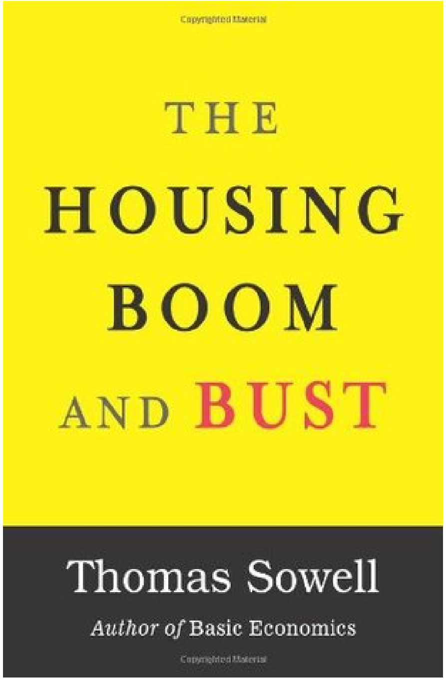

The Housing Boom and Bust

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This is a plain-English explanation of how we got into the current economic disaster that developed out of the economics and politics of the housing boom and bust. The “creative” financing of home mortgages and the even more “creative” marketing of financial securities based on American mortgages to countries around the world, are part of the story of how a financial house of cards was built up—and then suddenly collapsed.The politics behind all this is another story full of strange twists. No punches are pulled when discussing politicians of either party, the financial dangers they created, or the distractions they created later to escape their own responsibility for what happened when the financial house of cards in the financial markets collapsed.

What to do, now that we are in the midst of an economic disaster, is yet another story—one whose ending we do not yet know, but one whose outlines and implications are explored to reveal some surprising and sobering lessons.

The Housing Boom and Bust Details

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From Reader Review The Housing Boom and Bust for online ebook

Toe says

In his latest effort, Thomas Sowell outlines the origins of the American housing boom and bust in the first decade of the new millennium. The current economic downturn began with the decline in real estate prices and the increase in payment delinquencies and foreclosures. Few people understand the details behind this real estate collapse, which led to a consumption slowdown, which led to the stock market collapse and relatively high unemployment. Sowell draws on his economic background, conservative free market allegiance, and natural disinclination towards government activity to offer his explanation of how we winded up here. In a nutshell, Sowell puts the blame where it belongs: on government intervention.

A consistent theme throughout many of Sowell's books is that when government intervenes in the workings of the free market, many unforeseen and negative consequences ripple outward. These negative consequences create problems where none existed and exacerbate problems that are already underway. So why intervene in this manner? Politicians have an incentive to act on behalf of certain constituents, hide the costs and negative consequences of their actions, and shift the blame to others. All of this helps them receive campaign contributions and win reelection. These are, of course, political motivations and not economic ones. Indeed many speculate that FDR's actions in the New Deal and Barack Obama's current actions are not about solving economic problems at all. Rather, advocates of big government seek to fundamentally change the institutions of American society away from private corporate control and towards collectivism and restrictive government (that they, of course, will influence and control). As Sowell says, "It is a matter of record that many leading decision makers of the New Deal administration of the 1930s were advocates of government intervention in the economy and of a fundamental restructuring of the economy--a New Deal--years before the stock market crash of 1929 and the Great Depression that followed, which put them in a position to carry out ideas to which they were dedicated long before there was any economic crisis to deal with. The New Deal succeeded in using a transient crisis to create enduring institutions, including among others the Federal National Mortgage Association or "Fannie Mae," which FDR created in 1938, and which as been at the heart of the housing boom and bust that lead to today's financial crisis." Rahm Emanuel, Obama's Chief of Staff, said, "You never want a serious crisis to go to waste. What I mean by that is that it's an opportunity to do things you could not do before." This belief explains why Congress rushed through a 1,000 page, $700 billion stimulus bill in 2 days even though the projects wouldn't be funded for several years. It wasn't about injecting money into the economy to speed recovery (though this wouldn't accomplish such a goal anyway). It was about using the current crisis to forward an already established agenda of government expansion and a politically guided economy.

This has been happening for a long time. It would be extremely difficult to argue that FDR's interventions did not prolong the Great Depression. Consider the Smoot-Hawley tariffs of June 1930, the National Industrial Recovery Act of 1933 that controlled prices and wages in industry (and lead to businesses offering health care since they were prohibited from paying what they wanted), the Agricultural Adjustment Act of 1933 that established federal control over prices and outputs in agriculture, and the National Labor Relations Act of 1935 that made it mandatory for employers to negotiate wages and working conditions with labor unions. Each of these interventions had well known negative consequences. FDR took the country off the gold standard, which opened the door to fiat money and inflation. FDR issued thousands of executive orders--more than all the subsequent Presidents in the twentieth century combined. Two months after the crash of October 1929, unemployment peaked at 9%. By June 1930 (the same month Smoot-Hawley was signed), unemployment had fallen to 6.3%. Unemployment reached double digits in November 1930, a full year after the crash but five months after Smoot-Hawley, which was supposed to decrease unemployment.

Unemployment never fell below double digits for the entire decade of the 1930's and even hovered just under 25% at one point. The depression only ended when the 12 million unemployed became soldiers and shipped off to WW2, not because of government spending, which invariably means less private spending elsewhere.

More recently, the housing boom started because of political pressure to create "affordable housing". This is the political goal of putting people who can't afford certain houses into those houses anyway. Sowell mentions that various "open space" and "smart growth" laws caused housing prices in certain locations to spike dramatically. Note that these are government restrictions on the type of building that can be done in certain areas. The laws include the prohibition of building at all in certain places, height restrictions on apartment or office buildings, and others. Naturally, these restrictions lead to costly building delays as required permits are acquired, and such arbitrary restrictions decrease the supply of available land, which drives up the price. Coastal California, Florida, Arizona, and Nevada were particularly affected by these government policies. These are precisely the places that saw the biggest spike and decline of housing prices. Other parts of the country, notably Texas, which didn't have such restrictive laws never saw the same fluctuations. The percentage of total income required of the residents in most parts of the country to fund their housing needs hovered around 13-25% in the 2000's. This was lower than earlier decades and lower than other parts of the world, which indicates that there was no national affordable housing problem to begin with. There were only specific areas where housing was difficult to afford because of idiotically intrusive laws. These laws actually served to segregate certain cities and counties since many minorities could not afford to pay 50-60% of their incomes on housing alone, as was common in parts of California.

