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Don't blame the banks for the economic crisis!

Abstract

The USA and the world are in a complex economic crisis. As of February 2013, President Obama and his followers both in government and the mass media, continue to extol the virtues of "staying the course" of massive deficit spending on a scale comparable to this nation's involvement in the Second World War. As has been true throughout this nation's history, economic mismanagement by the political party in power is always deflected from its true origin to that of being the bastard child of the former administration. And this is just as true today.

"Fat cat" bankers and Wall Street financiers became a convenient whipping boy since few Americans understand the intricacies of financial markets and their importance to a smoothly operating national economy. The authors conclude that since the economic crisis encompasses most of the world's advanced economies, there is no single financial institution or confederacy of institutions that were large enough to bring about a crisis of this magnitude.The paper seeksthe answer from whence the crisis began – the housing market of the United States. The two most influential entities in these markets are: (1) the Federal Reserve; and (2) Fannie Mae and Freddie Mac, the two Government Sponsored Enterprises specific to the U.S. housing market. With the epicenter of the world financial crisis pinpointed, an investigation found that the activities of both entities had been championed by preceding administrations of both political parties. With this knowledge in hand, we were able to identify the individual protagonists of this debacle. The contribution to this on-going, complex financial crisis is that we have done much more than just present a historical account of the event that has shaken the economies of the advanced nations.The authors identify the protagonists and we capture their shoddy economic analysis and self-serving public statements from the time period several years before and in the weeks following the bomb's ignition.

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Introduction

"Encumbered forever, by desire and ambition, There's a hunger still unsatisfied, Our weary eyes still stray to the horizon, Though down this road we've been so many time"(Pink Floyd).

The USA and the world are in a complex economic crisis. While it is natural to ask "Who did it?" most individuals seem quick to blame and tend to be looking in one direction only for the culprit: capitalism. This tendency is likely what President Obama alluded to when he warned CEO's of America's major financial institutions: "My administration is the only thing between you and the pitchforks" (Eamon, 2009). The immoral behavior of Wall Street – through its greed, selfishness, and profit-driven behavior – we have long been told, cannot go on forever. Like the drug-addict's binge or the con-artist's spree, capitalism's immoral practice too will eventually come crashing down and this crisis is an indication of that.

The fact is, however, that neither greed nor capitalism nor capitalism's financial institution are responsible for our current economic crisis. Greed is not to blame here, not just because greed is an anti-concept, which has no precise definition and is often used simply to smear profit-seekers, but, more straightforwardly, it is improper in any situation to blame an emotion or desire[1]. Individuals are not victims of their emotions. Individuals are victims of their thinking or lack of thinking, a choice which is open to them[2].

While it takes a more intricate explanation to show that capitalism is not morally culpable and thus, should not be a scapegoat in this crisis, the method of analysis is the same. What is required is a careful and sober inquiry into origins of this crisis and a rejection of the frenzied "pitchfork" emotionalist attitude that has captured our nation. As economist Lawrence H. White (2008) notes, in "confront[ing] the ongoing U.S. financial crisis, it is important to take a step back and understand its origins. Those who fault 'deregulation,' 'unfettered capitalism,' 'fat cat bankers' or 'greed' would do well to look instead at flawed institutions and misguided policies." Speaking to the complexity of the issue, Peter Wallison (2008) notes that this is a complicated matter and there is *plenty*

[1] Ayn Rand identified an anti-concept as a fallacy. It is "an unnecessary and rationally unusable term designed to replace and obliterate some legitimate concept" (Rand, 1971). Thomas Sowell discusses this aspect of "greed" in his work *Basic Economics* (2004): "Greed is seldom defined. Virtually everyone would prefer to get a higher price for what he sells and pay a lower price for what he buys….But, if everybody is greedy, then the word is virtually meaningless" (361). Thus, if greed is defined as simply wanting more, or more than many others, and it is directed by reason, greed can be a powerful motivator for good; but, if greed is defined as an "irrational desire" prodding one toward short-sighted, reckless behavior, then the following one's greed turns out not to be the path to greater wealth accumulation.

