The Blame Game - Who's at Fault in the Mortgage Crisis?

Rita Jones
Columbus State University
Columbus, Georgia USA
jones_rita@ColumbusState.edu

Jason Beard
Columbus State University
Columbus, Georgia USA
JASON.BEARD@oig.usda.gov

Vicky Langston
Columbus State University
Columbus, Georgia USA
langston_vicky@ColumbusState.edu

Abstract

There is a plethora of blame to be shared when the breakdown of the current mortgage crisis is studied. Those that share in this blame include individuals who borrowed money, policy-makers, lenders, regulators, Wall Street, homebuilders, as well as speculators. Everyone must take collective responsibility for their actions and bear the burden of the consequences. Hopefully, this country will work its way back to financial stability, and all will learn from their mistakes.

Introduction

Many economists refer to the current housing crisis in the United States as the worst financial crisis since the Great Depression (Markels, 2008). As many banks and credit institutions begin to fail, Americans are wondering what caused this financial crisis, and who is to blame? What caused the strongest economy in the world to reach the point where the government is forced to pass a $700 billion bailout plan to save some of the biggest financial institutions in the nation? Society has always tended to place blame on one individual, or one entity. The Democrats point to the Republicans, and the homeowners point to the lenders, but in reality, everyone shares a responsibility for the crisis at hand. This paper will discuss the numerous causes of the mortgage crisis while attempting to determine who is truly to blame.

In order to better understand the factors that led to the mortgage crisis, it is important to obtain background information about the housing and credit markets and review the many studies being produced by economists at the U.S. Federal Reserve Board (FED) and elsewhere. The research to date points us in four directions: (1) U.S. consumer and producer behavior with respect to housing; (2) underlying macroeconomic trends; (3) Wall Street securitization practices; and (4) government supported policies and accounting practices in place.

The United States mortgage crisis is often referred to as the subprime mortgage crisis. A subprime mortgage is simply a loan made to someone with a poor credit history or insufficient documentation and insufficient down payment savings. This has typically been a narrow market and has involved a fairly small portion of borrowers. It may seem improbable that such a small percentage of borrowers would have such a huge impact on the housing and credit markets; however, when the macroeconomic forces shifted and increasing numbers of these borrowers were unable or unwilling to pay their mortgage payments, the Wall Street practices, government oversight practices and accounting practices created a major financial shock and the "perfect storm" was the result.

According to the Mortgage Bankers Association and FED, the crisis began in 2005 to 2006; however, the dramatic deterioration was precipitated in 2007 and 2008 when mortgage rates began to rise and default rates jumped from 1.7 percent to 5.2 percent by mid 2008. It has been concentrated in seven states California, Florida Arizona, Nevada, Ohio, Michigan and Indiana, but has spread and weakened the rest of the country. (Mayer et al., 2009)

Real Estate Markets & Affordability

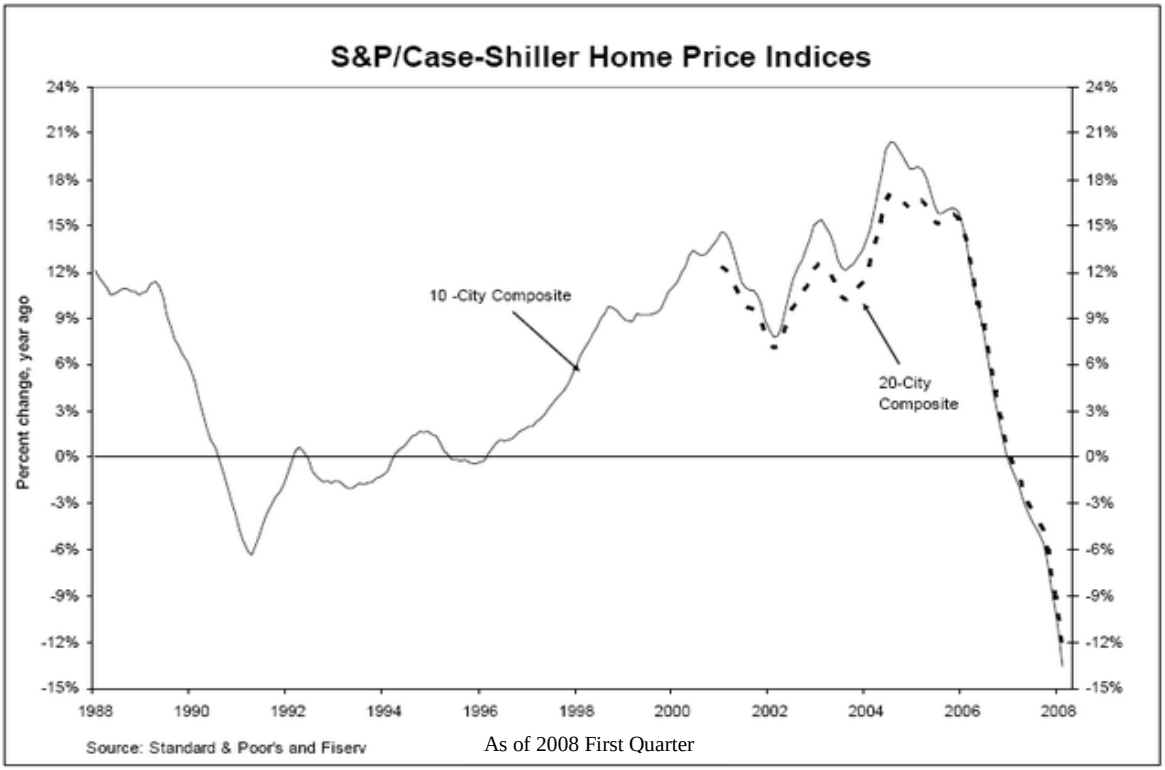
Owning a home is the "American Dream." Even in light of the housing market and financial market collapses, people with bad credit or limited financial resources are still asking when will there be a program to help them buy a house. The beginning of the boom/bust cycle was in the mid 1990s about the same time the U.S. stock market took off. According to FED studies, similar quality inflation-adjusted average home prices increased about 60 percent between 1995 and 2007. Inflation-adjusted after-tax income for typical families, however, increased only 22 percent, and the income of single adults trailed further behind. Despite the fact that 30 year mortgage interest rates dropped from 8 percent to around 6 percent, the inflation-adjusted total cost of owning a relatively new home increased at least 40 percent. By 2007, the average couple was spending just over 30 percent of their after-tax income on housing. While this demand on after-tax income was not high by historic standards experienced in the late 1970s and early 1980s, there was a rapid increase beginning in 2003 which resulted in distorted expectations including the amount of remaining discretionary income, home features and price increases, and family member work requirements (Rappaport, 2008).