So, government laws convert a non-problem into a problem that government officials such as Barney Frank and Chris Dodd then sweep in to "fix." Enter the Community Reinvestment Act of 1977; Fannie Mae; Freddie Mac; Housing and Urban Development; ACORN; and creative financing such as subprime loans, 0 down loans, and interest only loans. As part of the "affordable housing" crusade, politicians (mostly Democrats but also some Republicans) forced lenders to make proportionate loans to all ethnicities regardless of financial status. The cold fact is that blacks and Hispanics are greater credit risks based on the objective criteria of the likelihood of loan repayment (income level, net worth, down payment as a percentage of the cost of the house, credit history, neighborhood, type of residence, etc.). When you control for all these variables, people of different ethnicities are loaned money at about the same rate. In fact, Asians are approved at a higher rate than whites, which should destroy any notion of racist lending practices. All this indicates that loans are made on the basis of economic reality, not discrimination. It's funny to hear claims that bankers are greedy out of one end of their mouth and that they are racist out of the other. Bankers will either loan money to people of all color out of their greed, or they are sacrificing money to indulge their racism. They can't be both greedy and racist, and the data indicates that they are neither. But, alas, I digress.

All these political organizations, politicians, easy credit from the Federal Reserve and Alan Greenspan's loose monetary policy, zoning laws, and regulatory laws requiring proportionate loans had the effect of increasing the riskiness of outstanding mortgages. Banks got away with this because Fannie and Freddie would buy mortgages in the secondary market, so the originators weren't bearing the full brunt of the risk. Fannie and Freddie did it because the taxpayers were on the hook in case of failure. This massive housing bubble, like all bubbles, couldn't last forever. The slightest tightening of credit from the Fed, which had to arrive at some point to prevent rampant inflation, sent housing prices down like a lead balloon. An increase in interest rates makes borrowing more expensive, which means less people can borrow, which means there are less buyers of homes, which means the prices of homes go down. Increased interest rates also mean higher monthly payments for all those with adjustable rate mortgages, which caused many to foreclose on the houses they couldn't really afford anyway, which flooded the market with more homes. So, we have more homes and fewer buyers, which further decreased the price of homes. In short, all this government intervention created a bubble that eventually popped, bringing down a lot of people with it.

Sowell argues that the market is the answer to our problems. The market recovers quickly enough and well enough on its own if it is simply allowed to operate. Without all the government intervention, we wouldn't have the harmful side effects and uncertainty. People would plan according to known rules without the coercive force of government to steal from some to bail out others. People and companies would be forced to accept the full costs of their mistakes. Some companies would go bankrupt, some people would lose their houses, some people would lose their jobs. However, there would never be a systematic collapse in real estate or the financial system under a truly open and free market. Growth and recessions have occurred naturally since the beginning of the industrial revolution. The shallowest recessions all occurred prior the existence of the federal reserve and massive government interventions. As FDR showed, government only has the power to deepen and prolong the necessary corrections. Obama seems hellbent on repeating the same mistakes. Unfortunately, enough people are ignorant of history and economics to let him do it.

Though characteristically lucid and easy to read, I would have enjoyed a little more depth from Sowell. Many portions of this book are rehashed from his earlier works. For example, the differences in mortgage acceptances as broken down by race were straight out of another Sowell book, though I can't recall which one. It was most likely Basic Economics, Economic Facts and Fallacies, or Applied Economics. Additionally, while I agree with Sowell's premise that government action is to blame, the argument would have been stronger with more detail around Fannie Mae and Freddie Mac's involvement. He does mention the two government sponsored entities briefly. However, all of the following are extremely important to the story and go entirely unmentioned: a detailed history behind the GSE's, the moral hazard that arose due to the implicit guarantee from the U.S. government, the exact level of their involvement in the industry, the fact that they were designed specifically to interfere with the free markets, the OFHEO report to Congress about the accounting improprieties and the Democrats' reaction to these charges, The Democrats' treatment of Armando Falcon Jr., Franklin Raines's actions that basically mirrored the actions of the executives of Enron, and the incentives the mere existence of these secondary mortgage market makers had on other companies to generate loans. The fall of the housing market is a complicated tale with many pieces that Sowell unfortunately leaves out. I would have enjoyed the addition of more, fresher details over the repetition of facts from previous works. Nonetheless, for those looking to gain an elementary understanding of what happened from a pro-market, anti-government stance, this is a good start.

Memorable Quotes:
"Demogoguery beats data." - Former Congressman Dick Armey

"Crackbrained meddling by the authorities aggravate an existing crisis." - Karl Marx

"Fannie Mae and Freddie Mac have played a very useful role in helping make housing more affordable. [Critics:] exaggerate a threat of safety and conjure up the possibility of serious financial losses to the Treasury, which I do not see." - Congressman Barney Frank, 2003

"I believe that we, as the Federal Government, have probably done too little rather than too much to push them to meet the goals of affordable housing and to set reasonable goals. I would like to get Fannie Mae and Freddie Mac more deeply into helping low-income housing and possibly moving into something that is more explicitly a subsidy. I want to roll the dice a little bit more in this situation towards subsidized housing." - Congressman Barney Frank

"ACORN, for example, has used the CRA [Community Reinvestment Act:] as leverage to compel banks to create pools of loans for low- and moderate-income families. Its efforts have generated about $6 billion in loans to these borrowers, while also generating funds for ACORN's nonprofit housing corporation. Supporters call that a win-win scenario; critics say it's legalized extortion." - Los Angeles Times

"Loudoun County, Virginia enacted laws in 2001 which restricted the building of homes to one house per 10 acres in some places, 20 acres in others and 50 acres in still others."

