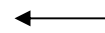


# THE POLITICAL ECONOMY OF CHOOSING WINNERS & LOSERS

“Everybody wins if we can increase minority homeownership, so together we’re taking on the challenge of getting more people into homes.”



ANGELO MOZILO  
Chairman and CEO  
COUNTRYWIDE FINANCIAL CORPORATION



## Origins of the Crisis: Subprime Redistribution

As Mozilo notes, “You can’t quantify the emotional impact of homeownership in people’s lives.” So as long as there is a gap in minority and non-minority homeownership rates, Fannie Mae and Countrywide will continue to make sure all Americans have the chance to realize the dream of homeownership.

FNM annual report, 2003  
pp. 16-17

# Can the political class ever get it right?



President Clinton signed the Gramm-Leach-Bliley Act in November 1999. Senator Gramm, second from left, proudly declared it “a deregulatory bill,” and added, “We have learned government is not the answer.”

Howard Rosenthal, Columbia Conference, 12/11/2008

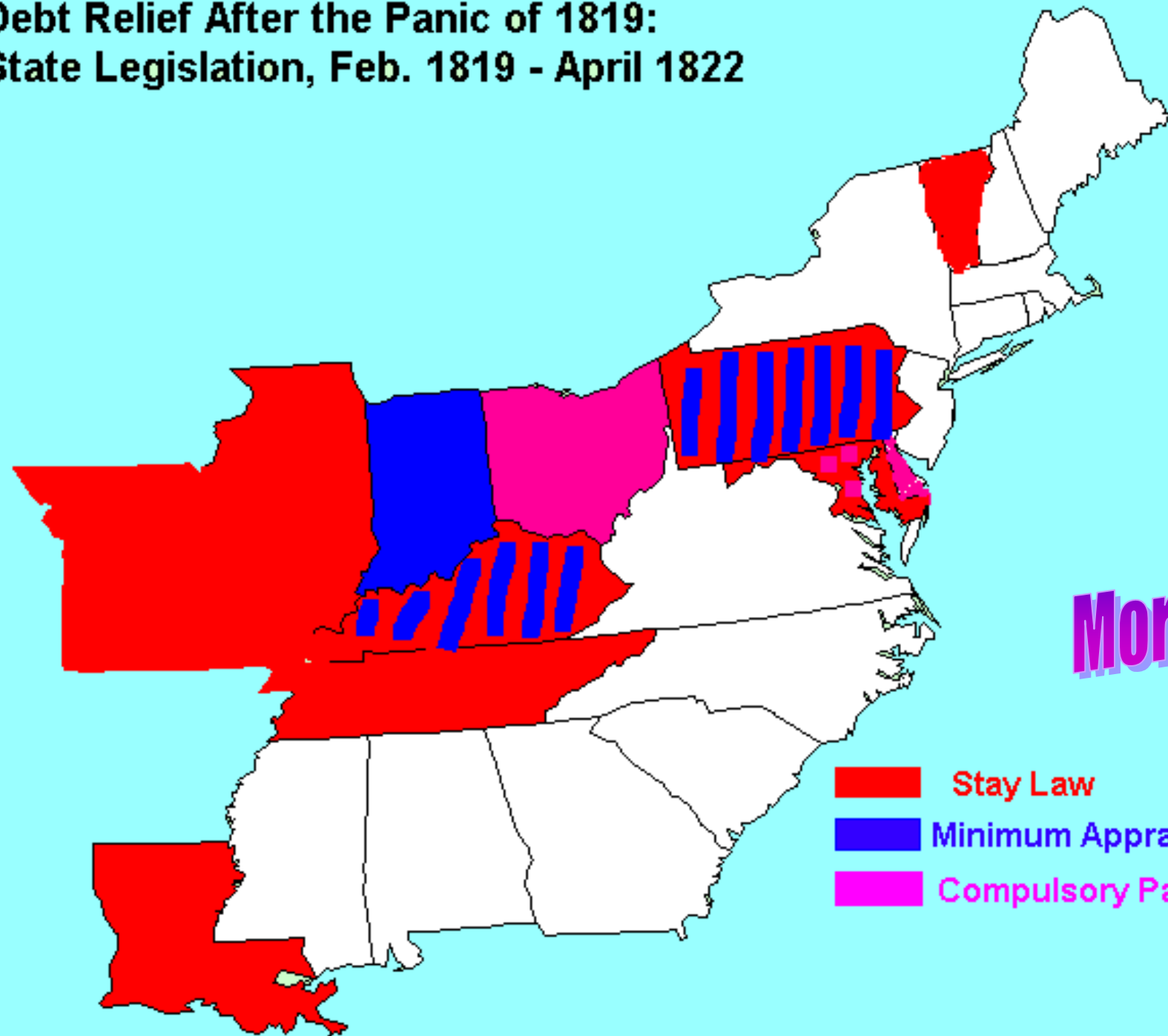
# Who wins from government intervention in debt crises and the politics of intervention?

- Theory (Bolton & Rosenthal, *JPE*, 2002):
  - ▣ Debtors win in severe “depressions”.
  - ▣ Politics (referendum, congressional voting) “certifies” a “depression”.
  - ▣ Rules for intervention exist that leave creditors, as well as debtors, ex ante better off. [Partial repayment better than default.]
  - ▣ Moral hazard no big deal. Allowing for intervention does not cause the permanent collapse of credit markets.