Many analysts use the term "bubble" to describe the above-average housing appreciation rate while many economists use the term to describe speculative behavior. Speculation is the purchasing of an asset with the exclusive intent to resell it for a gain (InvestorDictionary.com). When speculation occurs, the demand for the asset becomes inflated for a short time period. This behavior leads to price movements that are detached from the economic principles of supply and demand. The economy cannot possibly sustain such high demand for very long, and eventually the price of the asset decreases. Economist Karl Case describes a "bubble" as:

> "The term bubble is widely used but rarely defined very clearly. We believe that in its widespread use the term refers to a situation in which excessive public expectations for future price increases cause prices to be temporarily elevated. During a housing price bubble, home buyers think that a home that would normally be considered too expensive for them is now an acceptable purchase because they will be compensated by significant further price increases" (Case & Shiller, 2004).

During the peak of the housing boom, house prices were increasing at a very high rate. Over the past 30 years, house prices at the national level have grown at about a 6 percent annual rate. The year-over-year growth in house prices at the national level as of the first quarter of 2005 was 12.5 percent, according to the Office of Federal Housing Enterprise Oversight (OFHEO, 2008). During the bubble, the housing appreciation rate increased significantly. When the bubble burst, the market eventually crashed. Table 1, S&P/Case-Shiller Home Price Indices, clearly depicts the bubble that occurred between 2004 and 2005, followed by the housing collapse from 2006 to 2008.