"In reality, less than 10 percent of the land area of the United States has been developed. Trees alone cover more than six times the area of all the cities and towns in the country put together."

"Neither by comparison with the recent past nor by comparison with other countries today is most housing in the United States unaffordable. The median-priced home in the United States is 3.6 times the median income of Americans. For Great Britain, the median-priced home is 5.5 times the median income and, in Australia and New Zealand, the ratio of home prices to income is 6.3."

"In 23 of the 26 urban areas around the world where housing is rated 'severely unaffordable,' there are severe land use restrictions under the heading of 'smart-growth' policies."

"The importance of Fannie Mae and Freddie Mac in the housing markets is demonstrated by the magnitude of their mortgage guarantees, which total more than two trillion dollars. That is larger than the Gross Domestic Product of all but four nations."

"Whatever the empirical weaknesses of the evidence for attributing intergroup differentials in mortgage loan approval rates to racial discrimination, the legal case for lending discrimination has been much easier to make, given the standards used in civil right law, where the existence of statistical disparities is enough to establish a prima facie case against the accused--after which the burden of proof shifts to the accused to prove his innocence. When neither side can convincingly prove anything--as is often the case--the accused stands to lose..."

"In fact, however, each of these groups, for whom much concern has been expressed, have been precisely the groups disproportionately forced out of these high housing cost communities. In San Francisco, for example, the black population has been cut in half since 1970.

Josie says

Bleh. Over-simplified and clearly slanted. My favorite was the blatantly racist message that part of the bust was because we lent to too many minorities, and it's "proven fact" that minorities have worse credit, and don't take care of property. Also, didn't you know that people bring their slums with them? If you give them a nice house, they'll just trash it like they do to their slum rentals. Almost no attention was paid to the sub-prime mortgage market, because, you know "these securities would have remained secure if people had continued to make their monthly mortgage payments." Too bad we gave all those loans to minorities! This segued into the rant about protected land and open spaces (aka National Forests and Parks caused the housing bubble).

No, but seriously, I feel like this book was written by an racist Republican, forced to dumb things down for the rest of us. When it wasn't making me mad, it was leaving me hanging on information.

Gordon Brooks says

I agree with almost everything Thomas Sowell says in this book about the role the government played in the run-up of prices and the unsustainable mortgage frenzy that eventually had no option but to collapse.

But as with most writers on this subject, Sowell is so focused on the one issue that he fails to see a few important points.

The first is that The Government did not force banks to make bad loans. Yes, government policies put tremendous pressure on chartered banks to lower lending standards, but a lot of the impetus for those policies came from executives of these same banks, who stood to make huge bonuses from the additional business (even as they were putting the futures of their own companies at risk).

Second, a very large number of those loans came from origination companies such as Countrywide and Ameriquest, who were not subject to the same pressures as the chartered banks, yet continued to make sub-prime loans because there was a lot of money to be made, until it all collapsed (by which time the executives of those companies had padded their bank accounts pretty handily).

Third, I find it disappointing that Sowell, a respected economist, fails to explain the role of twisted incentives in the mortgage mess. With the companies who collect payments and manage foreclosures isolated from the investors who actually put up the money, the incentive to play both ends against the middle and collect fees in relative safety are very, very strong. This is exactly the position that the mortgage servicing industry finds itself in (still).

And finally, while Sowell makes a great case against government intervention in markets, there is an important role for governments, at all levels, in preventing a new crisis, a step that they have failed to avail themselves of in any meaningful way. Not regulation, but prosecution. Because even if Sowell doesn't see fit to explore it, this crisis was, in many ways, the result of a long series of fraudulent transactions, of tissue of lies from the originators' promises to the homeowners, to the implied promises of the ratings agencies who told investors, including the managers of our pensions and 401(k)s, that the securities these mortgages were bundled into were as safe as government bonds. Fraud demands prosecution, With jail time. Without it, the incentives to stop the bad behavior just don't exist.

No one book can tell the whole story, and this one is an important read. But it does leave an awful lot out.

Mark Geise says

"The Housing Boom and Bust" is a useful and simple look into the financial crisis of 2008-09 by the great Thomas Sowell. Sitting at about 200 pages, Sowell does not go through the same talk of complex derivatives and securities and "greedy bank" on which many other accounts choose to place much of the blame. Yes, mortgage-backed securities and collateralized debt obligations contributed to the financial crisis, but what led banks down this path? Did banks somehow get greedier from 2004 to 2006? Or did the incentives facing these institutions change? Sowell places much of the blame on government policy.

Sowell does not simply blame one party or group of actors for the housing boom and bust. The Community Reinvestment Act gave bank regulators the power to halt mergers, acquisitions, and office/branch openings and closings if a bank was not "investing" enough in its local communities. For some banks to comply with the CRA, it required them to lend to people they otherwise would not have lent to due to lack of creditworthiness. Banks engaged in risk and creative financing to lend to these "underserved" groups. At the same time, Fannie Mae and Freddie Mac, public-private companies with implicit guarantees by the federal government behind them, were purchasing more and more mortgages on the secondary market. Fannie Mae and Freddie Mac had a high risk appetite because of the implicit backing by the federal government, so banks had an easy buyer for riskier mortgages. Also, housing prices in certain locales, namely coastal California, New York City, Las Vegas, Arizona, and Florida, surged throughout the 1990's due in large part to land-use and zoning restrictions that artificially inflated the cost of the land on which housing was built. These locales became the hotbeds for speculation and creative mortgage financing, including interest-only, adjustable rate, and negative amortizing mortgage loans. Though the Community Reinvestment Act, the activities of Fannie Mae and Freddie Mac, and the institution of land-use and zoning restrictions were largely well-intentioned to "create affordable housing" and "save the environment," the actual results of these policies do not live up to their billings. "The Housing Boom and Bust" fits in well with many of Sowell's other writings; he implores the reader not to take political rhetoric at face value and instead to critically explore the outcomes of given programs. Intentions mean nothing; results do.