[2] See: Chapter 5: "Emotions" in Branden (2001). In regard to the choice "to think or not", see: Peikoff (2001, pp. 198-205).

of blame to go around: "There are so many potential culprits in the current financial crisis that it is difficult to keep them all straight or to assess their relative culpability. Greedy [commercial] and investment banks, incompetent rating agencies, predatory lenders, and mortgage broke seven the entire system of asset securitization have all been blamed for the current condition of the financial markets." As an advocate of personal responsibility, we do not exclude from blame imprudent and short-sighted borrowers who took on more debt than they could afford, likely because of the exciting prospect of home ownership. For, barring physical force, fraud, or accident, responsibility must always end with the individual. Thus, to varying degrees, all actors who participated in this debacle must accept moral responsibility for their part in it.

1. Who or what caused the financial crisis?

Yet, while all actors participating in this crisis hold some moral responsibility, we would be remiss not to point out that the blame is not to be evenly distributed across these groups. What we have before us in this economic crisis is not a situation akin to erosion or over-fishing, where the collective behavior of self-interested individuals somehow combined to cause an unintentional, negative externality. Far from this explanation of cause and effect lies only a few culprits whose actions are akin to imbecility at a level that far exceeds anyone's expectations or, and more likely, to the existence of but a few culprits whom, however, were in powerful government positions but whose lack of a functioning moral compass permitted each to knowingly engage in actions of unbelievably self-serving and heartless disregard for the welfare of others.

This financial crisis, now five years and counting, continues to engulf the United States while casting its net of dismal macroeconomic performance far past the shores of the manynations that, unknowingly, participated in the scam. The current financial malaise exceeds in severity all previous crises with the exception of the Great Depression of the 1930s. Far more than just being limited to our shores, this turbulence has overwhelmed financial markets throughout the world. Financial institutions on both sides of the Atlantic have either failed or have been saved from failure, for good or bad, by government bailouts, as a result of the failure of financial institutions worldwide to honor the first rule of sound financial management: "Do not engage in any transaction if there is an uncomfortable level of uncertainty as to the likelihood that one or more participants cannot or will not meet his contractual obligations."

The only institutions truly capable of such a reach and influence are the U.S. government and its collaborator, the Federal Reserve. Together these entities created, bred, and fed the "financial monsters," Fannie Mae and Freddie Mac, until they grew to be toxic "time bombs" ready to explode on Wall Street (Wallison 2000; 2002)[1] . Thus, this crisis had a culpable architect and precise origins: Our government, since in the early 1990's.

2. Origins of the economic crisis: financial turmoil began in the mortgage market

In order to understand the origins of the present crisis, it is helpful to understand the nature of savings. When individuals produce more than they consume, they save. The holders of these savings want to do more than put this money under their mattresses. Their wish is to make this savings grow. And, there are plenty of individuals and companies who are willing to pay money, i.e. interest, to borrow this saved money. The key is to find somewhere safe to invest one's savings, while at the same time getting a worthwhile return. U.S. Treasury securities, until 2011, when, for the first time ever, lost their AAA rating, were regarded as the world's safest investment, and had long been a favorite conduit for investors.

In a speech following the 2001 terrorist attack on the New York City twin towers and in the midst of the accompanying U.S. recession, Federal Reserve Chairman Alan Greenspan made a declaration that turned the world of the investment bankers upside down, however. Alan Greenspan declared that, the FOMC (Federal Open Markets Committee) stands prepared to maintain a highly accommodative stance of policy for as long as needed to promote satisfactory economic performance. Translated from central banker speak, what Greenspan meant is that he is willing to inflate the money supply and hence lower interest rates for as long as necessary to "revive" the economy and repair it from the shock it received on that fateful day. What this meant for worldwide investors in the U.S. Treasury bond market is that they were not going to make any money on U.S. Treasury securities for a very long time. Smart investors, diverted from the bond market, scanned Wall Street for a similar low-risk, high-return investment that could take the place of U.S. Treasury securities and they fell in love with residential mortgages.

