This book could be read as yet another defence of pluralism and multiculturalism. However, such an interpretation would miss the strength of the book’s argument and its refreshingly pragmatic force. A plurality of beliefs is not put forward as a good in itself. Rather it is the stepping stone that connects religious freedoms to a reduction in persecution and religious conflict. Their argument is that where there is freedom of ideas, beliefs flourish and multiply, producing a diverse spectrum of groups (p. 71 and elsewhere). In such a context, no group has the numbers or influence to either dictate to government or pose a political or cultural threat that might justify persecution or conflict between groups.

Grim and Finke point out that the cycle of religious oppression is self-perpetuating. Once freedoms are denied, conflict ensues, which is then used to justify further regulations and limits on freedom. How can a state reduce the persecution of religious minorities when it views them as a cause of conflict or as a genuine threat to the state and its people? The solution is easier said than done. Granting religious freedom to religious minorities is the last thing a state would consider. Counterintuitive though it might be, this is the logical implication of the book.

At this point, the book could have benefited from some discussion of the role and impact of plural secularism in many of those ‘Christian-majority’ countries it refers to throughout. Authors such as Charles Taylor and Peter Berger, in discussing this, have pointed out that is it not always the win/win for religion and the state that is suggested here. However, this would go beyond what is being attempted.

That being said, The Price of Freedom Denied is a valuable contribution to the current debates about religion and the state. Its factual foundations are refreshing in an arena often dominated by polemic and opinion. However, this is a debate that, in many places, is yet to be had. The authors put forward a strong case for the connection between religious freedom and reduced persecution and violent conflict. But, as always, freedom is ‘inconvenient and fragile’ (p. 213).

Reviewed by John Shellard

Guaranteed to Fail: Fannie Mae, Freddie Mac, and the Debacle of Mortgage Finance
By Viral V. Acharya, Matthew Richardson, Stijn Van Nieuwerburgh, and Lawrence J. White
Princeton University Press, 2011
US$24.95, 232 pages
ISBN 9780691150789

The global financial crisis has occasioned a vast literature purporting to analyse the causes and consequences of the crisis. The crisis literature ranges from morality play narratives, insider accounts, and melodramas to wise-after-the-fact analysis. Yet most of this literature, like many of the policy responses to the crisis, has been beside the point.

A new book, Guaranteed to Fail: Fannie Mae, Freddie Mac, and the Debacle of Mortgage Finance, stands out among all the others. Written by economists Viral V. Acharya, Matthew Richardson, Stijn Van Nieuwerburgh, and Lawrence J. White, it is one of the very few books to focus squarely on the ultimate cause of the crisis: US government housing policy and the role of the two government-backed mortgage giants Freddie Mac and Fannie Mae in giving effect to that policy.

It has become common practice to date the crisis from 15 September 2008 when Lehman Brothers was allowed to fail. Yet the failure of Lehman Brothers was a trivial event compared to a much bigger but largely ignored failure that took place one week before, when Freddie and Fannie were put into ‘conservatorship’ by the US government. The failure of the two government-sponsored enterprises (GSEs) was far more serious than any other financial failure during the crisis.

While the two GSEs have a long history, their role in US housing finance changed dramatically from 1992, when they were given ‘affordable housing’ mandates by the US government. These were explicitly designed to extend credit to those least able to finance a mortgage. An alphabet soup of government programs and agencies were active participants in this overall mandate, but it was Freddie and Fannie that ultimately financed it. While private financial institutions participated in the growth of high-risk mortgage lending, it was Freddie and Fannie that led the race to the bottom.
in mortgage quality. The biggest predatory lender in the United States was the government itself. By 2007, the GSEs had an 87% market share in high-risk mortgage lending and accounted for more systemic risk in the financial system than any other institution through the highly leveraged, undercapitalised expansion of their balance sheets. They would ultimately own or guarantee around two-thirds of the bad mortgages in the US financial system.

The authors note that ‘AIG’s CDS (credit default swap) positions were peanuts in comparison to the GSE’s writing $3.5 trillion worth of credit guarantees on much riskier assets.’ By 2009, the value of the GSEs debts and GSE-backed securities was a staggering $8.1 trillion, constituting one the world’s largest fixed-income markets. By comparison, the US government at that time owed $7.8 trillion and all non-financial companies $7.1 trillion. The two GSEs were ‘magnitudes bigger than the largest hedge fund’ and were 20% as large as the entire hedge fund industry. Because these liabilities were implicitly backed by the US government, they were widely held throughout the United States and international financial system. Among the largest holders of GSE debt were China and Japan, providing the channel through which financial market repression in those countries fed the US housing boom. The so-called ‘global saving glut’ and ‘global imbalances’ would have far more benign implications for the global economy, were it not for the role of the GSEs in misallocating global capital flows.