Of course, the banks were not blameless in the financial crisis. Some blame can be placed at the feet of all the parties involved: banks, regulators, rating agencies, borrowers, and politicians. However, it is far too simplistic to simply blame the banks without looking at how the incentives facing those banks had changed. Not only was there political pressure for banks to make riskier loans and a guaranteed market to sell those loans, but the Federal Reserve's low interest rate policy also increased the appetite for risk in the marketplace. One of the few weaknesses in this book that stands out to me was that Sowell was not hard enough on the Fed. He mentions Alan Greenspan and the Fed multiple times, but they play a complementary rather than a main role in his story. Another of the few weaknesses is that he perpetuates the myth that World War II got the United States out of the Great Depression. What actually got the United States out of the Great Depression was the massive cut in government spending following the U.S.'s exit from the war, which Sowell fails to mention.

I am glad that Sowell decided to write a book on the housing boom and bust. I would have been disappointed if one of the great economic writers of our time did not have a work on the financial crisis. Though the reader will not come away from this book with a perfectly detailed understanding of everything that happened in the housing boom and bust, he or she will understand that things are not as simple as the politicians and talking heads made them out to be. Generic calls for more regulation will do no good unless we understand the actual incentives created by that regulation. Until politicians face the brunt of the backlash for their incorrect assertions, things will not change on the political stage during the next crisis (which is not far around the corner).

Rod says

A short, focussed inquiry into the causes of the financial crisis of 2008. And the causes are not what we've generally been told. Since housing was at the core of the crisis, changes in housing policy under several administrations set the industry up for a catastrophic collapse when neared pulled the entire financial system down with it. Some specific problems:
- Land use laws that drove up housing prices
- The "affordable housing" campaign that did attempted to counter high prices by government intervention
- The Community Investment Act of 1977 and its regulation, which forces lenders to make loans to borrowers who were poor risks

- The American Dream Downpayment Act (thank you, G.W. Bush!) which had the government pay certain people's Downpayment.
- lack of oversight, by Congress or internal inspection agencies, such as the Office of Federal Housing Enterprise Oversight.

Sowell points out that using social programs instead of the market to allocate resources is problematic since "It is precisely the market that is voluntary and "social" programs that mean following government rules."

Bottom line: "why did so many mortgage payments stop coming? Because mortgage loans were made to more people whose prospects for repaying them were less than in the past." Due to political pressure, I might add.

Devin says

The housing market is greatly affected by interest rates and credit eligibility rules (p.2).

While the individual home buyer may deal solely with a bank that provides the money to buy the house, in exchange for a mortgage to be paid off in monthly installments, behind that bank and over the bank are all sorts of other institutions,whose actions affect or control the housing markets. The Federal Reserve System regulates many across the country, and also has the power to take actions which affect interest rates and the money supply. Given the great importance of the level of interest rates in the home mortgage markets, the Federal Reserve is a major player in that market (p.2-3).
*Fannie Mae (The Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation) are two government-created, but privately owned, profit-making enterprises that buy mortgages from banks. By selling these mortgages banks get money from a 30-year mortgage without have to wait 30 years for monthly payments from home buyers to pay off their debts. With the proceeds from these sales to Fannie Mae and Freddie Mac, or to other financial institutions, the banks then have money to lend again to create more mortgages from which to profit (p.3). In order to qualify to sell their mortgages to Fannie Mae or Freddie Mac, mortgage lenders must conform to the rules and standards prescribed by these mortgage market giants, including rules and standards that lenders must in turn apply to people who seek loans to buy houses. One of the consequences however, of reselling mortgages on a large scale is that the initial lender has fewer incentives to be meticulous about the financial qualifications of the people to whom mortgage loans are made.
HUD (U.S. Department of Housing and Urban Development) is another major institution in the housing market. HUD exercises authority over Fannie Mae and Freddie Mac and therefore indirectly over banks and home buyers, as well as directly influencing mortgage lending practices. HUD is a Cabinet-level agency responsible for whatever administration is in power in Washington.
Wall Street firms also buy mortgages, bundle them together and issue stocks and bonds based on the value of those mortgages. These firms sell these bundles to investors across the country and world (p.4).

Fannie Mae and Freddie Mac are also "government-sponsored enterprises" meaning that they were created by the federal government, which has some continuing involvement in their policies. More important, that government involvement leads other financial institutions to led to these two hybrid institutions at lower interest rates than they would to completely private enterprises, because of the implicit assumption that, in the event of a crisis, the federal government would not let Fannie or Freddie fail (p.4).

Interest rates are set nationwide by the Federal Reserve System, through the interest rate it charges to lenders, who in turn lend to the general public, including home buyers (p.6). Those individuals whose credit ratings are below par may be denied loans at the prevailing interest rates, but granted "subprime" loans, which charge higher interest rates to offset the greater risk of lending to people who have lower incomes or a history of credit problems. People charged with higher interest have higher rates of late payment or foreclosures. Declining interest rates enable more people to afford a house, but also let the same person buy a more expensive house without a higher monthly mortgage payment (p.7). Lower interest rates increase the demand for housing and thereby drive up home prices.

What varies drastically from one place to another is the price of the land on which houses are built (p.11). The high cost of the land in San Francisco helps explains why modest but very expensive homes in that city are often jammed close together (p.11-12). The decade of the 1970s saw a rapid spread of laws and policies in California severely restricting the use of land. Often these laws and policies forbade the building of anything on vast area of land in the name of preserving "open space", "saving farmland", "protecting the environment", "historical preservation", and other politically attractive slogans (p.12). These restrictions were extended to more and more land over the years. Less than 10%of the land area of the United States has been developed. Trees alone cover more than six times the area of all the cities and town in the country put together (p.17).
A fundamental misconception of the of the housing market existed both during the housing boom and after the bust. The misconception was that the free market failed to produce affordable housing, and the government intervention was therefore necessary, in order to enable ordinary people to find a place to live that was within their means. Yet the hard evidence shows that it was precisely where there was massive government intervention, in the form of severe building restrictions, that housing prices skyrocketed. Where the market was more or less left alone (like Houston and Dallas) housing prices took a smaller share of family income than in the past (p.18).