The Federal Reserve's credit expansion to counteract the recession of 2001 provided the monetary fuel for the unsustainable financing of residential mortgages. In 2001, Greenspan lowered the federal funds rate from 6.25 % to 1.75 % and by the middle of 2003, the federal funds rate had been lowered even further to 1 % where it was kept until mid-2004. As economist

[1] It should not go unnoticed that these articles by Wallison (2000; 2002) chronicle the inherent risk Fannie and Freddie posed to the market and the taxpayer as far back as December 1, 2000.

Lawrence H. White (2008, p. 3) notes, though, in actuality, "[t]he real Fed funds rate was negative – meaning that nominal rates were lower than the contemporary rate of inflation – for two and a half year during that period a borrower was not paying but rather gaining in proportion to what he borrowed." With interest rates at record low levels, droves of Americans found it advantageous to borrow money. The housing market swelled and the housing bubble was created.

From the midpoint of 2003 to the midpoint of 2007, real estate loans at commercial banks in America grew at a remarkable 12.26% annual rate over a 4-year period (White, 2008, p. 4). This led to a continuous rise in the price of homes and condos and the construction of new housing on undeveloped land – a large share of which were financed using subprime loans[1]. In addition to the loans for existing and new homes being financed by subprime loans, adjustable rate mortgages (ARM's) grew dramatically in number relative to the age-old 30-year fixed-rate mortgage. ARM's made up 20% of the loans extended in 2001 but by 2004, they constituted 40% of the total number of housing loans made.

The advantage to having an ARM is that when interest rates are low, one's mortgage payment would correspondingly also be low. Yet, these mortgages were risky because there existed the chance that imprudent individuals, who formed certain spending habits when interest rates (hence, mortgage payments) were low, could be in for a real shock when interest rates rose. Yet, despite this risk and in the face of an already incredible rate of expansion in ARMs, Alan Greenspan called for banks to increase their ARM percentages. As economist Richard Salsman notes (2009), Greenspan even went so far as to "chastise lenders for extending too many traditional, fixed-rate mortgages and not enough ARMs. Citing Fed research, he declared that 'many homeowners might have saved tens of thousands of dollars had they held adjustable - rate mortgages rather than fixed-rate mortgages".

Accompanying this unprecedented plunge in interest rates and rise in adjustable-rate mortgages of the mid-2000's were a plethora of policy and institutional changes motivated by the bipartisan political goal of bringing home ownership to underprivileged and minority groups regardless of the risks or costs. These policies and institutions would have the effect of grossly amplifying the risks posed by a rapidly growing, already unstable housing sector. The expansion of political measures to "encourage" greater home ownership by means of relaxed lending standards came in large measure from new changes in the Federal Housing Administration's accepted loan equity standards, a drastic new expansion of the provisions set forth in the formerly benign Community Reinvestment Act (CRA), as well as a new mission adopted by Fannie Mae and Freddie Mac, under the pressure of the Department of Housing and Urban Development (HUD), to increase the availability of loans to individuals with low and moderate income.

The Federal Housing Administration (FHA) is an institution created during the New Deal legislation of the 1930s to ensure mortgage loans, much as the Federal Deposit Insurance Corporation (FDIC) insures a portion of individual bank accounts. Whereas the FHA had for many years required a 20% down payment on mortgages, the 1990's saw a steady decrease in this requirement until it reached a mere 3% in 2004. These depreciating standards were induced to help the government's mission of increased home ownership to the underprivileged and minority groups become a reality.

The newly strengthened Community Reinvestment Act (CRA) gave regulators "serious teeth," in the words of Lawrence H. White (2008). Whereas before, the CRA required minor provisions of selected banks, for example, to maintain a certain percentage of their loans staying within the community, new provisions gave the CRA expanded power to force banks to lower their lending standards for the "sake of the community." Amendments added in 1995 enabled regulators to deny banks with "poor" CRA ratings the right to merge with other banks or open up new branches. A simple complaint from a community organization, such as ACORN, could, for example, lower a bank's CRA rating. Janet Reno, Attorney General of the United States at this time, left little room for misunderstanding the power which she welled in the enforcement of the newly strengthened CRA. Her verbal dictum to CEOs of the nation's largest bank was, in so many words, "Banks that fail to lower their lending standards so that more and more families can achieve home ownership and thus share in the fruits that this great nation makes available to other families will find: (1) bank auditors in the banks with no date set for their disengagement; (2) prevention of bank mergers; and (3) the denial of bank expansion by opening new branches.

