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Essays

# CAUSE AND EFFECT: GOVERNMENT POLICIES AND THE FINANCIAL CRISIS

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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](http://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/2007aharfmanarrative.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](http://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/pdffiles/investor-presentation.pdf](http://www.freddiemac.com/investors/pdffiles/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](http://www.jchs.harvard.edu/publications/markets/son2008/index.htm)
7. Ibid., 37.

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