

Statement Before the Joint Economic Committee

November 8, 2007

Mr. Chairman, our economy finds itself in a precarious state. Oil prices are rising, gold is nearing all-time highs, and the dollar is nearing all-time lows. The root of this crisis, as with past financial and economic crises, results from federal government intervention into the economy, not to anything endemic to the market, nor to the the actions of market participants.

The collapse of the housing market has served as a catalyst for the economy's latest bust. For years the federal government has made it one of its prime aims to encourage homeownership among people who otherwise would not be able to afford homes. Various federal mortgage programs through the FHA, Fannie Mae, and Freddie Mac have distorted the normal workings of the housing market.

The implicit government backing of Fannie Mae and Freddie Mac provides investors an incentive to provide funds to Fannie and Freddie that otherwise would have been put to use in other sectors of the economy. It was this flood of investor capital that helped to fuel the housing bubble.

Legislation such as the Zero Downpayment Act and the misnamed American Dream Downpayment Act made it possible for people who could not afford down payments on houses to receive assistance from the federal government, or even to pay no down payment at all, courtesy of the taxpayers. The requirement of a down payment has always helped to ascertain the ability of a buyer to pay off a mortgage. It requires the buyer to show hard work and thrift, the ability to delay present consumption in order to make a larger acquisition in the future.

When this requirement is minimized or eliminated, you introduce a new class of homebuyers,

people who are unable to budget and save for the purchase of a home, or who should wait for a few years until they have saved enough to purchase a home. Federal policies have encouraged investors, lenders, and brokers to cater to these people, so it is no surprise that market actors came up with ever more sophisticated means of bringing these people into the real estate market.

Finally, the Federal Reserve's loose monetary policy and lowering of interest rates were a major spur to the housing boom. Low interest rates influence marginal buyers, those who are sitting on the fence, and encourage them to take on a mortgage that they otherwise would not. Even when interest rates are raised, no one expects them to stay high for long, as there is always pressure from politicians and investors to keep rates low, as no one wants the cheap credit to end.

Thinking that interest rates will cycle from low to higher, back to low, lenders begin to offer adjustable rate mortgages, 2/28's, 3/27's, and other sophisticated mortgages that may trap many unsavvy buyers. Buyers go short, lenders go long, and many people have been burned as a result.

It is time that the federal government get out of the housing business. Through our interventionist legislation we have caused the boom and bust, and any attempts at reform that fail to address the causes of our current problem will only sow the seeds for the next bubble.