

THE INTERNATIONAL FINANCIAL CRISIS AND THE UNITED STATES OF AMERICA

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It is well known that the USA was the starting point of the current world financial crisis. Defective regulation, as occasionally depicted, is not its only cause. Others include massive state intervention and the failed monetary policy of the US Federal Bank.

Owning a house has always been an essential element of the American Dream. Therefore, it is the politicians' key objective to increase the number of private house owners, especially among minorities and marginal social groups. At the end of October this year, the website of the White House featured the *Homeownership Policy Book* of 2002. Chapter 1 presents the general orientation: 'Expanding the dream: Innovative financing measures to promote homeownership'. Chapter 2 specifies key objectives, which include 'establishing a national goal of at least 5.5 million new minority homeowners', 'challenge the [...] mortgage finance industries to dramatically increase their efforts to reduce the barriers to homeownership', and 'convene a White House Conference on Increasing Minority Homeownership'.

Thus, the intervention of the state follows a system. The key players of government funding for house and home ownership in the USA were the two government-supported mortgage banks Fannie Mae and Freddie Mac which, both operating in the secondary mortgage market, collateralize mortgages, collate the mortgages purchased into securities, and sell these to interested investors. About half of all mortgages issued are on the books of these two banks.

Fannie Mae and Freddie Mac have been supporting private home ownership ever since they were founded – a goal whose realization has always been assisted openly and aggressively by the state. In 1999, for instance, the Clinton administration urged the institutes to loosen their award criteria for borrowers so as to increase the credit volume.

There have been many warnings which, however, all went unheeded: On September 30, 1999, for example, the *New York Times* wrote: 'Fannie Mae is taking significantly more risk.' Four years later, the same paper said: 'Fannie Mae's risk is much larger than is commonly held.'

And corruption was also involved. An audit of Fannie Mae in 2004 revealed irregularities that were 'deliberately and systematically created'. The figure given was 10.6 billion US Dollars. Even back then, Senator John McCain was one of the fiercest critics of the bank, demanding more severe restrictions on

the grounds 'that Fanny Mae employees deliberately and intentionally manipulated financial reports'. At the same time, he accused the company's leadership of exerting pressure on Congress to influence the inquiry.

There is a long list of prominent senators and congressmen who received money from Fannie Mae and Freddie Mac. Senator Chuck Hagel launched a bill in 2005 to tighten the regulations for the two banks. Mr McCain joined this initiative as co-sponsor. It should be obvious that Fannie Mae and Freddie Mac were abused to help achieve the political goal of increasing home ownership without the state assuming financial liability.

Next to structural conditions, another cause of the dilemma is the often irresponsible behaviour of the leading bank players – the borrowers and the banks – on the mortgage market. The latter were occasionally even willing to issue mortgages that exceeded the value of the object in question, expecting that real-estate prices would rise constantly. What is more, some banks would update the value of a property after some years had passed. The wealth increase generated that way stimulated the Americans' desire to buy, thus giving a boost to the global economy. Accordingly, the savings-to-income ratio declined and even plunged into the red.

All this went well as long as real-estate prices remained high and interests low. However, those two things were no longer given from the middle of 2006 onwards. The higher burden put owners under pressure as they fell behind with interest payments and debt repayment. When property prices began to fall, their homes suddenly were worth less than the mortgage with which they were encumbered. As a consequence, some banks claimed the difference in advance in order to adjust the credit amount to the new collateral value. That left many home owners unable to pay.

And another factor played its part: At the time of the real-estate boom, many banks blithely accepted the property itself as sole security for a mortgage. Today, many of the owners affected who are now, after the onset of the crisis, falling behind with their interest payments, move out and hand over their house to the bank.

The derivatives market that has blown itself up markedly within the last few years is also marred by deficient regulation. Experts had warned against this risk years ago. There was a severe – albeit fruitless – dispute in 1993, in which some, such as Brooksley Brown, the chairwoman of the Commodity Futures Trading Commission of Chicago, called for more forceful supervision of the expanding 'black market' in derivatives, while others, led by Alan Greenspan, the chief of the Federal Reserve, strongly opposed the idea. And even later warnings fell on deaf ears: By the middle of 2005, the market for the popular credit default swaps alone had grown ninefold. Late in June

2008, the global derivatives market logged a volume of 530 trillion US Dollars.

The monetary policy of the Federal Reserve must also be seen against the background of the expanding derivatives market. When the markets and banks of Asia collapsed in 1997, the US government intended to meet the expected decline in global demand by stimulating its own economy. The Fed reduced interest rates but failed to raise them again at the right time. The resultant bubble on the international equity markets burst in 2001. To eliminate the imminent risk of recession, the same solutions were applied – and created the housing bubble: From 2001 to 2006, house prices increased by 130 percent until this bubble burst as well.

Growing real-estate assets and the monetary policy of the Federal Reserve led to an enormous demand which could only be met by drastically increasing US imports. Especially Asian central banks accumulated tremendous sums in US bonds: Another bubble that will burst?

The bailout programme of the US government, which was to bring the solution, was a flop right from the beginning. Suspicion arose when the Secretary of the Treasury expected that Congress would grant him 700 billion US Dollars – on the basis of a bill of only three pages. Huge numbers of US citizens protested to their senators and congressmen. Even weeks later, as stated by the *New York Times* on October 18 this year, most citizens still rejected the programme which was by then endorsed by a Congress majority, albeit only after an unpredictable risk had been painted on the wall.

According to the *New York Times*, only 28 percent of the citizens interviewed expect that the bailout programme will have a positive effect on the economy, while almost two in three are convinced that the measure will only 'save the neck' of those who caused the dilemma in the first place – investors, Wall Street employees, and CEOs of the major banks and investment firms. In this context, the tremendous expenditure of the programme, which also fosters the fear that the influence of the state might expand considerably, is not the only thing that is alarming.

Today, most US citizens do not ask about the causes of the crisis, i.e. deficient regulation, massive intervention by the state, and the failed monetary policy. However, they are convinced that those who benefit from the bailout programme are primarily at home in Wall Street. Furthermore, they believe that the crisis caused by this same Wall Street will sooner or later reach them as well.