Table 1: S&P/Case-Shiller Home Price Indices



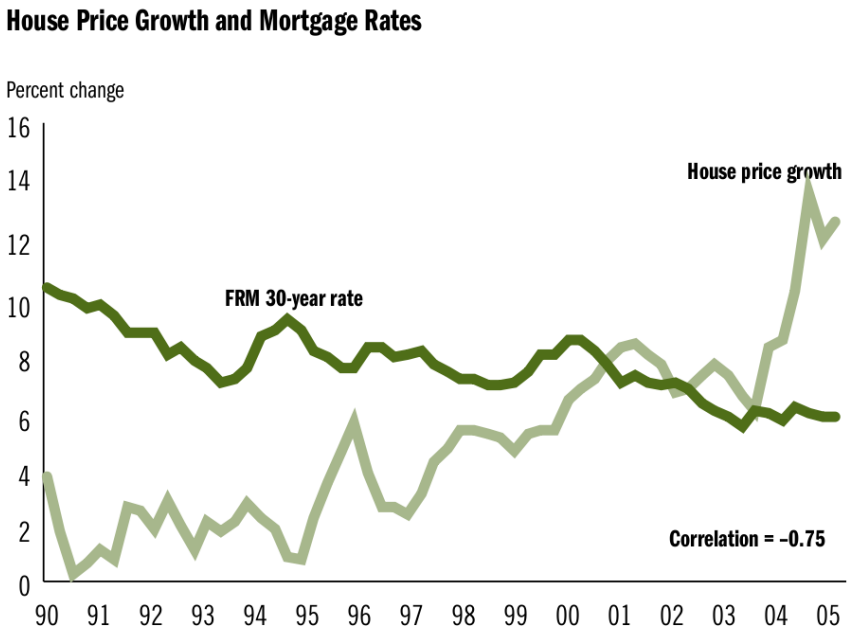
Impact of Interest Rates

The decrease in mortgage interest rates between 2000 and 2005 coupled with house price declines between 2001 and 2003 are key elements that fueled housing affordability expectations that eventually resulted in the mortgage collapse. Over the past 30 years, mortgage rates have decreased significantly. In the 1980s, the interest rate on a 30-year

fixed mortgage reached a high of 18%, and adjustable rates were not much lower prior to the real estate crisis of the mid-1980s.

After September 11th attacks, the interest rates fell as low as 5.25 percent (Zandi 2009). Table 2, House Price Growth and Mortgage Rates, shows that as mortgage rates declined for the 10 years between 1990 and 2000, housing suppliers absorbed much of the savings through housing price increases. After the 2001 recession, the combination of declining housing prices and declining mortgage rates, for a least a few years, resulted in improved housing affordability. As the interest rates on mortgages decreased, many Americans could now afford to buy a home or a more expensive home. The rising demand for housing by American consumers ultimately led to unprecedented house price growth and with stable interest rates and the demand for alternative loans grew. Eventually, this demand phenomenon proved to be unsustainable. Between 2005 and 2006, house appreciation gave way to depreciation. In addition to those who had bought "more house than they could afford", many American homeowners who were relying on house price growth to sustain their standard of living through home equity loan refinancing began to default on their mortgages because they could no longer take out loans on their decreasing home equity.

Table 2: House Price Growth and Mortgage Rates
(Source: Standard and Poor's as of 2005 First Quarter.)



The Modern Adjustable Rate Mortgage (ARM)

One of the most common factors that people associate with the housing crisis is the use of adjustable rate mortgages (ARMs) by lending companies. Adjustable rate mortgages differ from fixed mortgages in that their interest rate adjusts after a specified period of time or other pre-determined market conditions. These types of loans have been in existence since the late 1970s, and were used on a more frequent basis during the 1980s

as inflation and interest rates increased. Policymakers then, and more recently, argue that the use of ARMs offer a major advantage to home buyers. For example, in the early 1980s when rates were their highest, adjustable rates started at 16 percent. As interest rates fell from these highs, buyers benefited.

The adjustable rates are based on short-term market rates, which are usually lower than long-term rates. When inflation and interest rates were high, ARMs appeared to be a reputable alternative to fixed rate mortgages. While this may appear true, the default rate on ARMs has almost always been at least twice as high as the default rate on fixed mortgages (Zandi, 2009).

Lenders took the idea of the ARM and manipulated it to make it riskier. They began to offer ARMs that would include a low initial rate, called a teaser rate, which resulted in lower-than-average payments. These rates would remain low for a year or two, and then would increase substantially for the remaining life of the loan. According to a survey conducted by the FED, approximately one third of all ARM mortgage holders did not understand various features of their loan. This percentage was even higher among the risky subprime mortgage holders. In 2006, 90 percent of subprime loans carried adjustable rates (Zandi, 2009). When these mortgages adjusted to higher rates, many of these subprime mortgage owners were caught in a bind because they could not afford the increased mortgage payments. Out of options, many of these homeowners were forced into foreclosure.

Role of Lenders

Some economists argue that lenders are the main cause of the financial crisis. They argue that the lower standards established by lenders set the housing market up for an unavoidable collapse. With an increase in mortgage-related securities, lenders were more willing to lend to home buyers who would not have qualified for home loans under the former standards. Borrowers with poor credit history could now be approved for a loan. Lenders began to offer “stated income” loans, where the borrowers simply reported their income without any proof or background check. These quickly became known as “liars' loans” because many people explicitly misstated their income. Lenders were also requiring a smaller down payment, or none at all (Zandi, 2009).

The usual down payment-to-loan ratio is 20 percent down to finance 80 percent of the home’s purchase price. Historically, second mortgages of the 20 percent were not allowed. With the creation of piggyback mortgages, the standards were made flexible in 5 percent increments. For example, borrowers with a 15 percent down payment could get a 5 percent piggyback mortgage, those with 10 percent down would have a 10 percent piggyback, those with 5 percent down would have a 15 percent piggyback, and borrowers who put no money down would need the entire 20 percent in a piggyback mortgage (Zandi, 2009).

