Building a new house of cards to create the illusion of economic recovery

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Again the Obama administration is trying to engineer financial markets. But should mortgage markets really be in the government's crosshairs given recent history? In telling banks to make loans “more accessible” to risky borrowers, the White House demonstrates that it has learned exactly nothing from the housing crisis. Just as we all paid for that debacle, we will all pay again if this latest scheme moves forward.

President Obama hinted at this move in January, saying, “Even with mortgage rates near a 50-year low, too many families with solid credit who want to buy a home are being rejected. ... That's holding our entire economy back, and we need to fix it.” This should sound frighteningly familiar to anyone who lived through the last decade or so. But the central planners seem to have the memory of common goldfish. All we need, they say, are taxpayer-funded insurance policies against default.

If we had recovered from the last bout of governmental interference in the housing market, this would be high comedy. Given the current “recovery,” it is nothing short of inexcusable. So without further ado, here is a brief history of a crisis wholly caused by governmental meddling. Think of it as a cautionary tale.

The crisis was born the moment politicians realized they could use the promise of home ownership to buy votes. Through the Community Reinvestment Act of 1977, Congress forced private banks to provide loans to low-income borrowers. To twist bankers' arms further, the Riegle-Neal Act of 1994 tied regulatory approval of bank mergers (something banks wanted) to compliance with the 1977 law (something they didn't).

But because banks were left holding the bag if borrowers couldn't repay, banks were only willing to bend so far to congressional demands.

Politicians' salvation came in the form of Fannie Mae and Freddie Mac. Once upon a time, the prospect of profit drove banks to lend money, while the risk of loss held them back. The result was prudent lending. Using Fannie Mae and Freddie Mac (both government-owned corporations), the government forced taxpayers to underwrite the losses on risky loans. The result, predictably, was that banks started lending to anyone and everyone. Not because they had suddenly become greedy but because the government had removed the market's penalty for greed: losses.

The banking sector didn't collapse due to the presence of greed. It collapsed due to the absence of accountability.

In 1996, the government mandated that 40 percent of Fannie's and Freddie's loans go to low-income borrowers. Meanwhile, the Federal Reserve held interest rates at historically low levels, making mortgages cheaper. This encouraged more people to borrow more money to buy more houses.

When the bubble finally burst, Fannie and Freddie were holding 43 percent of all U.S. mortgages.

Politicians told us that the problem was bankers who, greedy for dollars, pushed irresponsible loans on ill-informed borrowers. Wrong. It was politicians who, greedy for votes, pushed banks to push loans on high-risk borrowers who, in turn, would show their appreciation at the ballot box.

Banks played the role of the corner drug pusher; government played the role of the drug cartel.

In the last mortgage crisis home prices soared because the government flooded the market with cheap and easy money while simultaneously guaranteeing repayment of high-risk loans. Prices crashed when enough people realized it was just a Ponzi scheme.

Now, President Obama seeks again to inflate home prices to create the illusion of economic recovery. But we already know what will happen when it inevitably falls apart.

Betting that we have the memory of common goldfish, the president will blame markets instead of government manipulation. If we fall for that, then we deserve what's coming.

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