ON THE MONEY

Dissecting the big lie about the economic crisis

BARRY RITHOLTZ
On Investing

It's fair to say that our discussion about the big lie touched a nerve.

The big lie of the financial crisis, of course, is that troubling technique used to try to change the narrative history and shift blame from the bad ideas and terrible policies that created it.

Based on the scores of comments, people are clearly interested in understanding the causes of the economic disaster.

I want to move beyond what I call "the squishy narrative" — an imprecise, sloppy way to think about the world — toward a more rigorous form of analysis. Unlike other disciplines, economics looks at actual consequences in terms of real dollars. So let's follow the money and see what the data reveal about the causes of the collapse.

Rather than attend a college-level seminar on the complex philosophy of causation, we'll keep it simple. To assess how blameworthy any factor is regarding the cause of a subsequent event, consider whether that element was 1) proximate 2) statistically valid 3) necessary and sufficient.

Consider the causes cited by those who've taken up the big lie. Take for example New York Mayor Michael Bloomberg's statement that it was Congress that forced banks to make ill-advised loans to people who could not afford them and defaulted in large numbers. He and others claim that caused the crisis. Others have suggested these were to blame: the home mortgage interest deduction, the Community Reinvestment Act of 1977, the 1994 Housing and Urban Development memo, Fannie Mae and Freddie Mac, Rep. Barney Frank (D-Mass.) and homeownership targets set by both the Clinton and Bush administrations.

When an economy booms or busts, money gets misspent, assets rise in prices, fortunes are made. Out of all that comes a set of easy-to-discern facts.

Here are key things we know based on data. Together, they present a series of tough hurdles for the big lie proponents.

• **The boom and bust was global.** Proponents of the Big Lie ignore the worldwide nature of the housing boom and bust.

A McKinsey Global Institute report noted "from 2000 through 2007, a remarkable run-up in global home prices occurred." It is highly unlikely that a simultaneous boom and bust everywhere else in the world was caused by one set of factors (ultra-low rates, securitized AAA-rated subprime, derivatives) but had a different set of causes in the United States. Indeed, this might be the biggest obstacle to pushing the false narrative. How did U.S. regulations against redlining in inner cities also cause a boom in Spain, Ireland and Australia? How can we explain the boom occurring in countries that do not have a tax deduction for mortgage interest or government-sponsored enterprises? And why, after nearly a century of mortgage interest deduction in the United States, did it suddenly cause a crisis?

These questions show why proximity and statistical validity are so important. The Community Reinvestment Act of 1977 is a favorite boogeyman for some, despite the numbers that so easily disprove it as a cause.

For example, if the CRA was to blame, the housing boom would have been in CRA regions; it would have made places such as Harlem and South Philly and Compton and inner Washington the primary locales of the run up and collapse. Further, the default rates in these areas should have been worse than other regions.

What occurred was the exact opposite: The suburbs boomed and busted and went into foreclosure in much greater numbers than inner cities. The tiny suburbs and exurbs of South Florida and California and Las Vegas and Arizona were the big boomtowns, not the low-income regions. The redlined areas the CRA address missed much of the boom; places that busted had nothing to do with the CRA.

The market share of financial institutions that were subject to the CRA has steadily declined since the legislation was passed in 1977. As noted by Abromowitz & Min, CRA-regulated institutions, primarily banks and thrifts, accounted for only 28 percent of all mortgages originated in 2006.

• **Nonbank mortgage underwriting exploded from 2001 to 2007, along with the private label securitization market, which eclipsed Fannie and Freddie during the boom.** Check the mortgage origination data: The vast majority of subprime mortgages — the loans at the heart of the global crisis — were underwritten by unregulated private firms. These were lenders who sold the bulk of their mortgages to Wall Street, not to Fannie or Freddie. Indeed, these firms had no deposits, so they were not under the jurisdiction of the Federal Deposit Insurance Corp or the Office of Thrift Supervision. The relative market share of Fannie Mae and Freddie Mac dropped from a high of 57 percent of all new mortgage originations in 2003, down to 37 percent as the bubble was developing in 2005-06.

