The authors of *Reckless Endangerment* suggest mortgage finance companies Fannie Mae and Freddie Mac have a lot to answer for.

Source: AFP

**IN 2001, Graham Fisher & Co, a six-person financial research firm in New York, issued a report, Housing in the New Millennium.**

It warned that the "virtuous circle" of US home ownership based on easy credit would become a "vicious cycle" of defaults, foreclosures and contractions in consumption and construction, leading to recession.

Seven years later, the housing bubble burst, investment banks went bankrupt and the US economy imploded.


It began, they suggest, with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which required government-backed mortgage finance companies Fannie Mae and Freddie Mac to direct 30 per cent of their loans to low and middle-income families and another 30 per cent to units in inner cities.

Fannie Mae chief executive James Johnson used the law to transform the company from a steward of the public trust, purchasing safe mortgages when other sources of capital dried up, into a "high-flowing growth enterprise with a vast web of political patronage, run for the benefit of top executives".

Along with a host of active and passive enablers, including Wall Street, Standard & Poor's, the Federal Reserve, the Department of Housing and politicians in both parties, Johnson flouted fundamental principles of lending and government regulation designed to check predatory practices.

Clearly Fannie and Freddie have a lot to answer for.
According to the authors, they passed on to borrowers only two-thirds of the billions of dollars received in government subsidies, using the rest for large compensation packages, dividends to shareholders and payments to lobbyists and political campaigns.

And they fought ruthlessly for capital standards based on risk assessments provided not by regulators but by the financial institutions themselves.

This was the equivalent, Morgenson and Rosner write, "of allowing a serial speeding driver to set limits on how fast cars should go". Nonetheless, Reckless Endangerment may assign too much blame to Johnson, as the architect of a "homeownership drive that almost destroyed the economy".

After all, as Morgenson and Rosner acknowledge, the private sector invented subprime mortgages and bundled mortgage-backed securities for sale as a safe investment, realising that these instruments represented "a veritable profit bonanza, generating lending fees, interest payments, loan purchase fees, underwriting revenues and a path into the lucrative retail lending businesses".

Nor did bankers learn "what they had to do to be heard in Washington" from Fannie and Freddie. They had been throwing their weight around, with considerable success, for decades.

The most important message of this book, it seems to me, is that left to their own devices private corporations will buy off politicians, protect themselves and if possible one another, even if they know they are putting their nation at risk.

In 2004-05, for example, following accounting scandals, congress considered giving the Housing Department the power to take over Fannie and Freddie in a crisis.

The big ratings agencies - Standard & Poor's, Moody's and Fitch - stopped the legislation in its tracks by threatening to downgrade the securities held by the two companies, which would generate enormous losses for investors across the world.

And they continued to rate securitised loans based on data provided to them by the issuers, acting in essence as advertisers rather than investigators.

Reckless Endangerment concludes with ominous warnings about the likelihood of another economic debacle.

Since the 1990s, the authors point out, government regulators of financial institutions have been stripped of their powers, asleep at the switch, in bed with the corporations or all of the above. When it was clear to just about every informed observer that the housing bubble had burst, they continued to make reassuring (and misleading) statements to the public.

Many of them, including Ben Bernanke, now chairman of the Fed, and Timothy Geithner, now Treasury Secretary, rose to positions of even greater authority.

Worst of all, the moment for substantive change may have passed.

Morgenson and Rosner claim, with considerable justification, that the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 fails the most basic tests: it says nothing about how to return Fannie Mae and Freddie Mac to solvency; does not make financial institutions appreciably more accountable; and does not reduce the size of institutions deemed "too big to fail".

Reckless endangerment, it appears, describes our present as well as our past.

Glenn C. Altschuler is the Thomas and Dorothy Litwin professor of American studies at Cornell University in New York.

Reckless Endangerment: How Ousized Ambition, Greed and Corruption Led to Economic Armageddon
By Gretchen Morgenson and Joshua Rosner
Henry Holt, 333pp, $39.95 (HB)