Many lenders advised borrowers to take out a piggyback mortgage for their down payment. In essence, they would not have to wait and save money for a down payment. In fact, they would pay no costs up front at all. A major advantage of a piggyback

mortgage is that borrowers would be able to avoid the private mortgage insurance (PMI) that is required for loans with down payments less than 20 percent of the purchase price. Another advantage of piggybacks is the interest payments on the piggyback mortgages are considered tax deductible, while the PMI is not (Zandi, 2009). According to Standard & Poor's, by 2004, approximately 66 percent of loans contained a piggyback mortgage.

The piggyback mortgage results in more exposure for loan defaults for the mortgage holder. If the home's value declined, there would be little or no equity and the homeowner would owe more money on the house than it is worth (referred to as negative equity). By March 2008, approximately 10.8 percent (8.8 million) of homeowners had zero or negative equity in their home (Andrews, 2008). Many of these homeowners were motivated to simply "walk away" from the home to avoid the liability. When this happened, lending institutions lost money due to the lack of PMI. Furthermore, as the market collapsed, lenders became reluctant to allow these borrowers to refinance due to the decrease in liquidity in the financial market.

As previously mentioned, in earlier times banks strongly discouraged this sort of lenient lending. However, due to the housing boom, lenders argued that as long as house prices rose, homeowners would gain equity in their home and be able to refinance if they fell into trouble. After all, refinancing produces more income for lenders due to the bulky penalties accumulated from paying the original mortgage off early.

The voice of reason and conservatism was either not present or it was ignored by most. Harsh competition between lenders also motivated lending companies to lower their standards. Due to the abundance of liquidity in the banking system at that time, competition among lenders became very intense. Therefore, if one bank didn't lower its standards to issue loans, they would lose those loans to other banks that were willing to compromise. In other words, the "bad" lenders that were willing to lower their standards had an edge on the "good" lenders that refused to compromise their integrity. In addition, many banks would simply sell the home mortgages to companies such as Fannie Mae and Freddie Mac. This perhaps caused the lenders to care less about the integrity and financial position of their customers.

There has been a flurry of recent FED studies examining lending practices and economic conditions. Haughwout et.al. (2008) used a simulation model of subprime loan early defaults, (that is within the first twelve months) and found that a 10 percent decrease in housing prices would result in a 4.8 percent increase in defaults and a 1 percent increase in unemployment would lead to a .25 percent increase in defaults. They also found that relaxed lending standards played a role, but their model could not explain much of the dramatic changes that unfolded in 2007. Also using a simulation model, Gerardi et. al. (2008), found that the main culprit in the lack of understanding by lenders of the extent of credit risk exposure was primarily house price expectations. The lending simulation model found that had lenders and investors incorporated more downward risk in housing prices, the default scenario that unfolded would not have been a surprise. When lenders eventually adjusted their expectations, those 2005 and 2006 loans made at the height of prices collapsed rapidly at adjustment dates. In 2008, prices of homes continued to

decline until the excessive surplus was eliminated. Mayer et.al. (2009) also conclude in their study that volatile housing prices and faulty price expectations, plus slackened underwriting standards, were the most significant root causes.

Role of the Construction Industry

Like the aggressive lenders, the construction industry also had a significant role to play in the financial crisis. As the housing market began to show signs of decline in 2005, homebuilders' greed started to take over. Homebuilders had accumulated so much capital from the housing bubble that they were able to continue building new homes even though the demand was decreasing. Many of these construction companies argued that the housing market was going to continue to increase due to immigration; however, there were fewer immigrants than expected, partly because of the terrorist attacks on September 11th and partly because of the loss of mobility among homeowners with declining equity. Ferreira et. al. (2008) found that mobility among negative equity homeowners is almost 50 percent lower. Rising interest rates pose another deterrent. The four most problematic states: California, Florida, Nevada and Arizona are states that historically had high immigration and when that migration slowed, and in some cases reversed direction, builders were not prepared.

Speculation by investors also led many homebuilders to build a surplus of homes. Speculation is the purchasing of an asset with the exclusive intent to resell it for a gain. In fact, many speculators in real estate never occupy the homes they purchase. During 2005, 28 percent of homes purchased were for investment purposes (Christie, 2008). Speculation pushed the demand for homes far above the actual demand. This may have deceived some regional/local home builders, which in turn led to overbuilding. This overbuilding led to a surplus in homes, which eventually caused a moderate decline in housing prices beginning around August of 2006. Once housing prices began to decline, homeowners with adjustable rate mortgages found it hard to refinance and began to default on their loans. Investors shortly followed suit. In 2007, the sales volume of new homes dropped by 26.4 percent (Zakaria, 2008). This was mainly due to the increasing foreclosure rates and the unwillingness of homeowners to sell their homes at a loss. Overbuilding was not fully recognized until after the housing bust when speculators were no longer buying homes, but instead were trying to sell.