• **Private lenders not subject to congressional regulations collapsed lending standards.** Taking up that extra share were nonbanks selling mortgages elsewhere, not to the GSEs. Conforming mortgages had rules that were less profitable than the newfangled loans. Private securitizers — competitors of Fannie and Freddie — grew from 10 percent of the market in 2002 to nearly 40 percent in 2006. As a percentage of all mortgage-backed securities, private securitization grew from 23 percent in 2003 to 56 percent in 2006

These firms had business models that could be called "Lend-in-order-to-sell-to-Wall-Street-securitizers." They offered all manner of nontraditional mortgages — the 2/28 adjustable rate mortgages, piggy-back loans, negative amortization loans. These defaulted in huge numbers, far more than the regulated mortgage writers did.

Consider a study by McClatchy: It found that more than 84 percent of the subprime mortgages in 2006 were issued by private lending. These private firms made nearly 83 percent of the subprime loans to low- and moderate-income borrowers that year. And McClatchy found that out of the top 25 subprime lenders in 2006, only one was subject to the usual mortgage laws and regulations.

A 2008 analysis found that the nonbank underwriters made more than 12 million subprime mortgages with a value of nearly $2 trillion. The lenders who made these were exempt from federal regulations.

A study by the Federal Reserve shows that more than 84 percent of the subprime mortgages in 2006 were issued by private lending institutions. The study found that the government-sponsored enterprises were concerned with the loss of market share to these private lenders — Fannie and Freddie were chasing profits, not trying to meet low-income lending goals.

Beyond the overwhelming data that private lenders made the bulk of the subprime loans to low-income borrowers, we still have the proximate cause issue. If we cannot blame housing policies from the 1930s or mortgage tax deductibility from even before that, then what else can we blame? Mass consumerism? Incessant advertising? The post-World War II suburban automobile culture? MTV's "Cribs"? Just how attenuated must a factor be before fair-minded people are willing to eliminate it as a prime cause?

I recognize all of the above as merely background noise, the wallpaper of our culture. To blame the housing collapse that began in 2006, a recession dated to December 2007 and a market collapse in 2008-09 on policies of the early 20th century is to blame everything — and nothing.

Ritholtz is chief executive of FusionIQ, a quantitative research firm. He is the author of "Bailout Nation" and runs a finance blog, the Big Picture.

THE COLOR OF MONEY

Facing fundraising challenges, nonprofits tap new sources for cash

COLOR FROM G1

Fund will initially have about $10 million.

"With the right business model, organizations could really thrive," said David Brand, president and chief executive of the alliance.

Too often organizations can't make a difference on a larger scale because they are living from donation to donation, Brand said. He noted that groups such as the Chicago-based North Lawndale Employment Network inspired the idea for the innovation fund. The organization created a for-profit beekeeping enterprise, Sweet Beginnings, to help ex-offenders and other low-income residents of Chicago's Westside neighborhoods get employment training.

The idea for the urban honey business developed out of frustration. Ex-offenders who had gone through the group's job-training program were finding that employers didn't want to hire them. Without steady employment, many released offenders end up back in prison.

"When people were ready for placement, we couldn't find them jobs," said Brenda Palms Barber, executive director of the North Lawndale Employment Network and chief executive of Sweet Beginnings. "So I decided we would become their first employment."

Additionally, by selling honey, the group has developed a market-driven revenue stream to expand and help more people improve their earnings potential.

"I knew we could not depend on government funding," Barber said. "We couldn't depend on private foundation funding. We had to change. We had to come up with an earned income strategy."

> *"I knew we could not depend on government funding. . . . We had to come up with an earned income strategy."*
>
> **Brenda Palms Barber,** Sweet Beginnings

Employees of Sweet Beginnings harvest chemical-free honey. Program participants receive training in beekeeping, food handling, retail sales, inventory and distribution. In addition to table honey, Sweet Beginnings markets a line of honey-based bath and body products under the "beeline" label. (You can order products at *www.beelinestore.com.*)

"We are seeing growth even in a really tough economy," Barber said.

