to protect the integrity of the system, the investors and consumers. It was the anti-capitalist left that insisted the regulators make banks originate bad loans and made sure that the GSEs would not have to abide by the rules that everyone else did. If you have any doubt about this, take at look at this video, which shows members of Congress attacking the regulator and defending the improper practices of Fannie Mae and Freddie Mac, which touched off the financial crisis: http://www.eyeblast.tv/public/video.aspx?RsrcID=36431.

There is a danger that the bailout bill and other related measures will be used to further undermine free-market capitalism, and again permanently expand the scope of the federal government, rather than put in measures to correct the real problem of laws and regulations that undermine the proper functioning of the market. Ronald Utt, former associate director of the Office of Management and Budget and now a senior fellow at the Heritage Foundation, recently wrote this following bit of history that all too many have forgotten:

"Following the stock market collapse in October 1929, the Hoover administration tried to spend its way out of the Great Depression, increasing federal spending by 47 percent between 1929 and 1932. As a result, federal spending as a percentage of GDP increased from 3.4 percent in 1930 to 6.9 percent in 1932, and reached 9.8 percent by 1940. During that period, many of the federal programs now being buffed up for expanded action - Fannie Mae, Home Owners' Loan Corp., the FHA [Federal Housing Administration], the FHLBB [Federal Home Loan Bank] - were created."

"While this point of nostalgia has excited many advocates of an expanded federal government, ordinary citizens and taxpayers should note that, despite all of the new government spending and bureaucracy, fewer Americans had jobs 1940 than in 1929. Furthermore, the homeownership rate of 43.6 percent in 1940 was the lowest recorded by the Census Bureau, even below the 47.6 percent rate of 1890."

Federal government spending has now grown to more than 20 percent of GDP, and the total of federal, state and local spending now totals more that one-third of GDP. Regulatory expenditures have even grown more rapidly. The problem is not a result of too little regulation, but of too much regulation used to line the pockets and power of politicians rather than serve legitimate purposes.

What we have seen is not a failure of free-market democratic capitalism, but another failure of a government that destroyed the normal market mechanisms for dealing with risk. There have been many calls for the "greedy" to be punished, but the political "greed" for power and money is even more dangerous than excesses practiced by occasional business people. If the greedy should pay fines or go to jail for their sins, it is important not to leave out Democratic Rep. Barney Frank of Massachusetts and Sens. Chris Dodd of Connecticut and Charles Schumer of New York, and many of their colleagues. Their actions have been far more costly to the American people, and others, than the actions of any Wall Street executive.

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