Yaron Brook (2008) comments on this political pressure noting that: "According to one of several enforcement agencies, 'discrimination exists when a lender's underwriting policies contain arbitrary or

[1] "Sub-prime" and "Alt-A" are financial terms referring to riskier loans, loans where the borrower usually has a credit score below a particular level, e.g., a FICO score below 680. Sub-prime borrowers include individuals with a history of loan delinquency or default, those with a recorded bankruptcy, those with limited debt experience, or with little to no down-payment. Sub-prime loans are considered riskier than Alt-A loans.

outdated criteria that effectively disqualify many urban or lower-income minority applicants.'" He then remarks on the astounding illogic regarded by this agency as "arbitrary and outdated criteria" for assessing the credit worthiness of an applicant was, precisely, "the essentials of responsible lending: income level, income verification, credit history and savings history."

Beyond lowering mortgage standards to the level that low and moderate income earners could now qualify, financial policy analyst Peter Wallison, notes that such devalued loan standards started to be applied to the prime market. For, since "[L]oan members of underserved groups did not come with labels the same unsound practices were extended to borrowers who could have qualified under the traditional underwriting standards." In fact it was typical for loan originators to encourage home buyers to buy bigger and more luxurious houses as their down-payment could easily be adjusted to a mutually agreed upon level. From the home buyer's perspective, this seemed to make some sense too because, they were told, even if the mortgage payments became onerous, one could simply sell one's home for a profit in the rapidly appreciating home market. In most of these individuals' lifetimes home prices had always gone up and yes, there had been localized declines in home prices – but only in the "sand states" of California, Arizona, Texas, and Florida. But there had never been a nation-wide fall in home prices. Thus, conventional wisdom hailed, home prices could never fall.

At this point, one might be wondering, "How could a bank go on making such a preponderance of bad loans without facing massive defaults?" Enter Fannie Mae and Freddie Mac. Fannie Mae, the Federal National Mortgage Corporation, and Freddie Mac, the Federal Home Mortgage Corporation, are Government Sponsored Entities (GSE's). They are factitiously known as "financial centaurs" since they have government charters, government missions, and government privileges, but are driven by the profit motive because they are publicly traded corporations on the New York Stock Exchange (Fannie the Centaur, 2004).

Their government endowed mission is to provide liquidity to the mortgage market and they did so by purchasing mortgages from loan originators, then repackaging these loans into Mortgage Backed Securities (MBSs), which investors would therein purchase. Because our government believes this is an especially important mission they endowed these GSEs with special privileges that other companies do not legally have. Such special privileges include access to a line of credit through the Treasury, exemption from taxes, and an exemption from registering their securities with the U.S. Securities and Exchange Commission (SEC). Perhaps of greatest significance to this crisis is the fact that Fannie and Freddie also were implicitly (and correctly) believed to be guaranteed by government (i.e. bailed out) in the event of bankruptcy. The author can't emphasize strongly enough how important this imimplicit guarantee was to the explosive growth of the mortgage markets. Normally cautious lenders threw caution to the wind for they could easily sell their loans to Fannie Mae or Freddie Mac. Under such conditions, what was the incentive on the part of banks to make careful loans?

Banks were well aware that most of the mortgage loans they were making would almost certainly go into default. But since the loan could be sold to Fannie Mae the next day, the bank literally wiped its hands of a toxic asset. Remember Janet Reno's threats to destroy any bank that didn't follow the new loan protocol? The banking community knew that these were not idle threats. What do you do knowing that you will be driven out of business if you follow the new loan protocol? You are almost certain to fail since the history of banking emphatically teaches us that toxic loans will end in default. But if you don't follow Reno's marching orders, failure also is a certainty because it's impossible to survive if you do as she demands! Ultimately, the banks did what any of us would do: follow the new loan protocol and quickly rid yourself of the toxic loans by selling them to Fannie Mae and Fannie Mae, preferable the next day!

