

Rortybomb

Bloomberg's Awful Comment; What Can We Say For Certain Regarding the GSEs?

Posted on [November 1, 2011](#) by [Mike](#)

(**Note, 2/13/13:** There is an alternative, updated version of this post designed to address Marco Rubio's response to the 2013 State of the Union live at Wonkblog. [Check it out there.](#))

Sigh.

Bloomberg blames congress.m4v



Mayor Bloomberg:

It was not the banks that created the mortgage crisis. It was, plain and simple, Congress, who forced everybody to go and give mortgages to people who were on the cusp....But they were the ones who pushed Fannie and Freddie to make a bunch of loans that were imprudent, if you will. They were the ones that pushed the banks to loan to everybody.

My sense is that these are people who can't accept that some markets, especially financial ones, are disasters when completely unregulated – and thus find any far-fetched excuse to blame the government. But since we are going to hear a lot of it in 2012, how should one respond to the line that Congress and Fannie/Freddie caused the housing crisis?

1. The first thing to point out is that the both the subprime mortgage boom and the subsequent crash are very much concentrated in the private market, especially the private label securitization channel (PLS) market. The GSEs were not behind them. That whole fly-by-night lending boom, slicing and dicing mortgage bonds,

derivatives and CDOs, and all the other shadiness of the 2000s mortgage market was a Wall Street creation, and that is what drove all those risky mortgages.

For some data, [start here](#): “More than 84 percent of the subprime mortgages in 2006 were issued by private lending institutions....Private firms made nearly 83 percent of the subprime loans to low- and moderate-income borrowers that year.”

As Center For American Progress' David Min [pointed out](#) to me, the timing doesn't work at all: “But from 2002-2005, [GSEs] saw a fairly precipitous drop in market share, going from about 50% to just under 30% of all mortgage originations. Conversely, private label securitization [PLS] shot up from about 10% to about 40% over the same period. This is, to state the obvious, a very radical shift in mortgage originations that overlapped neatly with the origination of the most toxic home loans.”

2. The next thing to mention is that the “affordability goals” of the GSEs, as well as the Community Reinvestment Act (CRA), didn't cause the problems. Randy Krozner summarized [one of the better studies on this so far](#), finding that “the very small share of all higher-priced loan originations that can reasonably be attributed to the CRA makes it hard to imagine how this law could have contributed in any meaningful way to the current subprime crisis.” The CRA wasn't big enough to remotely cause these problems.

For the GSE's, I'd recommend checking out Jason Thomas and Robert Van Order, [A Closer Look at Fannie Mae and Freddie Mac: What We Know, What We Think We Know and What We Don't Know](#), which, in addition to explaining how their affordability mission is a distraction, argues that subprime was only 5% of the GSEs losses and the GSEs bought the highly-rated tranches of mortgage bonds for which there was already a ton of demand.

3. This is not exactly an obscure corner of the wonk world – it is one of the most studied capital markets in the world. What has other research found on this matter? [From Min](#):

Did Fannie and Freddie buy high-risk mortgage-backed securities? Yes. But they did not buy enough of them to be blamed for the mortgage crisis. Highly respected analysts who have looked at these data in much greater detail than Wallison, Pinto, or myself, including the [nonpartisan Government Accountability Office](#), the [Harvard Joint Center for Housing Studies](#), the [Financial Crisis Inquiry Commission majority](#), the [Federal Housing Finance Agency](#), and virtually all academics, including the [University of North Carolina](#), [Glaeser et al at Harvard](#), and [the St. Louis Federal Reserve](#), have all rejected the Wallison/Pinto argument that federal affordable housing policies were responsible for the proliferation of actual high-risk mortgages over the past decade.

The other side has virtually no research conducted that explains their argument, with one exception we'll cover in a second.

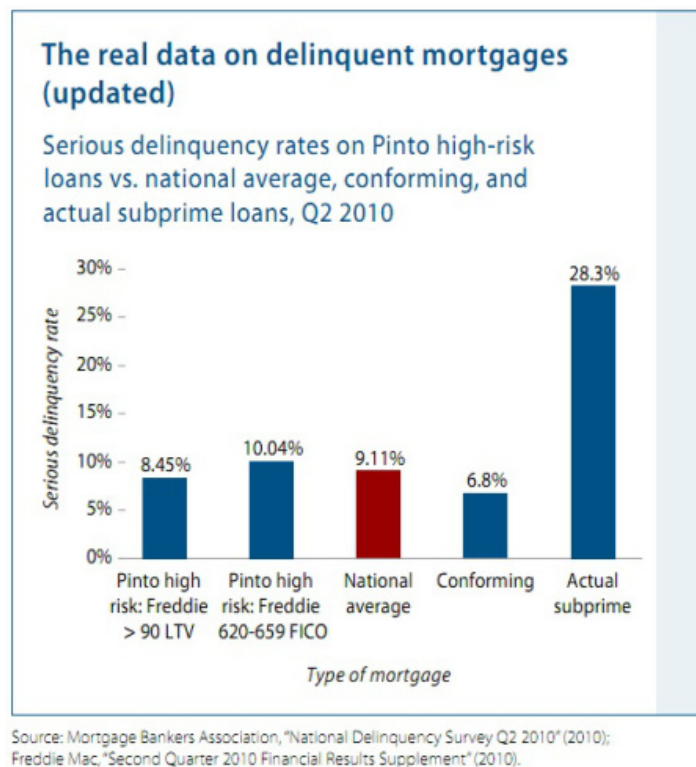
4. For fun, we should mention that the conservative think tanks spent the 2000s saying *the exact opposite of what they are saying now*, and the opposite of what Bloomberg said above. They argued that the CRA and the

