

COMMENTARY | Time for government to make it right
YOU BROKE IT, YOU FIX IT

By **CALLON B. JONES V**
 Guest columnist

Why do the banks appear to be getting special government “breaks” and “bailouts”?

U.S. government administrative, legislative and **Federal Reserve** policies since late in the Clinton administration are the primary culprits for the problems in the banking and housing industries. Isn't the government responsible for fixing what it broke?

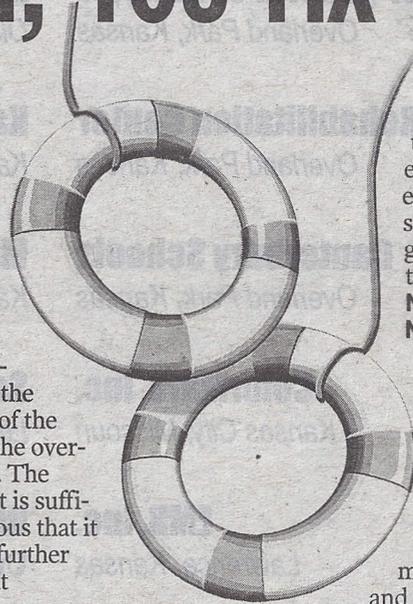
Simply put, credit is the lifeblood of the economy. When the banking industry lacks sufficient capital, lending contracts or stops. Not many businesses or entrepreneurs have the liquid working capital to function on a cash basis.

The result? Business activity grows slowly or contracts — across all industries. Business failures. Job losses. Severely limited entrepreneurial activity.

Recession, perhaps depression.

In a nutshell, the banking industry deserves special treatment due to government culpability and the importance of the industry to the overall economy. The second point is sufficiently obvious that it requires no further discussion. It may be instructive, however, to examine how government created the current situation.

Late in the Clinton administration through the mid-2000s, the government pushed to



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increase the homeownership rate in the U.S. That entailed lowering borrowing standards. The government, through **Fannie Mae** and **Freddie Mac** and through forcing banks to accept loans that would not previously be qualified, managed to get many marginal and below-margin buyers loans.

Of course, the government never asked if it was a good idea to string out lower-income borrowers on credit or to introduce such risk to the system.

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After all, what could go wrong? *Everybody* knows real estate never goes down in price.

In 2001, Alan Greenspan and the Fed began lowering overnight Fed funds interest rates to between 1 percent and 2 percent and left them there for three years.

Greenspan tried to help the U.S. economy recover quickly from the dot-bomb stock market decline that began in 2000. This policy qualified even more marginal buyers into housing, bringing a huge number of marginal and below-margin buyers into the marketplace, causing a surge in demand, increasing housing prices.

In short, it created a housing boom generally built on marginally qualified and unqualified buyers.

Finally, with interest rates so low due to Fed policies, Wall Street got creative. To fund the mountains of capital required to support the borrowing, loans were bundled and sold as mortgage-backed securities.

However, few investors were interested in bonds paying 4.5 percent to 5 percent or less, even at supposedly low risk. Therefore, the securities were “tranching.” These arcane securities offered a higher yield at supposedly no higher risk.

Common sense alone says that's

not realistic.

In order to meet governmental capital requirements and to mitigate risk, Wall Street outdid itself in creating credit default swaps.

Effectively, these were uncensured insurance contracts that supposedly eliminated risk and were not required to appear on an institution's balance sheet if they purchased an “offsetting” credit default swap.

Effectively, the risk was invisibly transferred to the banking system. Counterparty risk became important, as defaults on credit default swaps would ripple through the banking system. A sufficiently large counterparty such as **JP Morgan Chase** or **Citigroup** failing could shatter the banking system. And it did, beginning with **Bear Stearns**.

U.S. government policies broke economic law to accomplish goals, effectively breaking the banking industry and the economy. Yes, Wall Street had some bad actors, but they contributed, not caused.

Now the government needs to fix what it broke without increased socialistic control of the banks and economy. Or is the economic pain an excuse for a power grab?