Letter to the Editor: Keep Government Out of Lending

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To the Editor:

In "How to Shape the Next Version of CRA" [Oct. 31], Jennifer Tescher argues for expanding the government's role in credit allocation.

Whoa! The government caused the gutting of mortgage credit standards and housing inflation, which were behind the huge increase in borrowers unwilling or unable to meet their payments. That precipitated the credit crisis.

By buying subprime mortgages on a massive scale, the government-sponsored enterprises Fannie Mae and Freddie Mac facilitated banks' meeting CRA bogeys and purposefully eviscerated credit standards. Moreover, if Fannie and Freddie had not had implicit (and now explicit) government backing, they would never have been able to acquire millions of subprime mortgages.

The CRA was intended to push banks to make loans to the poor and minorities they otherwise wouldn't. The Clinton administration gave teeth to banks' affirmative obligation to lend to high-risk borrowers. If they didn't kowtow to community organizers in making risky loans, new branches and M&A would be blocked. Former Senate Banking Committee Chairman Phil Gramm observed that the Clinton administration turned the CRA into a vast extortion scheme against America's banks.

However, notwithstanding these efforts, more non-CRA than CRA lenders' mortgages were to low-income borrowers.

The government's assault on credit standards picked up steam in the 2000s. Fannie's and Freddie's acquisition of subprime, alt-doc loans and home equity lines increased from 15% of mortgages in 2001 to 37% in 2004. Securities collateralized by subprime mortgages soared from $18.5 billion in 1995 to $507.9 billion in 2005.

In 2004, Congressman Barney Frank dismissed suggestions that a problem was brewing in Fannie and Freddie. Instead, he worried they weren't being loose enough. HUD instructed Fannie and Freddie that 45% of homebuyers whose mortgages they purchased between 2005 and 2008 should be "low- and moderate-income," 32% from "central cities, rural areas, and other underserved areas," and 22% from "very-low-income families or families living in low-income neighborhoods."

Reducing credit standards had the desired impact. Home-ownership rates began a sustained climb from 64% in 1995 to a peak of 69% in 2004.

But it had other effects, as well. It boosted demand and housing inflation. Loose monetary policy poured gasoline on the fire. Real fed funds rates were negative from 2001 through June 2005. Higher prices should have reduced demand, but instead they caused underestimation of high-loan-to-value mortgage risk, spurred credit and demand, and fueled speculative home purchases.

Tescher contends that "risky mortgage products, not risky borrowers," increased foreclosures. Risky borrowers chose accommodating products.

Attacking "risky products" implies that the government, rather than mutually consenting borrowers and lenders, should determine what products reign. It is a paternalistic and insidious idea that Americans competent to vote, serve on juries, and join the Army are not competent to select mortgages.

Tescher wants the CRA to ensure that the poor get "the credit they deserve," and she calls for a rebuilt financial system to be "fair." In reality, this means politicizing credit. When credit is politically allocated, it is more expensive and scarce for the rest of society.

The government's credit-market role should be one of a night watchman, not a principal. Fannie and Freddie should be broken up and privatized, and the CRA repealed.

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