GSEs were getting in the way of getting risky subprime mortgages to risky subprime borrowers.

My personal favorite is Cato's [Should CRA Stand for "Community Redundancy Act?"](#), (2000, here's a [writeup by James Kwak](#)), arguing a position amplified in Cato's 2003 Handbook for Congress [Financial Deregulation Chapter](#): "by increasing the costs to banks of doing business in distressed communities, the CRA makes banks likely to deny credit to marginal borrowers that would qualify for credit if costs were not so high." Replace "marginal" with Bloomberg's "on the cusp" and you get the idea.

Bill Black went through what AEI said about the GSEs during the 2000s [here](#) and it is the same thing – it was blocking subprime from being made. Peter Wallison, 2004: "In recent years, study after study has shown that Fannie Mae and Freddie Mac are failing to do even as much as banks and S&Ls in providing financing for affordable housing, including minority and low income housing."

5. There's an argument that the GSEs had huge subprime exposure if you create a new category that supposedly represents the risks of subprime more accurately. This new "high-risk" category is associated with a consultant to AEI named Ed Pinto, and his analysis deliberately blurs the wording on "high-risk" and subprime in much of his writings. David Min broke down the numbers, and [we wrote about it here](#). Graphic from Min's [follow-up work](#), addressing criticism:



Even this "high risk" category isn't risky compared to subprime, and looks like the national average. When you slice it by private-label, the [numbers are even worse](#). Private label loans "have defaulted at over 6x the rate of GSE loans, as well as the fact that private label securitization is responsible for 42% of all delinquencies despite accounting for only 13% of all outstanding loans (as compared to the GSEs being responsible for 22% of all

delinquencies despite accounting for 57% of all outstanding loans).” This issue isn’t this fake “high risk” category, it is subprime and private-label origination.

The Financial Crisis Inquiry Commission (FCIC) panel looked carefully at this argument, and also ended up [shredding the argument to nothing](#). So even when those who blame the GSEs make up categories, they can’t get the numbers to work.

6. The three Republicans on the FCIC panel rejected the “Blame the GSEs/Congress” approach in their minority report. Indeed, they, and most conservatives who know this is a dead-end, tend to do a “it’s a whole lot of things, hoocoodanode?” approach.

Peter Wallison, made this GSE argument when he served as the fourth Republicans on the FCIC panel. What did the other three Republicans make of his argument?

Check out these [released FCIC emails from the GOP members](#). They are really fun, because you can see the other Republicans doing damage control and debating whether Wallison and Pinto were on the take for making this argument – because the argument makes no sense for those looking at the data.

Lots of great quotes like: “Re: peter, it seems that if you get pinto on your side, peter can’t complain. But is peter thinking idependently [sic] or is he just a parrot for pinto?”, “I can’t tell re: who is the leader and who is the follower.”, “Maybe this email is reaching you too late but I think wmt [William M. Thomas] is going to push to find out if pinto is being paid by anyone.” And the infamous event where Wallison emailed his fellow GOP member: “It’s very important, I think, that what we say in our separate statements not undermine the ability of the new House GOP to modify or repeal Dodd-Frank.”

Good times. The GSEs had a serious corruption problem and were flawed in design – Jeff Madrick and Frank Partnoy [had a good column about the GSEs](#) in the NYRB recently that you should check out about all this – but they were not the culprits of the bubble.

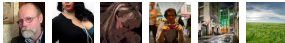
Share this:

[Tweet](#)
[Share](#)

6

[G+](#)

85

[Email](#)
[★ Like](#)


6 bloggers like this.

Related

[GSE Losses As Shadow Bailout](#)

With 11 comments

[What is a subprime mortgage?](#)

[Peter Wallison Discusses Fannie and Freddie for the American Spectator, or: Where are the Fact Checkers?](#)

With 29 comments