In 1992, Congress charged Fannie and Freddie with the new mission to facilitate affordable housing to low-income and minority groups. In 1996, for example, HUD gave Fannie and Freddie the mandate that 42% of its financed mortgages should go to "borrowers with an income below the median in their area" (Roberts, 2008). This mandate increased to 50% in 2000, to 52% in 2005, and to 55% in 2007. Fannie and Freddie met these goals each year and took their new mission seriously. While home ownership had risen only about 0.2% (64% to 64.2%) from 1982 to 1994, it leaped from 64.2% in 1994 to 67.5% in 2000 and continued to rise almost another two percentage points before falling to 67.8% in 2007. From 1994 to 2003, Fannie had increased the percentage of the newly originated loans it purchased from 37% to 57% (Wallison, 2009b). Commenting in this same year on the progress of their dual mission to serve the underprivileged and yet reward stockholders, Fannie Mae chairman, Frank Raines, announced that his company had "developed new mortgage products and devised underwriting experiments that redefined creditworthiness, but that "Fannie Mae must expand its 'American Dream Commitment' to underserved families, especially minority Americans" (as cited in Salsman, 2009).

In the years 2001 to 2006, the most aggressive years of Fannie and Freddie, the standard 30-year fixed-rate mortgage predictably saw a dramatic decline. It gave way not just to ARMs (as mentioned earlier), but also, substantially, to sub-prime and Alt-A loans.(an Alt-A mortgage, short for Alternative A-paper is a type of U.S. mortgage, that for various reasons, is considered riskier than A-paper, or "prime," and less risky than "sub-prime," the riskiest category). Whereas 30-year fixed rate mortgages constituted 57.1% of all mortgage loans in 2001, by 2006 it had fallen to 33.3%. Sub-prime loans had, on the other hand, risen from 7.2% to 18.8% and Alt-A loans increase from 2.5% in this five-year period to 13.9% (Wallison, 2009a).

In the years before its collapse, 2005-2007, Fannie and Freddie acquired nearly $1 trillion dollars in sub-prime and Alt-A loans. By 2007, Fannie and Freddie held 60% of all Alt-A loans. They are thought to have played a role in 80%-90% of all mortgages originated in 2007 (Salsman, 2009). And, by the end of 2007, Fannie and Freddie held approximately 50% of the entire U.S. residential housing market mortgages – mortgage assets of $6 trillion – but a net worth (capital) equivalent to less than 2 percent of that sum (Salsman, 2009)! Until December 2007, in terms of both the stock and flow of residential mortgages, they were involved in approximately 80% of the mortgages of the entire U.S. residential housing market!

December 2007, marks the beginning of the financial crisis. After this date and through 2008, Fannie and Freddie were, for all practical purposes, the only financial institutions originating residential mortgages in the United States. As a result, they were responsible for an estimated 90% of the flow of all residential mortgages in the United States. In 2008, the absolute number of residential mortgages that flowed through Fannie and Freddie exceeded the absolute number of residential mortgages originated world-wide! As to the $6 trillion of mortgage assets they were holding in December 2007, approximately $2 trillion of the mortgage assets were in the investment portfolio of Fannie and Freddie. However, they insured the payment of the entire $6 trillion! This was no accident as ex-Fannie Mae CEO Frank Raines remarked, "These assets are so riskless their capital should be under 2%!" (As cited in U.S. House of Representatives, 2003). In the face of these astounding statistics nearly all involved with Fannie and Freddie continued to deny any problems of instability with the companies. In the Senate Banking Committee and House Financial Services Committee meetings of 2003-2006, Representative Barney Frank, Representative Maxine Waters, Senator Chuck Schumer, Senator Christopher Dodd, and others continually downplayed or outright denied any need to worry about the financial stability of Fannie and Freddie. Even in July 2008, Sen Chis Dodd publically remarked that "[t]hose two institutions are fundamentally, fundamentally strong. There's no reason for the kind of reaction we're getting" (as cited in Crittenden, 2008). Even after the collapse of Fannie and Freddie, Fannie Mae's ex-CEO, Daniel Mudd, declared, "Almost no one expected what was coming' and insisted it was 'not fair to blame us for not predicting the unthinkable (as cited in Salsman, 2009). Why was there such blindness by those who were closest and most knowledgeable of the practices of Fannie and Freddie?