The traditional fixed-rate 30 year mortgages, which were once a majority of all mortgages, were no longer a majority during the housing boom, as ARMs and other "creative" ways of financing the purchase of a home grew rapidly to cope with soaring housing prices (p.20). In 2003, home equity loans totaled $593 billion (p.22). Such loans soared during the housing boom, nearly doubling to $1.13 trillion in 2007 (p.23). A special variation on the home equity loan was what was called "cash out refinancing". Someone owing $300,000 on a mortgage with a fixed interest rate of 8% could take out a new loan to replace the old loan when the interest fell to 6%. But instead of taking out another $300,000 mortgage loan at 6%, the homeowner could take out a $400,000 mortgage loan at 6%, paying off the existing loan from the proceeds of the new loan and keeping $100,000 in cash.

Where there is the greatest government intervention, housing is least affordable (p.35).
The Community Reinvestment Act of 1977 qualified government officials to tell lenders to whom they should lend money entrusted to them by depositors or investors (p.36). Studies in the early 1990s, showing set off media sensations and denunciations, leading to both Congressional and White House pressures on agencies regulating banks to impose new lending rules, and to monitor statistics on the loan approval rates by race, by community and by income with penalties on banks and other lenders failing to meet politically-imposed norms or quotas (p.37). --The regulators imposed quotas and, if lenders had to resort to "innovative" or "flexible" standards and methods to meet those quotas, so be it (p.39). Because banks are federally regulated enterprises, they need government permission to do many things that other business do as they see fit. That permission can be delayed or denied when objections are made that banks or other lenders are not living up to their obligations under the Community Reinvestment Act. Ex: When legislation was pending in 1999 to permit banks to diversify into selling investment securities, the White House urged "That banks given unsatisfactory ratings under the 1977 Community Reinvestment Act be prohibited from enjoying the new diversification privileges" of this legislation.

In 2002, the George W. Bush administration urged Congress to pass the American Dream Down payment Act, which subsidized the down payments of prospective home buyers whose incomes were below a certain level (p.41). After passage of the Act, the president also urged Congress to pass legislation permitting the FHA to begin making zero-down payment loans at low interest rates to low-income Americans (P.42). Between 2005 and 207, Fannie Mae and Freddie Mac acquired an estimated trillion dollars' worth of subprime and other non-traditional mortgage (traditionally risky assets). This was approximately 40% of the value of all the mortgages they purchased from banks and other lenders during those years (p.43). The importance of Fannie and Freddie Mac is their mortgage guarantees which total more than two trillion; that is larger than the Gross Domestic Product of all but four nations (p.44). Policies and practices of many institutions, local and national, public and private, set the stage for the housing boom and bust. "Un-affordable housing" in particular local areas and the responses with national policies to make buying a home easier were political in origin, and government regulation is what forced lenders to meet arbitrary quotas by eroding traditional mortgage lending safeguards.
Federal Reserve Chairman Alan Greenspan was the best-known public figure to issue warnings on the housing boom. His warnings were delivered directly to Congress (p.47). In response to warnings about the growing riskiness in housing markets,Congressman Barney Frank said in 2003, "Fannie Mae and Freddie Mac have played a very useful role in helping make housing more affordable." Critics "exaggerate a threat of safety" and "conjure up the possibility of serious financial losses to the Treasury, which I do not see." (p.48). As of January 2009, Fannie Mae and Freddie Mae were in line to receive $238 billion in federal bailout money and were asking for $70 billion more (p.49-50). Senator Christopher Dodd also dismissed the warnings and asserted that Fannie and Freddie Mac were safe (p.50).

Housing prices began falling in 2006, for the first time in more than a decade (p.58). They fell especially sharply in places where they had risen sharply before, which was where more people had done more with risky "creative" financing in order to be able to buy a house, and so were most likely to default when rising interest rates meant rising monthly mortgage payments. Speculators caught owning money on mortgages on multiple houses that could no longer be sold for rising prices--or even for the prices at which the speculators bought them--were also especially likely to default, even if that meant going bankrupt. As lenders repossessed more houses and put them up for sale, this increase in the number of houses for sale further lowered the prices of houses in general through supply and demand (p.59).
In June 2007, foreclosure notices nationwide rose 87% over the previous year. For California as a whole, there was an 800%increase in the number of homes whose deeds reverted to bank ownership. This was a major problem for the banks, as well as for those who lost their homes, since banks lose an estimated $40,000 per home foreclosed. Not being in the business of managing real estate, banks have every incentive to dump repossessed houses on the market at whatever price they can get for them.
Even existing home buyers who did not have either subprime mortgages or adjustable-rate mortgages were nevertheless affected indirectly by the rising interest rates, because those higher interest rates caused rising home prices to suddenly turn into falling home prices. Therefore many home buyers, regardless of what kind of mortgage they had, could find the value of their home falling below the amount that they owed on the mortgage. "Why continue to pay off a $500,00 mortgage on a home that is now worth only $350,000?" (p.66). People who borrowed against the equity in their homes were of course at increased risk of finding that what they owned now exceeded the value of the remaining equity in their home, when they had both a mortgage to pay and a home-equity loan to repay.

Bailouts of Fannie Mae and Freddie Mac would cost taxpayers more than the bailouts of Bank of America, Citigroup, J.P. Morgan Chase, and Wells Fargo combined (p.74).

Changing the terms of mortgage loans to help borrowers who are behind in their payments has not proven success (p.78). In February of 2009: "Of 73,000 loans modified in the first quarter of last year, 43% were again delinquent 8 months later." - The Economist

The very reason for the widespread neglect of the maintenance and repair of infrastructure is that political incentives favor building new things, rather than repairing or maintaining existing things (p.82). Building a plaza, a community center or a marina creates occasions for ribbon-cutting ceremonies that provide valuable favorable publicity for elected officials. But there are no ribbon-cutting ceremonies for filling in potholes or repairing bridges and sewers.