Macroeconomic Trends

Many of the factors that led to the mortgage crisis took root in the economic bubble, the collapse of the stock market, the recession that occurred in 2001 with September 11th, and the invasion of Iraq in 2003. The FED cut interest rates to an unprecedented low in an effort to minimize the recession impacts and manage worldwide capital flows. Interest rates also fell as the supply of loanable funds rose in response to the volatile stock market. Financials and mortgage securities became a natural haven because historically there had been little loss risk experienced.

As the data in Table 3, Labor Market and Consumer Price Indicators, indicates, the United States unemployment rate continued to rise after the 2001 recession was over and

only slowly recovered by 2006 to almost pre-recession levels. Real wages had held constant through 2004 and inflation had remained under 3 percent. Everything seemed okay. The dollar began to depreciate which should have been positive for exports. However, inflation began to rise, real wages dropped, and by 2007, unemployment started to increase. In addition to this, a new phenomenon was at play--China and United States consumer expectations. Although experts had been preaching globalization trends, and financial services companies were at the forefront in globalizing, they did not fully understand the potential impact on the United States economy.

Table 3: Labor Market and Consumer Price Indicators

Source: Bureau of Labor Statistics 2010

Year	Dec Unemployment Rate	3rd Qtr Earnings	CPI % Change
2000	3.9	---	3.4
2001	5.7	338	2.8
2002	6	337	1.6
2003	5.7	337	2.3
2004	5.4	335	2.7
2005	4.9	331	3.4
2006	4.4	334	3.2
2007	5.0	335	2.8
2008	7.4	331	3.8

China's induction into the World Trade Organization in November, 2001 (CNN News Associated Press, 2001) led to the introduction of many Chinese-made products in the United States. This caused prices to fall initially. The introduction of China to the global market led to major growth in the demand for oil and other common products. Coupled with the declining dollar value, the average cost of oil increased from $20 per barrel to over $145 per barrel from 2000 through 2008 (Zandi, 2009). The rise in demand for these commodities caused a rise in price, which in turn led to an increase in the United States trade deficit. China’s presence in the global market became even more evident when their restrictive trade agreement expired in 2005. This led to an abundance of inexpensive Chinese products that were shipped overseas to the United States. As a result, imports from China increased from $50 billion to $250 billion between 2000 and 2008. China now accounts for approximately one third of the United States trade imbalance (Zandi, 2009).

The rise in the United States trade deficit caused billions of dollars to be transferred overseas to the Middle East, Russia, China, and other European countries. Many of these countries took the new cash flow and invested this money in the United States, mainly in the form of United States Treasury bonds. These bonds were considered safe and liquid investments by many foreigners. Table 4, United States. Treasury Holdings by Foreign Countries, illustrates the rapid increase in United States Treasury holdings by China, the United Kingdom, and Brazil. By 2008, the Chinese owned nearly a tenth of all US Treasury bonds, or approximately $500 billion worth.

Table 4: United States Treasury Holdings by Foreign Countries
Source: U.S. Treasury Department as of January 2008

United States Treasury Holdings by Foreign Countries			
Country	**January 2008**	**December 2006**	**December 2004**
Japan	**587**	**623**	**690**
China	**493**	**397**	**223**
United Kingdom	**160**	**92**	**96**
Brazil	**142**	**52**	**15**

Many of these new investors became greedy as they saw other investments earning well above United States Treasury bonds. Eventually, foreign investors moved their investments away from Treasury bonds to other financial instruments, such as debt issued by former United States agencies such as Fannie Mae and Freddie Mac.

Fannie Mae was created during the Great Depression as part of Roosevelt's New Deal. The housing market collapse during the Great Depression discouraged investors from investing in assets backed by mortgages. Fannie Mae was created to help provide local banks with federal money to finance home mortgages. In 1968, Lyndon B. Johnson privatized Fannie Mae to remove it from the federal budget. Freddie Mac was created in 1970 to prevent further monopolization of the market (Alford, 2003). Many people perceived the debt issued by these agencies to be risk-free, even though the government no longer backed these companies. Much of this debt was backed by United States mortgages, which were considered to contain very little risk. By the peak of the housing boom, international investors owned nearly a third of all United States mortgages. The increase in foreign demand for mortgage-backed securities led to a surplus of funds available for lending, which increased liquidity and set the stage for the upcoming crisis (Zandi, 2009). The internationalization of United States debt makes the sector more sensitive to fluctuations in the value of the dollar.

Wall Street & Securitization Practices

The complex financial system created by Wall Street played a major role in the collapse of the housing market. Securitized bonds were invented by Wall Street and greatly compromised the inventor's integrity. Securitized bonds are bonds that are backed by many cash-flow producing assets (InvestorDictionary.com). These assets are bundled together and transformed into securities that can be sold to investors. These securities were invented in the 1970s, and they created many new opportunities for investors and borrowers. Banks no longer had to possess the capital necessary to lend to borrowers; the funds were simply backed by investors across the globe. This led to an abundance of liquidity in the financial markets. Banks now had more money than ever to lend to potential homeowners (Zandi, 2009).