3. Home ownership for all: a noble idea that demands sacrifice

In an article on the moral root of the financial crisis, economist Richard Salsman (2009) charges that altruism is responsible for the interventionist policies of government and its subsequent wanton irrationality and irresponsibility: "The fact that each of these interventions has caused (and continues to cause) financial-economic turmoil and wealth destruction is, to those who believe the interventions are moral, is simply beside the point. By demanding that one consider the needs of others above all else, altruism morally forbids one to consider the facts of reality that conflict with the mandate." In other words, what Salsman is saying is that the mandate of altruism, to serve others, begets irrationality and unscrupulousness.

Altruism is what Mother Teresa practiced in Calcutta, what those who volunteer in soup kitchens aim at satisfying, and what Barney Frank appealed to when he asked bankers at a House Financial Services meeting (February 11, 2009) to sacrifice profits for the sake of the underprivileged (as cited in Salsman, 2009).

The only difference between the altruist acting on his own merits and the politician acting for the "public good," is that the politician sacrifices his time only. The resources he expends to fund his altruistic projects are either taxpayer dollars or bor currency (which the taxpayer will eventually have to pay). This is why, regardless of the risk and costs Fannie and Freddie posed, Senator Chuck Schumer repeatedly deflected the need to more strictly regulate Fannie and Freddie as "it might curtail Fannie and Freddie's mission" ("What They Said", 2008). This is why Rep. Maxine Waters declared: "The 1992 act has worked just fine. What we need to do today is to focus on the regulator [OFHEO – Office of Federal Housing Enterprise Oversight] and this must be done in a manner so as not to impede their affordable housing mission, a mission that has seen innovation flourish, from desktop underwriting to 100 percent loans" (as cited in U.S. House of Rep-

resentatives, 2003). It also explains Sen. Chris Dodd's comments in the months before Fannie and Freddie collapsed that "[t]here's no reason to talk about failure [when] our primary focus is supporting Fannie Mae and Freddie Mac in their current form as they carry out their important mission" (as cited in Crittenden, 2008). Finally, it can also account for the unrepentant attitude of key players in this crisis, like Countrywide Financial CEO, Angelo Mozilla, who, after his company was bankrupted by all the bad loans it had made, declared, "Democrats and Republicans alike wanted to extend home ownership to people who did not have credit although it ended disastrously, it was a noble aspiration" (as cited in Salsman, 2009). These actors quite simply felt blessed with the superior moral mission of altruism and therefore reacted with indignation toward anyone who tried to question the practicality or effectiveness of what they were doing.

4. What can we learn from this crisis?

What all students of this crisis should take away is the lesson that, despite the 'good intentions' behind them, government intervention is what caused this crisis. Peter Wallison (2000) warned of this as far back as December 1, 2000, stating: "It is no exaggeration to say that this is a threat to the private sector to the same degree as it is a threat to the taxpayers. By combining the government's exemption from market discipline with the aggressiveness of private-sector management, Congress has created a financial monster." This "monster" was, as it had been shown, not a natural development of capitalism, but a deliberate creation of the government.

Wallison (2006) pointed out that the interventionist creation of Fannie and Freddie were "monsters" precisely because of the severe moral hazard they posed to the economy and the public. "A moral hazard exists in the very nature of these entities", Wallison argues. Because of its implicit government guarantee, Fannie and Freddie, was seen by the US and foreign investors as risk-free. Being perceived as risk-free, these GSEs could borrow an unlimited amount with virtually no questions asked. This made it possible for the GSEs to avoid (for a long period of time) the mechanisms of market discipline that all other players under capitalism were constrained by, particularly "the competition for reputation"[1].

Exempted from having to answer to the SEC or having any other real regulations or restrictions, Fannie and Freddie were effectively outfitted with a false reputation and armed with a blank checkbook, then cast out into the economy and naively expected to behave. What Fannie Mae and Freddie Mac predictably did instead, was go gambling in the mortgage market, on the one hand, and fill the wallets of their stockholders, executives, and newly befriended pals in Washington with borrowed funds, on the other. When asked to help target low-income and minority individuals acquire a mortgage, Fannie and Freddie happily agreed, then simply called in loan-originators, primarily banks, saying to them, "We'll take anything". This phrase, unfortunately, translates as "We will buy any loan that you send us regardless of its quality (level of default risk)," engaging in a level of borrowing and gambling that is simply unfathomable to those of us who have spent most of our adult life in the study of financial markets. Fannie and Freddie even partnered up with groups like the NAACP in $100+ million dollar deals to provide what Frank Raines explained as, "underwriting flexibility that put home ownership in [a minority person's] reach" (as cited in "NAACP Joins Fannie Mae", 1999).