The verbal packaging of housing policies has been crucial to mobilizing wide political support from people who have no material vested interest in the issues at hand. Land use restrictions, for example, would have far less appeal if called simply "land use restrictions", as they are by scholars specializing in the study of housing. But when verbally packaged as "open space" laws "protecting the environment," or policies "preserving farmland" for future generations, preventing "urban sprawl" or "preserving" places that "historic," these impediments to building homes take on an idealistic glow that can attract much wider support from people with no such personal stake as might cause them to scrutinize the specifics behind these glowing generalities (p.109).
Upscale communities like Loudoun County, Virginia, that keep moderate-income or low-income people from moving in, by such things as requiring several acres of land per house, would never gain public support by saying that the want to keep out the masses to protect the elite (p.111). Instead, the argument by such communities is that they are protecting "our community" and its "way of life" or perhaps its natural environment.

The market is nothing more and nothing less than many people competing with one another, and making voluntary transactions with each other, on such terms as are mutually agreeable (p.113). It is precisely "the market" that is voluntary and "social" programs that mean following government orders (p.114).

"Bad ages to live through are good ages to learn from" (p.117)
Government regulations and interventions are precisely what pushed lending institutions to reduce the standards which they had traditionally required of prospective borrowers before making mortgage loans to them (p.117). Why did do many monthly mortgage payments stop coming? Because mortgage loans were made to more people who prospects of repaying them were less than in the past. Nor was this simply a matter of misjudgment by banks and other lenders. The political pressures to meet arbitrary lending quotas, set by officials with the power of economic life and death over banks and over Fannie Mae and Freddie Mac, led to riskier lending practices than in the past (p.118).

"Government actions cannot be discussed as if government is simply the public interest personified. Government actions are political actions, and nowhere more so than in a democracy. The time horizon of elected officials is all too often bounded by the next election. Quick fixes are one result." (p.119) In politics, "good things" can be advocated or enacted into law on the basis of the beneficial consequences anticipated, with little or no consideration of the many other repercussions that spread in all directions (p.121).

Survival in the market often requires recognizing mistakes and changing course, while survival in politics often requires denying mistakes, continuing the current policies and blaming the bad consequences on others (p.122).
Home ownership has undoubted benefits but it also has costs and risks, however much those costs and risks were ignored, downplayed or dismissed by politicians and social crusaders during the housing crusades that led to the boom and bust.

"Politicians in Washington--a nationwide shortage of "affordable housing"--and have now left us with a problem whose existence is as undeniable as it is painful (p.127). What created the illusion of a nationwide problem was that, in particular localities around the country, housing prices had skyrocketed to the point where people had to pay half their income to buy a modest-sized home and often resorted to very risky ways of financing the purchase. In Tucson,for example, 'roughly 60% of first-time home buyers make no down payment and instead now use 100% financing to get into the market,'according to the Wall Street Journal...These locally extreme housing prices have been a result of local political crusades in the name of locally attractive slogans about the environment, open space, 'smart growth' or whatever other phrases had political resonance at the particular time and place."

The Stock Market
The stock market crash of 1929 has long been regarded the cause of the massive unemployment that marked the decade of the 1930s. Thousands of banks failed across the country. FDR has been credited with being the first President of the United States to understand the need for federal intervention to deal with a depression (p.131). It is now increasingly recognized that this intervention was begun by President Herbert Hoover, and that Franklin D. Roosevelt's New Deal was largely expansion of what Hoover had already begun (p.132). Even former members of Roosevelt's own administration admitted in later years that many of Hoover's initiatives were taken over and expanded under FDR, though the political and media image of Hoover invoked in many election years thereafter was that Hoover had been a "do nothing president." Since mass unemployment was the most visibly painful aspect of the Great Depression, one of the main thrusts of the Roosevelt administration then, like that of the Obama administration, was to create jobs (p.133). For the first 21 consecutive months of FDR's administration, unemployment never fell below 20%. The money that pays for government-created jobs is taken from the private sector, leaving less demand and less employment there. Huge increases in government-created jobs may make little or no net difference in mass unemployment.
The first of these major interventions began in June 1930, when Congress passed the Smoot-Hawley tariffs, the highest in more than a century, in an effort to reduce imports and thus preserve American jobs by having the formerly imported goods produced in the U.S. instead (p.135). FDR also took the country off the gold standard and issued thousands of executive orders--more than all the subsequent Presidents of the United States in the 20th century combined (p.136). Government policies in the 1930s prolonged the depression by several years (p.137). World War II ended the Great Depression.
The New Deal succeeded in using a transient crisis to create enduring institutions, including among others the Federal National Mortgage Association or "Fannie Mae," which FDR created in 1938, and which has been at the heart of the housing boom and bust that led to today's financial crises (p.141). It used a crisis to fundamentally and enduringly change the institutions of American society (p.143).

"The federal government exercising vastly more power over the economy and the society than was ever granted to it by the Constitution of the United States. What the government buy with the enormous sums of money it dispenses is the power to give orders to the recipients that the Constitution never authorized them to give. Politicians are, in effect, buying up our freedom with our own tax money (p.145).

DKL says

Sowell's *The Housing Boom and Bust* is a thorough and scathing analysis of government interference in the housing and lending market, from land-use restrictions to the corrupt influence of Congress over federal regulators to the Community Reinvestment Act to the artificially low interest rates of the Federal Reserve. Sowell convincingly demonstrates that ever-increasing levels of government meddling converted the US home mortgage market -- which had been the most reliably profitable business anywhere in the world for more than a century -- into a loser requiring massive government subsidies, but not a national loser, just a loser in those metro areas with the most active municipal, state, and federal players; most localities had significantly less government interference and suffered neither the boom nor the bust.

