The Daily Dish

10 Years After (Not the Band)

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Eakinomics: 10 Years After (Not the Band)

This week marks 10 years since the full fury of the financial crisis and raises the obvious question as to whether policymakers have absorbed the lessons of the crisis and are prepared to prevent a recurrence.

No.

They haven't, at least in the United States, because they continue to frame this as a U.S.-specific regulatory failure. That is wrong. As we put it in my dissent on the Financial Crisis Inquiry Commission (FCIC), "We also reject as too simplistic the hypothesis that too little regulation caused the crisis, as well as its opposite, that too much regulation caused the crisis. We question this metric for determining the effectiveness of regulation. The amount of financial regulation should reflect the need to address particular failures in the financial system. For example, high-risk, nontraditional mortgage lending by nonbank lenders flourished in the states and did tremendous damage in an ineffectively regulated environment, contributing to the financial crisis. Poorly designed government housing policies distorted market outcomes and contributed to the creation of unsound mortgages as well. Countrywide's irresponsible lending and AIG's failure were in part attributable to ineffective regulation and supervision, while Fannie Mae and Freddie Mac's failures were the result of policymakers using the power of government to blend public purpose with private gains and then socializing the losses. Both the 'too little government' and 'too much government' approaches are too broad-brush to explain the crisis."

Even more important, the financial crisis was global. Again, "There were housing bubbles in the United Kingdom, Spain, Australia, France and Ireland, some more pronounced than in the United States. Some nations with housing bubbles relied little on American-style mortgage securitization. A good explanation of the U.S. housing bubble should also take into account its parallels in other nations. This leads us to explanations broader than just U.S. housing policy, regulation, or supervision. It also tells us that while failures in U.S. securitization markets may be an essential cause, we must look for other things that went wrong as well."

But the one thing that continues to resonate is the role of real estate, commercial and residential. As *The Economist* succinctly put it, "The precise shape of the next financial crisis is unclear—otherwise it would surely be avoided. But, in one way or another, it is likely to involve property. Rich-world governments have never properly reconciled a desire to boost home ownership with the need to avoid dangerous booms in household credit, as in the mid-2000s."

That is the key. Policymakers across the globe continue to push home ownership, minimizing down payments, subsidizing interest costs, and looking shocked when the financially unprepared are unable to maintain their financial commitments. In the United States these terrible instincts are codified in the form of taxpayer-back subsidies to borrowing to own homes. (Think about it, why is it good public policy to force someone to go in debt to get help?) The poster children for this stance are Fannie Mae and Freddie Mac, whose public policy purpose was to keep low the 30-year fixed rate mortgage interest and use some of their earnings as off-budget slush funds to promote "affordable housing." The only catch was that Fannie and Freddie got to pocket all the earnings in the good times, and the taxpayer held them harmless when the inevitable downturn transpired.

It is depressing, but nothing has changed, as evidence by a recent House Financial Services Committee hearing, "A Failure to Act: How a Decade without GSE Reform Has Once Again Put Taxpayers at Risk." Former Acting Director of the Federal Housing Finance Authority Ed DeMarco summarized the state of play nicely, saying "Today's ten-year anniversary of the failures and conservatorships of Fannie Mae and Freddie Mac is not a cause for celebration. What happened ten years ago to Fannie Mae and Freddie Mac had been forecast by some but denied as a possibility by many. Yet, Fannie Mae and Freddie Mac did fail, and taxpayers were forced to take on extraordinary financial risks bailing them out. Moreover, the fundamental challenge posed by their failure remains today…"

As more evidence of the bipartisan bad instincts of policymakers, check out this giveaway.

The short version is that real estate risk is systemic risk and we will never cure the large risks in the financial system as long as we treat them as a financial problem. They are not. They are a policy problem—a policy problem manifested by inappropriate housing subsidies and an unwillingness to expect people to be financially ready to own a home before they actually own a home.