Meeting the increasingly irrational goals of Congress was almost effortless and trouble-free for Fannie and Freddie, for they merely had to borrow money with their privileged "flawless" credit status. Whereas a typical bureaucratized company usually finds themselves "bound to comply with detailed rules and regulations fixed by the authority of a superior body," wherein one's "objective can no longer be profit, but compliance with the rules and regulations," Fannie and Freddie had no rules or regulations to answer to, other than to make a designated amount of risky subprime purchases (Mises, 1969, p. 45, 49). Having unlimited funds, it could have its cake and eat it too, pursuing profit for executives and shareholders. All profits to be captured by its private sector and shifting all its losses to its public sector its government benefactors. This government-created moral hazard, was a condition that Fannie and Freddie took full advantage of, growing voraciously, like a "monster on steroids," until it exploded, taking other institutions (and even countries) down with it.

What we should take away from this is not the fact that more regulation is needed, but that less is: "Today, more than fifty regulatory agencies enforce tens of thousands of rules on individuals and businesses; the average length of the Federal Register, which lists regulatory rules, has recently hovered around seventy-five thousand pages," Brook & Watkins (2009) note. Yet, no regulatory agency was able to stop this catastrophe, perhaps the largest in history. No regulatory agency was able to identify the accounting fraud perpetrated by both Fannie and Freddie in 2003, either. We must understand that regulation simply means government intervention.

[1] Alan Greenspan (1966, p. 115) describes how market discipline "competition for reputation" provides and how intervention undermines this in his essay "The Assault on Integrity." In it he says, "Regulation-which is based on force and fear-undermines the moral base of business dealing. Protection of the consumer by regulation is thus illusory. Rather than isolating the consumer from the dishonest businessman, it is gradually destroying the only reliable protection the consumer has: competition for reputation".

Regulation severely penalizes honest businessmen, costing nearly $1 trillion dollars annually in accounting and record keeping fees, as one estimate has it (Brook & Watkins, 2009). This is, in addition, to the perverse incentives, moral hazards, and destructive consequences, it creates when such regulations try to alter every business' overarching mission – profit.

The profit-seeking behavior of Wall Street is not something that needs to be contained, it is something that must be permitted to operate and expand, if that is its natural tendency. The profit motive is a powerful force for good. Every individual's selfish drive for profit, one could even call it greed, "provides powerful incentives for the steady expansion and improvement of production" (Reisman, 1996, p. 138). It leads one to improve his products and services by innovation, creativity, and increased production so that, as a producer, he is more attractive to others. The profit motive is what motivates competition and together these institutions, unique to capitalism, are what are responsible for the unprecedented living standards, technology, economic growth, and creativity that we have today.

What do need to be fixed are the moral premises many businessmen and government officials operate under. Government bureaucrats need to recognize the extraordinary value the system of capitalism and actions of businessmen serve to our society. They need to develop a newfound respect for the rights of the citizens they serve (businessmen included) and they need to recognize that they do not have carte blanche on our income or our lives, no matter how benevolent the end is. Businessmen, on the other hand, need to recognize that morality is not a luxury, it is a profound need. There is a place in morality for profit but such must be constrained by a respect for individual rights. This is precisely what capitalism, as a system of individual rights, provides. Business must recognize that if it wishes to achieve high profits, it must provide consistently good products and services demanded by consumers, and it must operate on a philosophy of reason, that is, with a respect for reality, integrity, honesty, and productiveness/ingenuity. If it does this, the free-market will reward it[1].

