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Essays

CAUSE AND EFFECT: GOVERNMENT POLICIES AND THE FINANCIAL CRISIS

Peter J. Wallison

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ABSTRACT

The underlying cause of the financial meltdown was much more mundane than a “crisis of capitalism”: The real origins lay in mostly obscure housing, tax, and regulatory policies of the U.S. government. The Community Reinvestment Act, the affordable-housing “mission” of Fannie Mae and Freddie Mac, penalty-free refinancing of home loans, penalty-free defaults on home loans, tax preferences for home-equity borrowing, and reduced capital requirements for banks that held mortgages and mortgage-backed securities combined with each other to create the incentives for both subprime lending and the housing bubble that eventually led to the financial collapse.

Notes

1. See the extensive discussion of the Community Reinvestment Act's development in Hossain [2004](#).
2. Quoted in Mason [2007](#). The National Homeownership Strategy was removed from the Department of Housing and Urban Development website in 2007.
3. [Economagic.com](#), "Economic Time Series Page: US: Average Price of Houses Actually Sold," www.economagic.com/em-cgi/data.exe/cenc25/c25q07. The average price of homes sold increased from \$153,500 in the fourth quarter of 1995 to \$322,100 in the first quarter of 2007.
4. Federal National Mortgage Association, Fannie Mae's 2007 Annual Housing Activities Report, 5. Washington, D.C.: Department of Housing and Urban Development, 17 March 2008, <http://170.97.167.13/offices/hsg/gse/reports/2007aharfnmanarrative.pdf>
5. Federal National Mortgage Association, "2008 Q2 10-Q Investor Summary," 8 August 2008, 29-30, www.fanniemae.com/media/pdf/newsreleases2008_Q2_10Q_Investor_Summary.pdf; and Federal Home Loan Mortgage Corporation, "Freddie Mac Update," 30 August 2008, www.freddiemac.com/investors/pdf/files/investor-presentation.pdf
6. Joint Center for Housing Studies, The State of the Nation's Housing 2008, 39. Cambridge, Mass.: Harvard University, 2008, www.jchs.harvard.edu/publications/markets/son2008/index.htm
7. Ibid., 37.

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