Barber said the organization hires eight to 10 men and women per quarter. They work 90 days and are then assisted in finding a permanent job. The honey is sold at Whole Foods in five Midwestern states. Sweet Beginnings even has an apiary at Chicago's O'Hare Airport.

The nonprofit group said the recidivism rate for former Sweet Beginnings employees is less than 4 percent, compared with the national average of 65 percent.

"We can't just do what we've always done and expect to make headway in repairing the world," Brand said. "Innovation is essential."

A lot of the details for the Innovation Fund haven't been worked out. Nonetheless, Brand said his group would be accepting requests for proposals early next year. The new fund is intended to help both established and start-up charities. Grant winners will also be expected to mentor future fund recipients.

"We want to take an operation and help it grow and mature," he said.

I love the idea of the Innovation Fund and the focus on finding new ways to support human service organizations because these groups have to start thinking about how their programs can be sustainable during economic downturns.

With so many people out of work, the Innovation Fund could create an opportunity for someone to find the financing to pursue a philanthropic dream.

Readers can write to Michelle Singletary c/o The Washington Post, 1150 15th St., N.W., Washington, D.C. 20071. Or e-mail: singletarym@washpost.com. Personal responses may not be possible. Please also note comments or questions may be used in a future column, with the writer's name, unless a specific request to do otherwise is indicated.

"SOME PEOPLE'S LEGACIES ARE WRITTEN ON MONUMENTS... BUT YOURS WILL BE WRITTEN ON LIVES."

CHARITABLE GIFT ANNUITY

Your gift to create a Charitable Gift Annuity can help us continue our mission to serve every day in local communities, quietly meeting the most basic human needs... FOOD, SHELTER, HEAT, and perhaps the most important of all HOPE, while also providing you with many benefits including:

- Secure fixed payment for you and/or a loved one
- A charitable income tax deduction for those who itemize
- Preferential treatment of capital gain
- The satisfaction of knowing you are supporting a worthy organization

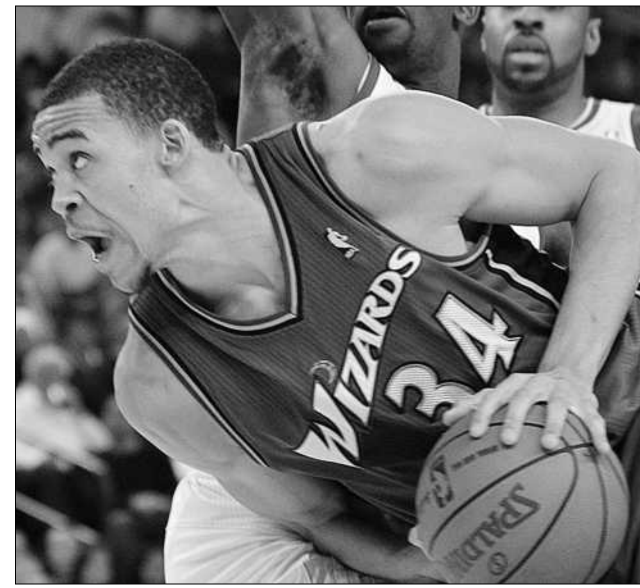
MINIMUM CONTRIBUTION
$5,000

SINGLE LIFE RATES

AGE	65	70	75	80	85	90
RATE	5.3%	5.8%	6.5%	7.5%	8.4%	9.8%

For more info please contact us at 1-800-814-3150

STEVEN PEARLSTEIN



BEN MARGOT/ASSOCIATED PRESS

A decent seat to watch JaVale McGee and the Wizards: $150.

Welcome to the new economic realities, NBA

PEARLSTEIN FROM G1

a game that was as likely as not to be an uninteresting blowout, with play interrupted every five minutes for some nonsensical stunts designed to distract you while the broadcasters were running commercials that made it possible for some superstar to sit on the bench with a knee injury and still earn $150,000 for the game.

In order to maintain the fantasy of never-ending revenue growth, the NBA had to keep adding teams to the league and games to the schedule, diluting the talent on the court and the fan intensity in the stands. It also had the effect of widening the income gaps between the superstars and the journeymen and between teams in big markets and small.

