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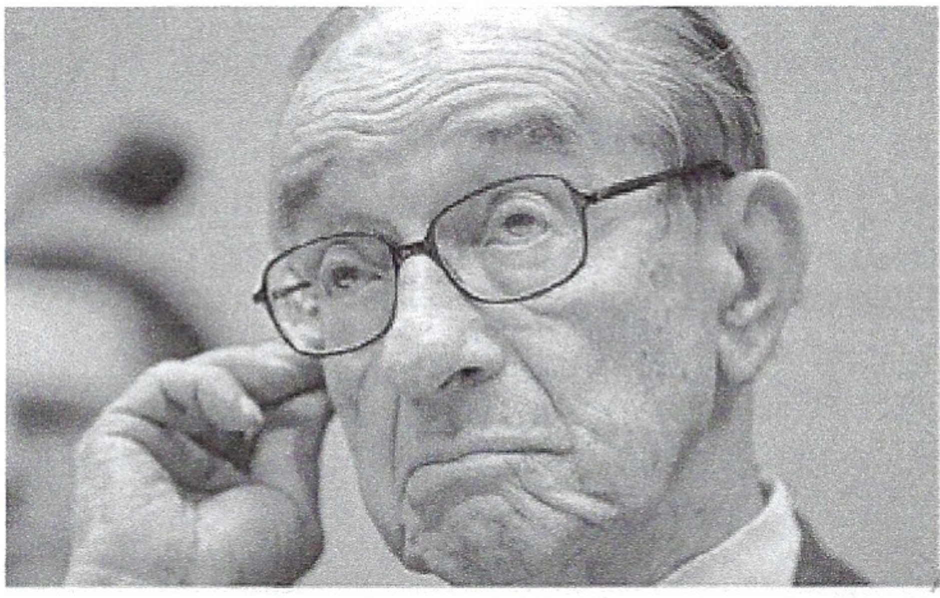

Alan Greenspan (1926-2026) J. SCOTT APPLEWHITE/ ASSOCIATED PRESS

Alan Greenspan and the Financial Crisis

By Phil Gramm And Jeb Hensarling

As eulogies and critiques pour in for Alan Greenspan, one thing has become clear: The left is using the former Federal Reserve chairman's death to peddle a false narrative yet again regarding the underlying causes of the 2008-09 financial crisis. Since so much bad economic policy rests on bad economic history, we need to set the record straight. Note

Greenspan's critics argue he carries much of the blame for the crisis and the housing bubble that triggered it, due to the low mortgage rates on his watch from 2000 to 2006, as well as his support for deregulation. Missing from this evaluation of Greenspan's career is any recognition that for extended periods

during the postwar era, mortgage rates were significantly lower than they were in 2000-06, yet they created no housing bubbles. Also missing is that for two decades leading up to the crisis, financial regulation grew stricter.

From 2000 to 2007 inflation-adjusted mortgage rates averaged 3.4%, almost triple the 1.2% between 1971 and 1980 and roughly double the rate from 2010 to 2025, yet there was no housing bubble or resulting financial crisis during either period. There is no evidence in postwar America that low interest rates precipitated a housing bubble except during the 2008-09 financial crisis.

Those who argue that Greenspan helped deregulate the financial system have yet to explain when this deregulation occurred. Through the passage of major laws like the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 and the Federal Deposit Insurance Corporation Improvement Act of 1991, not to mention the Sarbanes-Oxley Act of 2002, federal regulators gained expansive powers to impose new risk- based capital standards, increased reporting and compliance requirements, prompt corrective action rules and corporate governance rules. The only law that could remotely be called deregulatory in any sense was the Gramm-Leach-Bliley Act of 1999.

Gramm-Leach-Bliley, of which one of us was the principal Senate sponsor, amended the Depression- era Glass-Steagall Act to allow banks, securities companies and insurance companies to affiliate under well-capitalized financial-services holding companies. But it didn't deregulate anything. It established the Federal Reserve as a new superregulator overseeing all financial services holding companies. All activities of banks, security companies and insurance companies continued to be regulated under the same laws and by the same regulators as before, and by any measure Gramm-Leach-Bliley holding companies held up better during the financial crisis.

Contrary to the popular narrative, for at least three decades preceding the housing crisis, financial regulators gained more power and larger budgets and hired more personnel than ever. The Mercatus Center has found that from 1970 until the housing bubble burst, regulatory restrictions increased 250% and the number of regulatory personnel grew about 77%. There is no evidence that things would have been different if financial regulators had more authority or resources.

The true cause of the financial crisis wasn't low interest rates or deregulation, but instead bad regulation and plenty of it. For almost two decades leading up to the housing bubble, government regulation encouraged, cajoled and mandated financial institutions to loan money to high-risk borrowers who bought homes they couldn't afford. Greenspan consistently warned against the worst of it.

The Community Reinvestment Act of 1977 was originally a modest bill requiring banks to meet local credit needs. But during the Clinton administration bank regulators began using CRA to pressure banks to make subprime loans to low-income and underserved communities. Guidelines were turned into mandates and banks couldn't even open an ATM, much less acquire another bank, if they didn't receive a passing grade. According to the National Community Reinvestment Coalition, total CRA lending increased from $8.8 billion between the law's enactment and 1991, to $4.5 trillion from 1992 through 2007 when the housing bubble burst. Greenspan testified before Congress that "the early stages of the subprime [mortgage] market . . . essentially emerged out of CRA."

At the precipice of the financial crisis, the government-sponsored enterprises Fannie Mae and Freddie Mac, with their implicit government guarantee and imprimatur, either securitized or guaranteed roughly half of all mortgages in the U.S. Effective 1993, they were required to make 30% of their mortgage purchases socalled low- and moderate-income housing loans. That quota was gradually ratcheted up to 56% by 2008, when Fannie and Freddie collapsed, leading to perhaps the largest institutional bailout in U.S. history. A 2003 Fannie memo stated that because of the affordable-housing goals Congress imposed, Fannie "did deals at risks and prices we would not have otherwise done."

Conflicted legislation created conflicted regulations and regulators. Safety and soundness considerations required regulators to hit the brakes, while affordablehousing goals required them to step on the accelerator. A review of Greenspan's statements before the financial crisis shows that he was the earliest and most consistent government official to sound the alarm about the building threat from the securitization of subprime mortgages. In congressional testimony after the crisis, he said: "The evidence strongly suggests that without the excess demand from securitizers"— meaning Freddie and Fannie—"subprime mortgage originations, undeniably the original source of the crisis, would have been far smaller and defaults, accordingly, far fewer."

Unfortunately, Greenspan's inarticulate answer to a question about his regulatory philosophy was widely reported, and his definitive statement on the cause of the crisis wasn't. This helped feed the false narrative that financial deregulation caused the financial crisis, which was then used as a pretext to pass a massive expansion of government regulation of the financial system instead of a badly needed reform of government housing policy. Using Greenspan's death to restate this same false narrative in no way changes the fact that he was arguably the greatest central banker in the history of our country.

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