As Sowell notes, members of Congress don't help people by forcing a bank to give them loans that they can't repay, and now that the market has actually delivered "affordable housing" by bringing down artificially high home prices, the government actively seeks to reverse the decrease in home prices. Why? Because its goal isn't actually affordable housing. Sowell's analysis shows convincingly that the goal of elected officials (read: thugs) like Barney Frank and Chris Dodd is to subsidize special interest groups in exchange for their campaign donations and whatever favors they can extort from banks.

In the end, this book proves Margaret Thatcher's maxim that "Reality is conservative" better than any other treatise I know of.

Jonathan Mckay says

Have you ever talked with a stranger about relationships? Sometimes a normal conversation turns into a diatribe about the stranger's recent divorce and how all relationships are a sham. As you awkwardly pull away, they grab your elbow and plead, spittle landing on your arm, “Promise me you'll never marry! PROMISE!!”

That's what it felt like to read this book.

I wanted to learn more about the housing boom and bust of the 2000s, as part of a larger attempt to understand what it means to own real estate, hoping for a short (if simple) summary of what happened. I previously read the Economist every week during the crisis, and know a little bit about implicit government guarantees, market distortions, and sub-prime mortgages. Judging by my angry dismissals of Jon Stewart diatribes, I probably even have a bit of free market leaning when it comes to macroeconomic issues.

The book started off with some interesting historical statistics, and the initial reaction was “wow, a book on real estate that I can rate 5 stars!” Statements such as 'there is no one entity that can be blamed for the housing bubble' seemed realistic and I was excited to learn more about ARMs, housing policy, and local vs. national trends.

Slowly, the book became less historical and more ideological. I can get behind low-income housing being overweighted as a goal and the pernicious side effects of well meaning policies, but this book uses history and Economist quotes as a jumping off point to arguments I would expect in conservative crazyland. After a full chapter devoted to a breathless takedown of anti-discrimination housing policies, the author goes on to blame 'self-serving politicians' who are guaranteed to make the situation worse with further regulation. All of the author's arguments might even be true, I'm just sad that he chose to depart the realm of data and rely on classic tropes.

Worst book I've read in 2015. Learn from my mistake, stay away.

Mike says

As always Sowell writes in a consistently accessible way. The only thing I wish he added to this book was footnotes within the page rather than in the back of the book so that when I want to learn more about each study or stat he references it would be simple. It takes time to find his sources the way he does it all of them being dropped into the back of the book.

With that said it is very informative and he asks questions we should seriously look into as an economy.

Bernie says

Easy to read, and as usual with Sowell, amazingly illuminating. Sowell convincingly answers many questions. Here are just a few:

* The fact that there was no single cause made it easy to pass blame around.
* Reselling loans to places like Freddie and Fannie gives the initial lender fewer incentives to check closely into borrower qualifications.
* The assumption, proven correct that the government would bail out Freddie and Fannie if they got into trouble meant that bank profit remain privatized while risk was socialized.
* The Feds driving down of interest rates so more people could afford homes had the perverse effect of increasing demand for homes and thus home prices, making them less affordable.
*Government policies to restrict land use has had the effect of creating an artificial scarcity of land in some areas, which accounts for the dramatic differences in home prices between say, the Mid West and Coastal California.
* Despite public perceptions the reality is that less than 10% of land in the US is developed.
* In short, government intervention, based on the misperception that Americans did not have access to affordable housing lead to a situation where Americans did not have access to affordable housing.
*The government created a system that encouraged "predatory lending", that is easy terms, few qualifications, and then when the bottom fell out, blamed "predatory lenders".
* The government approved and drove lending institutions to loosen their loan standards and then when the bust came blamed them for having loose standards. The only remedy of course, being more government intervention.
* Realtors were only too happy to embrace policies that loosened standards as they stood to gain from a greater churning in the market.
* History shows that in times when government intervention has been the greatest, housing costs have been the highest.
* The Community Reinvestment Act of 1977 was one of the first major interventions that operated under the assumption that government officials, rather than lending officials were qualified to tell lenders who they should give money to. In fact eventually, they dictated this. For example, Attorney Janet Reno threatened legal action against lenders who raised her suspicions of racial bias.
* The fact that lenders would be cutting their own profits if they denied loans to minorities with good prospects of paying them back argues against any type of pervasive discrimination based on race.
* Politicians from both parties have distorted the housing market by working under the assumption that owning a house creates good citizens.
* Politically, placing the roots of the housing boom and bust in the market makes things very convenient for those who favor additional government interventions.

* To keep business churning, Fannie and Freddie offered money and jobs to politicians who favored their operations.
* Perversely, it was minorities, who generally have lower incomes and required “creative financing that were the hardest hit by the housing bust. In the end, the very policies designed to help minorities hurt them the most.
* The cost of the bad decisions in the past will be passed onto future borrowers who had nothing to do with these decisions.
* The bailouts that were a response to the bust present a huge potential for inflation.
* Amidst the voices calling for government to “do something” about the housing bust, few are interested in what happens when the government does nothing. But Sowell is, because one of the key things that happens when government gets involved is the creation of uncertainty.
* Section 8 policies, which enable those in slums to move into more affluent areas are unfair to those who played by the rules and moved up precisely to get out of the slums. As Jacob Riis noted in the early 1900’s people “carry their slums with them wherever they go”, meaning that artificially moving people out of slums generally only results in the creation of new slums.
* Here’s the bright side says Sowell, “Bad ages to live through are good ages to learn from”…. Assuming we take the effort to actually study them
* “Survival in the market often requires recognizing mistakes and changing course, while survival in politics often requires denying mistakes, continuing the current policies and blaming the bad consequences on others,” say Sowell. As this is true it makes no sense to get the government more involved in the housing market.
* Deposit insurance, started during the depression may be a good thing for the country, but it was precisely because of government policies that banks failed during the depression. Witness that during the same time, not ONE banking failure occurred in Canada, where deposit insurance was not offered.
* When government set out to make housing more affordable, it went to work on a problem that did not exist….. American housing as a percentage of income has traditionally been among the lowest in the world.
* The political success of the New Deal, and by extension, perhaps the similar Obama policies is undisputable even if they turned out to be, and for Obama, may turn out to be an economic disaster. This is because people usually vote for politicians who they think “gave them jobs.”
* We can’t conduct a laboratory experiment to see how the economy would react to government intervention vs non-intervention, but we can compare the stock market crash of 1929 under Hoover/Roosevelt to the 1987 crash under Reagan. The non intervention of Reagan led the stock market to recover on its own and 20 years of “steady growth and low inflation.