Residential Mortgage-Backed Securities (RMBS)

Securitization became even more confusing when Wall Street decided to split up securities based on the different levels of risk. Different investments were combined into consolidated pools for investment purposes. The interest and principle payments on these investments are paid to investors in a certain order. Investors who take less risk receive payments first. Those who are willing to take more risk receive payments last, but may earn a higher return. Many of the securitized investments contained a significant portion of mortgage-backed assets.

Securities that are backed by mortgages are referred to as residential mortgage-backed securities (RMBS). Many of these RMBS included the risky subprime mortgages. In fact, the amount of securitized subprime mortgages increased from 54 percent to 75 percent between 2001 and 2006 (Demyanyk, 2008). The mortgage-backed securitized investments realized a major decrease in demand once the subprime mortgage homeowners began to default on their loans.

Securitization ultimately led to a decrease in responsibility. No one had a direct link to a certain loan or security. Bad mortgages had been concealed by combining them with other securities. It seems that everyone relied on someone else to preserve the integrity of Wall Street. Stanley Milgram describes this dilemma effectively, “It is easy to ignore responsibility when one is only an intermediate link in a chain of action” (Thinkexist.com). However, in reality, no one accepted this responsibility. There was always a belief that someone else would step in and make sure that the financial system was working properly.

Structured Investment Vehicles (SIVs)

Structured investment vehicles (SIVs), another invention of Wall Street, also played a major role in the financial market. SIVs are funds that borrow money by issuing short-term debt securities at low interest rates. They then lend that money through the purchase of long-term debt securities at a higher interest rate, and the profit is pocketed by the investors. These investments eventually pose a problem because they can be structured in such a way that they avoid placement on the bank's balance sheet. Therefore, the banks could avoid maintaining the capital that was required to protect against the risk of the SIV. When the housing market collapsed, the demand for SIVs plummeted due to the fact that they contained subprime mortgage-backed securities. Banks were stuck with these failing investments as investors and money markets no longer desired them. This led to a major decline in liquidity that ultimately contributed to the failure of many banks (Zandi, 2009).

As Coval et. al. (2009) point out, structured finance has two flaws, (1) errors in estimating risk are amplified and highly sensitive to forecast errors, and (2) the securitization process exposes investors to systematic risk rather than diversified risk. The economic downturn that few thought possible saw triple A become “junk.” Coval et. al. (2009) suggest that the structured market may be permanently damaged.

Ashcraft and Schuermann (2008) examined the securitization of subprime mortgage credit and found five problem areas: (1) Predatory lending related to complex products, (2) Principal-agent problems with asset managers seeking extraordinary yield, (3) adverse selection due to asymmetric information between consolidator and asset managers, (4) Predatory practices between brokers and lending institutions, (5) Significant errors in credit ratings. They suggest some remedial measures including better legal and regulatory oversight regarding lending practices, reduction in asymmetric information, more due diligence by asset managers, changes in rating agency processes and incentives, increased peer review/benchmark information by asset managers, arrangers or originators maintain unhedged equity tranche exposure and have adequate capital for warranties.

Role of Policymakers, Regulators & Accounting Practices

As suggested by the information and recommendations above, policymakers and regulators had a role to play in the housing collapse. Washington has always considered the percentage rate of homeowners in the United States a key factor in determining economic success. Policymakers began to focus on home ownership in the 1970's, when they passed the Community Reinvestment Act. This act offered banks incentives to encourage lending in underprivileged communities that were traditionally refused loans. During the Clinton administration, the Community Reinvestment Act was reformed to not only encourage, but to require banks to target underprivileged areas. President Bush took over where Clinton left off with the enactment of the American Dream Down-payment Act. This act supplied money to low-income Americans to help alleviate the costs of down payments and closing costs on first homes (Zandi, 2009).

Many politicians in Congress were concerned about the use of predatory lending in the housing market. Predatory lending is defined as a loan made without regard to the borrowers' ability to make timely payments (Zandi, 2009). In 2005, legislators attempted to pass anti-predatory laws; however, this legislation was quickly shot down. Many people believe that a conflict of interest existed between the legislators and the American citizens they represent. Large mortgage companies, such as Fannie Mae and Freddie Mac, had an influence over the government. These two companies became very successful, in part, because of the government's involvement. Fannie Mae and Freddie Mac contributed an extensive amount of money to politicians and policymakers. In April of 2006, Freddie Mac was fined $3.8 million as a result of illegal campaign contributions (MSNBC Associated Press 2006). Fannie and Freddie wanted fewer restrictions and regulations by the government. Many people believe that this affected many politicians in their decision not to pass legislation.