5. What has our government learned?

Far from acknowledging the origins of this crisis in the government's interventionist policies, the Obama administration has sadly avoided any discussion of the association between the government and Fannie and Freddie, much less a parental one. It has become the customary procedure of the Obama administration to steer clear of any serious inquiry into the causes of this crisis and to substitute in its place the excuse that we do not need to 'play the blame game.' We should instead 'come together,' make sacrifices, and recognize the need for increased oversight and control over Wall Street. "[T]he key thing is for everybody just to stay focused on doing the job instead of trying to figure out who you can pass blame on to," Obama (2009b) has remarked. After all it is those "on Wall Street [who] threw caution to the wind, chased profits with blind optimism and [had] little regard for serious risks – and with even less regard for the public good" (as cited in United States, 2009). While outright blame for this crisis has not explicitly been cast, subtle statements and insinuations like this have revealed who our policymakers think should bear the moral costs of this crisis: capitalism and its financial institutions.

A clear example of the indirect way in which the Obama administration has passed blame to the free-market is the remark President Obama made in regard to the public's discovery that executives at AIG (American International Group), the world's largest insurance company, were receiving bonuses: This type of business culture has "….] existed far too long – a situation where excess greed, excess compensation, excess risk-taking have all made us vulnerable and left us holding the bag," Obama said (as cited in United States, 2009). Further, in response to a question asked by Tom Bradby from ITV News of whether or not "all governments at this point [should] acknowledge mistakes of policy and regulation in the past?" Barack Obama (2009a) replied, "I think there is no doubt that, setting aside who's to blame, in the past there have been some mistakes and lessons learned in terms of how we deal with the financial sector […] But what is also true is when you've got a whole series of unregulated pools of dollars outside of the banking system, but we still have a 1930's regulatory system in place in most countries designed from the last great crisis, that we've got to update our institutions, our regulatory frameworks".

The shocking irony behind all of this is that while GSEs, particularly Fannie Mae, were indeed creations of 1930's New Deal policy, they were relatively harmless until their mid-1990's regulatory expansion. Likewise, mortgage companies had their vast share of regulators, but it was not until the increased and "updated" regulations of the 1990's and 2000's that one saw mortgage banks driven to their

[1] Edwin A. Locke (2000) identifies seven traits of great wealth creators: Independent vision, active mind, competence/confidence, drive to action, egoistic passion, love of ability in others, and virtue. Also, the reader should be pointed to the "Guiding Core Principles" of, BB&T, one of the nation's five largest banking corporations, which can serve as a model for all corporations on the importance morality should play in business. In its "Guiding Core Principles," BB&T states that it strives to be "the best financial institutions possible" by "helping [their] clients achieve economic success and financial security" by means of "ten values [which] are the key elements to our success and help guide us to excellence in our decision making." These ten values are: reality, reason, independent thinking, productivity, honesty, integrity, justice, pride, self-esteem, and teamwork." See: http://bbt.mediaroom.com/index.php?s=18&cat=4 and http//www.bbt.com/bbt/about/whybbt.html.

own destruction. Worse, it was the government's deliberate calls for the origination of larger and larger non-prime loans, not some element of decadence within capitalism that motivated the kind of irrational and destructive decisions we saw take place in the mortgage industry.

Conclusion

What this crisis has shown is not the failure of capitalism, and in particular, the failure of capitalism's financial institutions, but the destructive nature of government intervention and the hybrid-monsters, Fannie Mae and Freddie Mac. In the aftermath of this crisis and in this "New Era of Responsibility" let us not allow our government to escape awareness of this fact. Let us also recognize that responsibility means personal responsibility, and that is precisely what the system of capitalism stands for[1]. In contrast to interventionism, which has bureaucrats dictate, through orders, commands, and prohibitions, how production and consumption should take place, capitalism, or the free-market, operates most efficiently "without government orders telling everybody precisely what he should do and how he should do it [because] it does not ask anybody to deviate from those lines of conduct which best serve his own interests" (Mises, 1949, pp. 720-721). In other words, being a political-economic system that respects the freedom and rights of individuals, capitalism leaves individuals alone to live their lives according to their own design and to cooperate with others only when they find it in their best interest to do so. There could be no better system for encouraging and promoting responsibility.

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[1] For a cogent explanation of the nature of capitalism see: Rand (1966).

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