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Wonkblog

No, Marco Rubio, government did not cause the housing crisis

By Mike Konczal February 13, 2013

In [his response](#) to the State of the Union, Sen. Marco Rubio said: "This idea – that our problems were caused by a government that was too small – it's just not true. In fact, a major cause of our recent downturn was a housing crisis created by reckless government policies."

For obvious reasons, this argument is very popular on the right, but there's precious little to back it up. The core claim can be a bit slippery, but it tends to go something like this: the existence and affordability goals of Fannie Mae and Freddie Mac (the GSEs) and the Community Reinvestment Act (CRA) were a major reason we had a subprime-driven housing bubble and then a crash. The only problem? Pretty much all the evidence on the housing crisis shows that that's not true.

(As I don't believe Rubio is referencing them, I'm putting to the side the complicated debate on interest rates being ["far too low for far too long"](#) and policy, or the idea that [there wasn't enough](#) U.S. government debt in the 2000s [!] to meet the demand for safe assets. Though those are the debates people actually engaged with these questions are studying.)

Let's go through some things we know.

1. Private markets, rather than the GSEs, created the subprime mortgage boom.

The subprime mortgage boom and the subsequent crash are very much concentrated in the private market, not the public market. Subprime is a creature of the private label securitization channel (PLS) market, instead of the Government-Sponsored Entities (GSEs, or Fannie and Freddie). The fly-by-night lending boom, slicing and dicing mortgage bonds, derivatives and CDOs, and all the other shadiness of the mortgage market in the 2000s were Wall Street creations, and they drove all those risky mortgages.

Here's [some data](#) to back that up: "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 University of California, Irvine law professor David Min [has argued](#), saying the government directly created either the housing bubble or subprime loans has a serious problem with the timing. "From 2002-2005, [GSEs] saw a fairly precipitous drop in market share, going from about 50 percent to just under 30 percent of all mortgage originations. Conversely, private label securitization [PLS] shot up from about 10 percent to about 40 percent 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 Community Reinvestment Act and the GSE's affordability mission didn't cause the crisis.

Many conservatives argue that the "affordability goals" of the GSEs, as well as the Community Reinvestment Act (CRA), which was created in the 1970s to make sure poor communities had access to credit, either directly or indirectly led to subprime loans.

[Research](#) from the Federal Reserve by Neil Bhutta and Glenn B. Canner (helpfully summarized in this [Randy Kroszner speech](#)), argues that the CRA couldn't have been behind the subprime and housing bubbles. "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." *Only six percent* of higher-priced loans (their proxy for subprime loans) were extended by CRA-covered lenders to lower-income borrowers or CRA neighborhoods.

[A recent paper](#) found that while the CRA might have introduced slightly larger risks in lending portfolios, extra loans done to meet CRA compliance weren't more likely to have higher interest rates, lower loan-to-value, or be balloon/interest-only/jumbo/buy-down mortgages, or hold other subprime characteristics. So it is unlikely that the CRA was priming the pump for subprime, or subtly encouraging subprime mortgages to be made by private lenders.

Jason Thomas and Robert Van Order's [research](#) argues that subprime loans were only 5 percent of the GSEs' losses. The GSEs' affordability mission led them to buy the highly rated tranches of mortgage bonds, for which there was already a ton of demand and were not essential to the completion of the deals.

3. There's a lot of research to back this up and little against it.

The United States' housing market is one of the most intensely studied capital markets in the world. What has other research found? [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..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](#) [also [here](#)], 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.

4. Conservatives arguments tend to blur the definition of subprime. Some, such as Ed Pinto of AEI, argue that the GSEs had huge subprime exposure if you create a new category that represents the risks of subprime more accurately. He created a new "high risk" category, which he then argues these high-risk loans were held by the GSEs. This argument blur categories together and obscures more than it reveals. David Min broke down the numbers, and there is more about this discussion [here](#). Here's a graphic [from Min](#), comparing Pinto's new "high-risk" category against subprime:

Even this new "high risk" category, introduced by AEI to supposedly show what the GSEs were taking on, shows that it isn't anything like subprime and is instead comparable to the national average. If you then take the logical step and divide 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 percent of all delinquencies despite accounting for only 13 percent of all outstanding loans (as compared to the GSEs being responsible for 22 percent of all delinquencies despite accounting for 57 percent of all outstanding loans)." The 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 [finding it doesn't work](#). So those who blame the GSEs can't get the numbers to work when they make up categories.

(Fun fact: These same conservatives sang a different tune before the crash. They argued that the CRA and the GSEs were getting in the way of getting risky subprime mortgages to risky subprime borrowers. See [Should CRA Stand for 'Community Redundancy Act?](#) from Cato in 2000 or AEI's Peter Wallison in 2004 [arguing](#) "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. The government policy that likely made an impact were deregulatory actions.

In 2000, Congress [passed the](#) Commodity Futures Modernization Act, which deregulated the derivatives market, in a lame duck session as a rider to an 11,000 page omnibus appropriation bill. A banking capital "recourse rule" [in 2001](#) allowed the ratings agencies and private bank risk modelers to decide what banks should hold against risk. In 2003 the [OCC preempted](#) and overruled Georgia's new anti-predatory lending laws. Alan [Greenspan refused to](#) enforce regulations on, or even investigate the wrongdoing of, the new subprime market during the 2000s. The 2005 bankruptcy reforms in BAPCPA, widely viewed as friendly if not written by the financial industry, [codified the market practice](#) of letting derivatives go to the front of the line in bankruptcy, helping create the conditions for shadow banking runs.

These government actions all fall under the rubric of deregulation, or "letting the market decide" how to manage the rules of the financial sector, and they are more relevant to the actual crisis. Though these are government policies, and they were reckless, I doubt they are what conservatives like Rubio mean.

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