Derek says

As he always does, Dr Sowell has written the most straight forward, well researched, and honest explanation for the housing and financial situation that we find ourselves in. I work in the mortgage industry and being an economics student, I have found myself reading many books and articles on this subject. This one is by far the best read for an expert and the layman, which would be someone who doesnt fully grasp MBS's and the many new financial instruments that use mortgages as collateral. The interesting thing is that you do not need to understand that aspect to appreciate the causes of the housing boom and bust. Those things exasperated the effects, but did not cause them. Ultimately, everything you hear and read about in the news, Wall Street, MBSs, bank fraud, etc relied on one simple thing, people making their mortgage payments. The question that rises then is why did people start defaulting on their mortgages? This book goes a long way in explaining this.

Greg Linster says

Thomas Sowell's book, *The Housing Boom and Bust*, explores the economics behind the many causes of the recent housing bust. In essence, it's an accurate account of how we all participated in the housing crisis. Lenders, government entities Fannie Mae and Freddie Mac, builders, local government regulations, local homeowners, government regulators (HUD and bank authorities), the Congress, and presidents each played a part. Sowell rightly points out that the crisis was namely a result of misinformed political decisions punctuated by a lack of understanding basic economics.

From a financial perspective, owning a home is not a categorically prudent decision. Despite the rhetoric from the "affordable housing" crusaders (who played a large role in the financial crisis of 2008), not everyone should or can own their home. Sowell writes: "Few things blind human beings to the actual consequences of what they are doing like a heady feeling of self-righteousness during a crusade to smite the wicked and rescue the downtrodden." Clearly, these "affordable housing" crusaders failed to understand that political interventions in complex economic systems have widespread repercussions that are often unintended.

Overall, I thought the book provided a nice explanation for both the economics and the political decisions that caused the housing boom and bust. Only time will tell if we learn any lessons from this crisis or if we are doomed to repeat it. If I were a betting man, I would bet on the latter.

Chris says

I've not had a sure sense of what made the financial crisis happen. I've read news accounts, and was vaguely aware of what was a kind of mass mania in the financial markets.

But what under-girded this mania is what Thomas Sowell details in economical prose, competently marshaled facts, and concise and plainly written explanations of key economic indicators.

Sowell's thesis is this: Government policy was the cause of the housing bust. Specifically, its implicit guarantee of Freddie Mac and Fannie Mae's future debt obligations. Beyond that, it was unreasonable and largely political housing edicts and requirements, informed by well-meaning intentions and artful political rhetoric, which did more to get us in this situation than anything.

What some of the edicts did, say relaxed lending standards, or interest-only or adjustable-rate mortgages, was give to unworthy borrowers for dubious political purposes. Financials markets were at turns pressured, and reward for going along with a political fix to what was a steady system of handing out mortgages based on merit.

All for the sake of politicians seeming to help a group a people acquire housing they could not afford. Also, having their hands in a pie that was largely unavailable to them before the 1977 Community Reinvestment Act, and the regulatory environment that developed thereafter.

All of this led to the rampant speculation that caused the fall. Sowell locates the fall as well as largely localized phenom insofar as some housing markets had unjustified pricing for homes ---San Francisco, Miami ---which was a result of the federal policies, and environmental impact regs. So the causes are disparate.

A combination of the speculation of the financial markets, the creation of complex financial instruments and bundling of toxic securities, inflated housing prices due to regulation, and a federal policy infrastructure which encouraged unsettling and politically coercive lending practices. This is what caused the most profound market and political failure of our time.

Sowell's account makes movies such as "Margin Call" which seek to explain the fall as the careless greed of Wall Street as awfully stupid tripe.

Kevin Cecil says

I was driving from Ohio to Utah with my conservative Mormon friend and he asked if we could put on this book. I agreed because I once made a deal with him to read the Book of Mormon if he read People's History of the United States, he finished Zinn while I only got about 3/4 through Book of Mormon, so I figured I owed him some book time. I wasn't very familiar with Sowell, and I'll at least grant him he ties his ideology to stronger research than paranoid such as bloviators Hannity, Beck and Limbaugh, even if this research is more cherry picked than a (no appropriate analogy available). Sowell actually makes a pretty strong case for the liberal origins of the housing crisis, though he goes to great pains to deflect the conservative role, and even throws a few GOP representatives under the bus to ensure his idealized ideology remains untarnished. The real trouble comes when Sowell uses his heavily tenuous blame of the Community Reinvestment Act (which was only responsible for a small fraction of the subprime loans* anyway) as being the driving force behind the banking crisis of '08. Any derision for the banks at all is saved only for their acquiescence with any government regulations. I did, however, appreciate his conceptualization of a "trillion" by pointing out a trillion seconds ago there were no modern humans.

*http://www.mcclatchydc.com/2008/10/12...

Brenda says

I chose this as "a book about money or finance" for the 2018 Challies Challenge and was a little surprised that I found it so interesting. I remember my dad's concern about making house payments in the 1970's. I remember being a newlywed in the 1980's and wondering how we would ever afford a house. I was certainly aware of the housing bust that is the subject of this book. Mr. Sowell provides a clear explanation of the factors involved, and he makes a convincing argument that government regulation (interference) was responsible.

One of the most interesting bits was near the end of the book when Mr. Sowell briefly touched on the causes of the Great Depression and the misconception about the helpfulness of FDR's New Deal. He writes that virtually all of the banks that collapsed during that time were located in states that had imposed regulations prohibiting banks from having multiple branches. This prevented banks from spreading their risk. Multibranch banks located in states without such regulations did not fail.

Bottom line, this was a pretty good book, and I feel that I understand that "boom, then bust" period better now.