It was thus two US government-backed entities, and not private financial institutions, that ultimately posed the single biggest threat to the global financial system. Defaulting on their obligations would have led to a financial ‘end of days.’ The conservatorship arrangements are an accounting fiddle designed to maintain the fiction that the GSE’s massive liabilities are not part of the US government’s balance sheet. US taxpayers are ultimately liable for the default risk on all $8.1 trillion. The Federal Reserve’s subsequent purchases of GSE debt single-handedly doubled the size of the central bank’s balance sheet. The GSEs have a blank cheque from the US government to make up their considerable losses. According to the Congressional Budget Office, these losses are likely to amount to $389 billion, more than all of the bailouts of private financial institutions combined.

While private sector institutions were engaged in sub-prime lending, it was the predatory behaviour of the GSEs that drove the race to the bottom in mortgage quality. Other countries also had house price booms and busts and subsequent recessions, but few experienced mortgage defaults on anything like the scale of the United States. As the authors note, ‘the United States has more programs subsidising home ownership than any other developed country, yet (and arguably, therefore) its housing bust was worse than almost anywhere else.’ It was exposure to US sub-prime mortgages that brought down financial institutions around the world, such as the UK’s Northern Rock.

Even without the financial crisis, the GSEs were a public policy failure. Homeownership rates in the United States before the crisis were not significantly higher than in other countries and have since fallen dramatically. The size of the GSE’s portfolios had little effect on the liquidity of secondary mortgage markets. The benefits of the implicit government guarantee were captured by the GSE’s shareholders as higher profits rather than passed on to home borrowers in the form of lower interest rates. What was already a domestic policy failure became an international financial catastrophe.

Why does the conventional crisis narrative differ so fundamentally from the one portrayed in Guaranteed to Fail? The conventional narrative is an attempt to divert attention from and cover-up the culpability of the US government, particularly Congress, but also other public institutions. As the authors note, the crisis ‘reflects a deep failure of a society’s ability to govern its own governments that in turn is generally a sign of poor quality of institutions.’ The comparison the authors go on to make with emerging market economies is one that few Americans, let alone the rest of the world, want to
contemplate. The conventional narrative of greedy bankers and failed markets is much easier to live with, but only because it is so far from removed from the reality of massive government failure.

Only a handful of people are on the public record before the crisis broke as having warned that the GSEs were a disaster waiting to happen. One was Alan Greenspan. The defamation and vilification of Greenspan in the wake of the crisis is part of the conventional narrative's cover-up. The authors reference the growing body of research highlighting the irrelevance of the US Federal funds rate for house prices and US mortgage interest rates.

The financial crisis was not, as some have tried to argue, a monetary phenomenon. Another is Peter Wallison of the American Enterprise Institute, who publicly raised the alarm on the GSE’s race to the bottom as early as 1999 and continues to argue for GSE reform.

The authors conclude, ‘nothing short of bringing the shutter down on Fannie and Freddie in the long-run will suffice.’ Yet ‘Fannie and Freddie barely register as news. In the most sweeping financial legislation since the 1930s, the Dodd-Frank Act of 2010 barely mentions them.’ Incredibly, the Australian government (with the full support of the federal opposition) has adopted a similar approach, having poured $20 billion in subsidies into mortgage securitisation markets since the crisis began, with no measurable benefit to home borrowers in the form of lower interest rates. As the authors conclude, ‘Ultimately, any policy that is not aimed directly at promoting economic growth by and large makes things worse. Government support of housing markets and institutions is a case in point.’

Reviewed by
Stephen Kirchner

---

WILL CHINA ECLIPSE AMERICA?

STRATEGY & ECONOMICS IN THE ASIAN CENTURY

A business lunch address by
Dr Paul Wolfowitz

Dr Paul Wolfowitz will discuss the geopolitical roles of America and China in the global order, and more specifically, the hard questions of whether China still needs America and whether the Dragon has the capacity to overshadow the economic and strategic might of Uncle Sam.

Dr Wolfowitz has spent more than three decades in public service and higher education. Most recently, he served as President of the World Bank and US Deputy Secretary of Defence. As ambassador to Indonesia, Dr Wolfowitz became known for his advocacy of economic reform and political openness and for his interest in development issues, which dates back to his doctoral dissertation on water desalination in the Middle East. He is currently a visiting scholar at the American Enterprise Institute.

Tuesday, 2 August 2011

The Westin Hotel, 1 Martin Place, Sydney
Noon–2pm

CIS Member – $165 inc. GST
CIS Corporate Member Table of 10 – $1,650 inc. GST
Non-Member – $175 inc. GST
Non-member Table of 10 – $1,750 inc. GST

Reservations essential at www.cis.org.au/events or by calling (02) 9438 4377.
For event and media enquiries please email CIS Events Manager, Meegan Cornforth, at mcornforth@cis.org.au.