The downturn has only just begun to force the NBA owners and players to confront new realities. The early signs could be seen in the falling attendance numbers, an inability to raise ticket prices and the $300 million loss that the owners, collectively, claim to have suffered last year. You can also see it in the large and growing gap between the face value and sales prices of tickets through online resale sites, and the so-what attitude on the part of fans and the public to the prospect of the season being canceled.

The players, to their credit, have acknowledged the new reality, agreeing to lower their share of revenue from 57 to 50 percent — in effect, a 12 percent across-the-board pay cut sufficient to wipe out the owners' losses. But the owners, who have been unable to agree among themselves on an effective revenue-sharing program to close the yawning gap between the revenues of big- and small-market teams, are demanding that the players solve that problem as well by agreeing to tighter team salary caps and restrictions on free-agent bargaining. These contract changes would further widen the pay gap between superstars and everyone else.

Declining sales, falling wages, teams that are worth less than their owners paid for them, a growing gap between the haves and have-nots — all of this should sound rather familiar. It is exactly what is happening throughout the economy as it adjusts to its own post-bubble reality. Just because the recession is technically over does not mean that the adjustment is complete. There is a lot of momentum and inertia in any system, and one thing we know about economic systems is that wages and prices are much "stickier" on the way down than they are on the way up.

In fact, even four years into the downturn, Americans continue to live well beyond their means, consuming more than they produce and investing more than they save. The best approximation of this gap is the country's trade deficit, broadly defined, which last year was $470 billion, or slightly more than 3 percent of gross domestic product. That's down from the peak of 7 percent of GDP in 2006, but still too high for the world's richest country, reflecting a near-record federal budget deficit, an overvalued currency and a household savings rate that is below what it needs to be over the long term.

Just getting this far in the rebalancing has required high levels of unemployment and stagnant or falling incomes for most Americans even while the rich grow richer. Completing the adjustment will require more of the same for several years to come.

What will it entail? Some wages and prices will have to fall, even as others rise. The exchange value of the dollar will have to drop against Asian currencies, resulting in more expensive imports even as exports rebound. Residential and commercial property values may have to fall further, making them more affordable for some even as current owners and their lenders write off billions of dollars more in losses. In industries still saddled with overcapacity, more companies will close their doors.

And because the economy is complex and interrelated, all of these things will affect all the others in ways that no one can accurately predict, creating winners and losers.

Here's a small example:

Last week's Bloomberg Businessweek had a cover story about the "dirty jobs" that are vacant — cleaning fish, plucking chickens, washing dishes, picking tomatoes — because illegal immigrants have left and even unemployed Americans refuse to do them.

The business community is inclined to think this a supply-side problem — that Americans are spoiled and lazy and protected by an over-generous safety net. But it is equally plausible that, in the post-bubble, post-illegal immigrant era, fish and chicken wholesalers, tomato farmers and restaurants will have to offer better wages, benefits and working conditions to attract the workers they need, even if it means charging higher prices. And if those higher prices mean that people will buy less fish and chicken, and fewer tomatoes and restaurant meals, well . . . that's just part of the free market's natural adjustment process.

Don't get me wrong: Such adjustments can be painful and disruptive and can seem quite unfair, particularly when they require people to give up something they already had, or thought they had.

That is why NBA team owners and players may be willing to cancel the season and give up $4 billion in revenue over remaining issues that, at most, involve the annual distribution of a couple of hundred million dollars.

It is why Europeans can't agree on the modest sacrifices necessary to save the euro and prevent the European economy, along with global financial markets, from collapsing.

And it explains why a partisan stand-off over a $50 billion a year in tax increases in a $15 trillion economy prevents Congress from reaching a long-term budget agreement that everyone knows is necessary to prevent our own calamity.

From the point of view of an Indian rice farmer or a Kenyan goat herder or a Mexican factory worker, we must all look like millionaire team owners and millionaire ballplayers squabbling over how to divide the box-office loot. Something to think about this week of national thanksgiving.

pearlstein@washpost.com