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**Beyond \$700 Billion
Smoke and Mirrors
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Imagine a patient visiting her physician for an annual checkup and is informed she has cancer. While in her physician's office, she has a heart attack and now the physician must attend to the patient's immediate health concern (the heart attack). That is the situation the Administration must confront. The \$700 billion request by the Administration will address the heart attack but not the cancer which some experts think has metastasized.

Last week when the Administration made its case before key leaders from Congress and the two presidential candidates, it was revealed credit markets were frozen and interbank lending had ceased. If we are to believe the Administration, famine, pestilence and locusts will plague us for the next 15 years if Congress does not approve their \$700 billion request.

Well on Monday, Congress refused to approve the \$700 billion plan. The rejection was not along party lines as 133 Republicans and 95 Democrats opposed the plan, but the ensuing finger-pointing surely turned partisan. The republican leadership (Reps. Boehner and Blount) quickly assailed the speech of Speaker Nancy Pelosi, D. CA, given during the debate prior to the vote, as the cataclysmic event which alienated many of the 133 Republicans. I can think of many reasons to run Speaker Pelosi out of town on rails but that speech was not one of them.

Speaker Pelosi flatly stated the truth in her speech: The Administration is responsible for running the economy into the ground. Actually, Speaker Pelosi, in a not-so-subtle effort, responded to media reports from over the weekend. The Republican spin machine was working overtime to place culpability for the economic collapse on the Democrats. For example, the "venerable" Investor Business Daily published an article on how the Democrats blocked Republicans' effort to reform Fannie Mae and Freddie Mac.

The article written by Terry Jones begins with the question, could the crisis at Fannie Mae-Freddie Mac and the subprime meltdown been avoided? According to Jones, "[t]he answer is yes. As early as 1992, alarm bells were going off on the threat Fannie and Freddie posed to our financial system and our economy. Intervention at any point could have staved off today's crisis. But Democrats in Congress stood in the way."

Do you believe a reasonable person would conclude, after reading the above paragraph that: 1) Fannie and Freddie was the cause of today's crisis and 2) Democrats are to blame for today's crisis because they could have prevented the collapse of Fannie and Freddie?

Jones establishes the premise that Fannie and Freddie are the cause of today's crisis when he conflates the collapse of the mortgage giants with the subprime crisis. Once this faulty premise is acknowledged, Jones' facts show how the Democrats stonewalled Republican efforts to reform Fannie and Freddie, thereby causing the crisis.

I do not disagree with Jones that the Republicans were seeking to dismantle Fannie and Freddie during the 1990's. But Jones and the Republicans do not reveal the true motive for such advocacy which was being done at the behest of Wall Street. Wall Street wanted the \$8-10 billion pre-tax income Fannie and Freddie were making annually. Goldman Sachs, Lehman Brothers, Merrill Lynch, Bear Stearns, and J.P Morgan wanted so desperately to capture the business of Fannie and Freddie, their lobbying effort was relentless with the fear inducing mantra "the risk they present is not worth the subsidy they receive".

The subsidy Wall Street referenced is the discount at which Fannie and Freddie could borrow money. For the past 38 years (the length of time both GSE's had federal charters) the perception in the marketplace was Fannie and Freddie's debt was backed by the federal government. With the government's balance sheet as a backstop, Fannie and Freddie were conferred the highest credit rating. Thus, they were able to borrow money at a lower interest rate than Goldman, et. al.

Fannie, Freddie and the Democrats claimed because of the lower interest rate the mortgage giants received in the marketplace, they (Fannie and Freddie) were able to pass the savings along in the form of affordable housing which was one of their mandates. Wall Street's counter argument was they (Wall St.) could provide affordable housing without the subsidy, which at various times ranged from \$5 to \$9 billion annually, depending on the researcher and which party was in office.

Wall Street and affordable housing do not pass the laugh test, yet in many congressional hearings, they proposed reforming Fannie and Freddie and they (Wall Street) would replace them because the free-market system was more efficient. Today, we are witnessing Wall Street's style of affordable housing. What Terry Jones neglected to tell you is that it is called subprime lending.

It is understandable that Terry Jones would arrive at the conclusion the Democrats are responsible for the crisis we are in today. If Terry had read chapter 5 in my book, Residential Real Estate Finance: From Application Through Settlement, s/he would have known that the subprime industry's birth came a few years earlier under the Reagan Administration. First, interest rate caps were removed with the Depository Institutions Deregulation and Monetary Control Act. Then adjustable rate mortgages, balloon mortgages and other products that were vigorously regulated became widely available after the passage of the Alternative Mortgage Transaction Parity Act. The door to subprime lending was opened wider with the Tax Reform of 1986, which paved the

way for lenders to introduce the Home Equity Line of Credit (HELOC).

Likewise, it is understandable that Speaker Pelosi would resort to partisan rhetoric during debate of the Republican president's request for \$700 billion to resolve a problem created by the republican free-market ideology that is now being spun as a problem created by her party.


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