Many economists and political analysts believe that the FED is the main culprit in the financial crisis. Alan Greenspan, former Chairman, argued that it was not the government's job to second-guess investors. He believes that the government was responsible to step in only after the bubble bursts, because spotting a bubble in advance would require telling millions of informed investors that they have it all wrong. Greenspan described the housing market in a speech he presented in 2003:

> "It is, of course, possible for home prices to fall as they did in a couple of quarters in 1990. But any analogy to stock market pricing behavior and bubbles is a rather large stretch. First, to sell a home, one almost invariably must move out and in the process confront the substantial transaction costs in the form of brokerage fees and taxes. These transaction costs greatly discourage the type of buying and selling frenzy that often characterizes bubbles in financial markets. Second, there is no national housing market in the United States. Local conditions dominate, even though mortgage interest rates are similar throughout the country. Home prices in Portland, Maine, do not arbitrage those in Portland, Oregon. Thus, any bubbles that might emerge would tend to be local, not national, in scope."

Greenspan believed that the time and cost associated with buying and selling a house was high enough to deter speculation. This theory proved to be wrong, as many speculators shortly began to flip houses for a quick profit and numerous TV shows enticed naïve speculators.

Between 2001 and 2003, Greenspan and the FED lowered the lending rate for banks from 6.5 percent to 1 percent (Zandi, 2009). He argued that reducing the interest rate would help bring the country out of the financial shock that was caused by the bubble in the NASDAQ tech-stocks. Greenspan's idea that the government should, and would, take action if a market experienced a meltdown, quickly became known as "the Greenspan put, "which in the options market, is as a security that gives the investor the right to sell a stock at a preset price (InvestorDictionary.com). This acts as a hedge and protects the owner against future drops in the market. Greenspan's promise to help out markets in distress gave Wall Street reassurance, which enticed them to be more aggressive in lending, and ultimately, this helped contribute to the mortgage crisis.

By 2007, the FED faced a credit contraction that threatened a deep recession and further collapse of the housing market specifically. The FED began modifying its tools to improve liquidity in fall 2007. Nevertheless, the flight to quality and interbank market problems continued to challenge the FED's capacity to manage the rapid erosion of liquidity. According to Cecchetti (2009), the FED did what it could. As with the Great Depression, economists will analyze these events and recommendations will be debated.

Lastly, the accounting practices of mark-to-market, known as FASB 157, also had a role to play in the creation of billions in paper assets and just as quickly destroying the value of relatively illiquid assets and bank balance sheets creating a boom bust cycle (Sloan, 2008; Dumortier, 2008). In addition, other normal accounting practices had been overruled by the FED (Sloan, 2008). In this regard, FASB Chairman, Robert Herz, reported on guidance and projects to improve reporting practices.

Summary & Conclusion

After analyzing the numerous causes behind the mortgage crisis, it is impossible to place the blame solely on one individual or entity. While the consequences of the actions of all parties involved are still developing, those that deserve the most blame may eventually

become more evident. However, for the time being, it appears that policymakers, lenders, regulators, Wall Street, homebuilders, speculators, and American consumers are all at fault. Everyone must somehow take collective responsibility for the actions taken and accept the consequences of their decisions. This financial crisis may be the worst since the Great Depression, but the United States is taking steps to recover. This country needs to establish a credible financial system that holds each individual and each company accountable for their financial actions and keeps the interests of Americans above all else. It will be a long and vigorous journey, but hopefully the United States will work its way back to financial stability, and all will learn from their mistakes.

References

Alford, Rob. 8 Dec. (2003). What are the origins of Freddie Mac and Fannie Mae? http://hnn.us/articles/1849.html (accessed Dec 4, 2008).

Andrews, Edmund L. (22 February 2008). Rescues for homeowners in debt weighed. http://www.nytimes.com/2008/02/22/business/22homes.html?_r=1&oref=slogin (accessed October 2nd, 2008).

Ashcraft, Adam B. & Schuermann, Til. (March 2008). Understanding the securitization of subprime mortgage credit. *Federal Reserve Bank of New York. Staff Report No. 318.*

Case, Karl E., & Shiller, Robert J. (2004). *Is there a bubble in the housing market?* Connecticut: Yale University. http://www.econ.yale.edu/~shiller/pubs/p1089.pdf (accessed September 28, 2008).

Cecchetti, Stephen G. (Winter 2009). Crisis and responses: The Federal Reserve in the early stages of the financial crisis. *Journal of Economic Perspectives*. 23:1, 51-75.

Christie, Les. (30 April 2008). Homes: Big drop in speculation. http://money.cnn.com/2007/04/30/real_estate/speculators_fleeing_housing_markets/index.htm (accessed September 20th, 2008).

CNN News Associated Press. (11 November 2001). China officially joins WTO. http://archives.cnn.com/2001/WORLD/asiapcf/central/11/10/china.WTO/index.html (accessed September 20th, 2008).

Coval, J., Jurek, J. & Stafford, E. (Winter 2009). The economics of structured finance. *Journal of Economic Perspectives*. 23:1, 3-25.

Demyanyk, Yuliya & Van Hemert, Otto. (19 August 2008). Understanding the subprime mortgage crisis. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020396 (accessed October 2nd, 2008).

Dumortier, Alex. (2008). Mark-to-market accounting: What you should know. http:/www.fool.com/investing/dividends-income/2008/10/02/…

Ferreira, F., Gyourklo, J. & Tracy, J. (October 2008). Housing busts and household mobility. *Federal Reserve Bank of New York. Staff Report No. 350.*

Financial Accounting Standards Board. (12 March 2009). FASB Chairman Robert H. Herz testifies on mark-to-market accounting. News Release. www.fasb.org/news/nr31209.shtml

Gerardi, K., Lehnert, S. A., Shane M. S. & Willen, P. S. (December 2008). Making sense of the subprime crisis. *Federal Reserve Bank of Boston. Public Policy Discussion Papers No. 09-01.*

Greenspan, Alan. (4 March 2003). Home mortgage market (speech presented at the annual convention of the Community Bankers of America,). http://federalreserve.gov/boarddocs/speeches/2002/20021219/default.htm

Haughwout, A., Peach, R. & Tracy, J. (August 2008). Juvenile delinquent mortgages: Bad credit or bad economy? *Federal Reserve Bank of New York. Staff Report No. 341*.

InvestorDictionary.com "put, speculation," http://www.investordictionary.com/ (accessed October 12, 2008)

Markels, Alex. (12 October 2008). Comparing today's housing crisis with the 1930s." February 28, 2008. http://www.usnews.com/articles/business/real-estate/2008/02/28/comparing-todays-housing-crisis-with-the-1930s.html (accessed Oct. 12, 2008)

Mayer, Christopher, Pence K. & Sherlund, Shane M. (Winter 2009). The rise in mortgage defaults. *Journal of Economic Perspectives*. 23:1, 27-50.

MSNBC Associated Press. (April 18, 2006). Freddie Mac pays record $3.8 million fine. http://www.msnbc.msn.com/id/12373488/from/RSS/ (accessed October 8th, 2008).

Office of Federal Housing Enterprise Oversight (OFHEO). (12 October 2008). House prices index quarterly data. http://www.ofheo.gov/hpi_download.aspx (accessed October 12, 2008)

Rappaport, Jordan. (Fourth Quarter 2008). The affordability of homeownership to middle-income americans. *Federal Reserve Bank of Kansas City Economic Review Fourth Quarter 2008* pp. 65-95. http://www.KansasCityFed.org.

Sloan, Allan. (28 October 2008). Don't blame mark-to-market accounting. *The Washington Post*. DO2. http:www.washington post.com/wp-dyn/content/article/2008/10/27/2008.

Thinkexist.com. (12 October 2008). Stanley Milgram quotes. http://thinkexist.com/quotes/stanley_milgram/ (accessed October 12, 2008)

Zakaria, Fareed. (11 October 2008). There is a silver lining. http://www.newsweek.com/id/163449 (accessed October 12th, 2008).

Zandi, Mark M. (2009). *Financial Shock: a 360° look at the subprime mortgage implosion*. Upper Saddle River: Pearson Education.

Biographies

Rita C. Jones is an Associate Professor of Accounting at Columbus State University in Columbus, GA. She received her doctorate in Accounting from Mississippi State University in 1994. Jones' research interests include ethics, healthcare accounting, and pedagogy, and she has published in the *Journal of Business, Industry and Economics; Journal of Business and Leadership: Research, Practice and Teaching; Journal of Advances in Business Research, and Decision Sciences Journal of Education*, among others.

Jason Beard graduated from Columbus State University in 2008 with a Bachelor of Business Administration in Accounting. He currently resides in Atlanta, where he works for the USDA Office of Inspector General as an Auditor. While working full time, he is pursuing his Masters of Accountancy from Auburn University and studying for the CPA exam. When he is not working, Jason enjoys playing drums on the Atlanta Falcon's Drumline, reading, and spending time with his wife.

Vicky C. Langston is Chair of the Department of Accounting and Finance and Associate Professor of Economics in the Turner College of Business and Computer Science at Columbus State University. Vicky earned her Ph.D. in Economics from the University of Texan at Austin. Prior to CSU, she held the Chair of Free Enterprise at Austin Peay State University from 1997-2003 and was the Chief Economist at the Lower Colorado River Authority from 1985-1996. In addition, she has served on Boards including the Board of Trustees of the LCRA Retirement Plan, the Board of the LCRA Credit Union and the Texas Public Employees Retirement Systems (TEXPERS). Her current research focus is on regional economies and labor markets.