# Example: The Panic of 1819

- Debtors get relief by state moratoria legislation.
- Federal government takes a haircut on loans for purchases of federal lands.
  - ▣ Either defer repayment or repay immediately with a 37.5% discount. (Mayer-Hubbard proposal for 4.5% refinances.)
- Tension in Congress between debtor regions and creditor regions.

# Debt Relief After the Panic of 1819: State Legislation, Feb. 1819 - April 1822



**Moratoria**

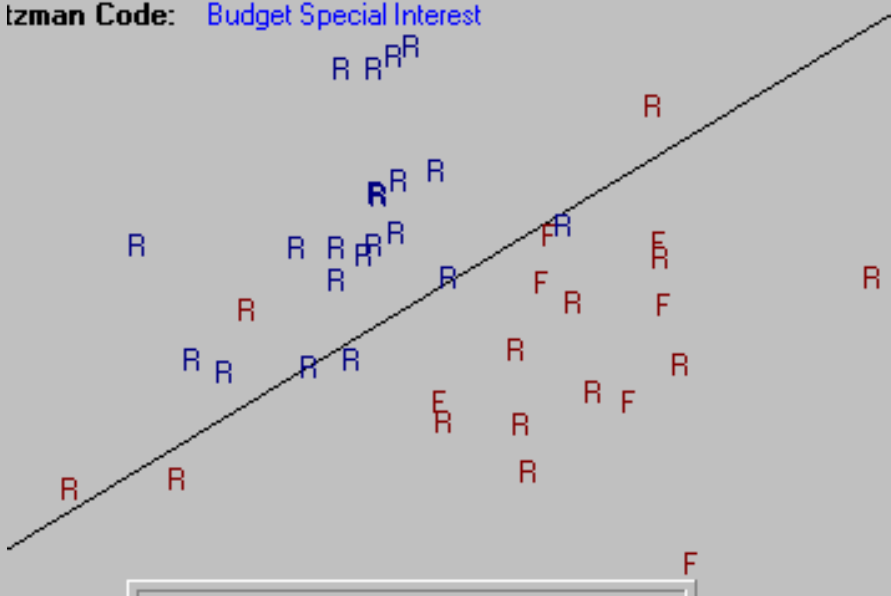
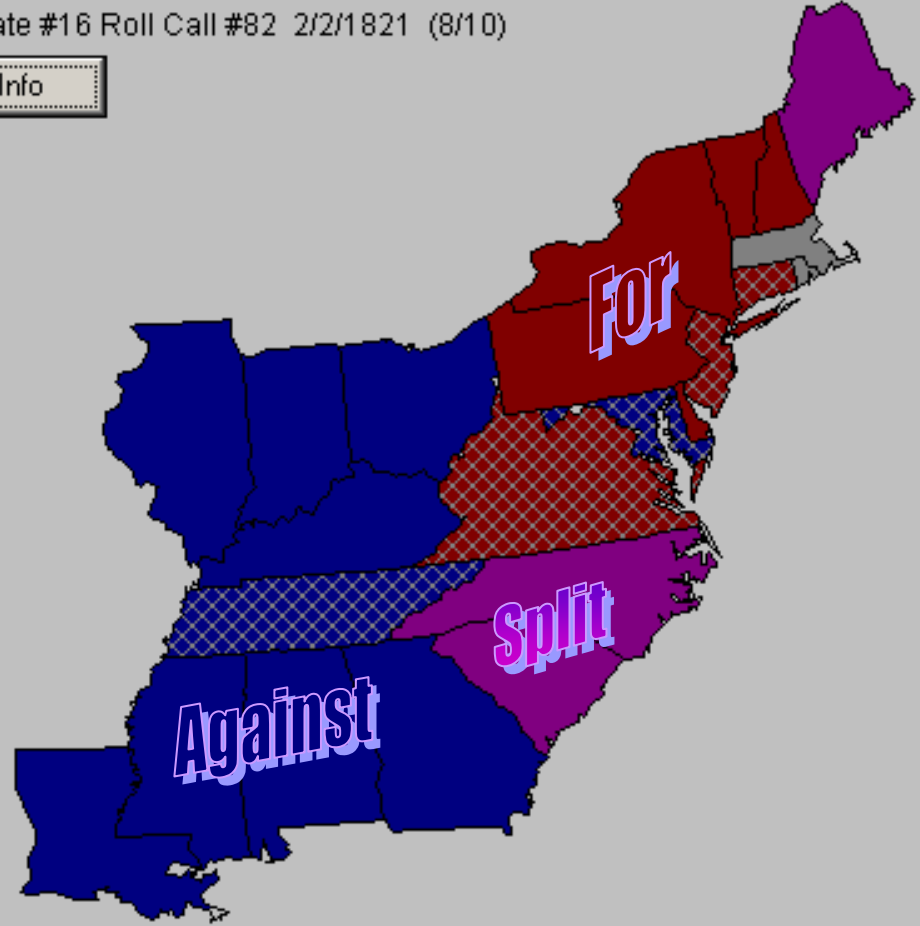
-  Stay Law
-  Minimum Appraisal
-  Compulsory Par

Info

RELIEVE PURCHASERS OF PUBLIC LANDS

Senate #16 Roll Call #82 2/2/1821 (8/10)

Issue Code: N/A  
ausen Code: Government Management  
izman Code: Budget Special Interest



Yea:	20
Nay:	21
N/A:	12
Errors:	6
P.R.E.:	.7

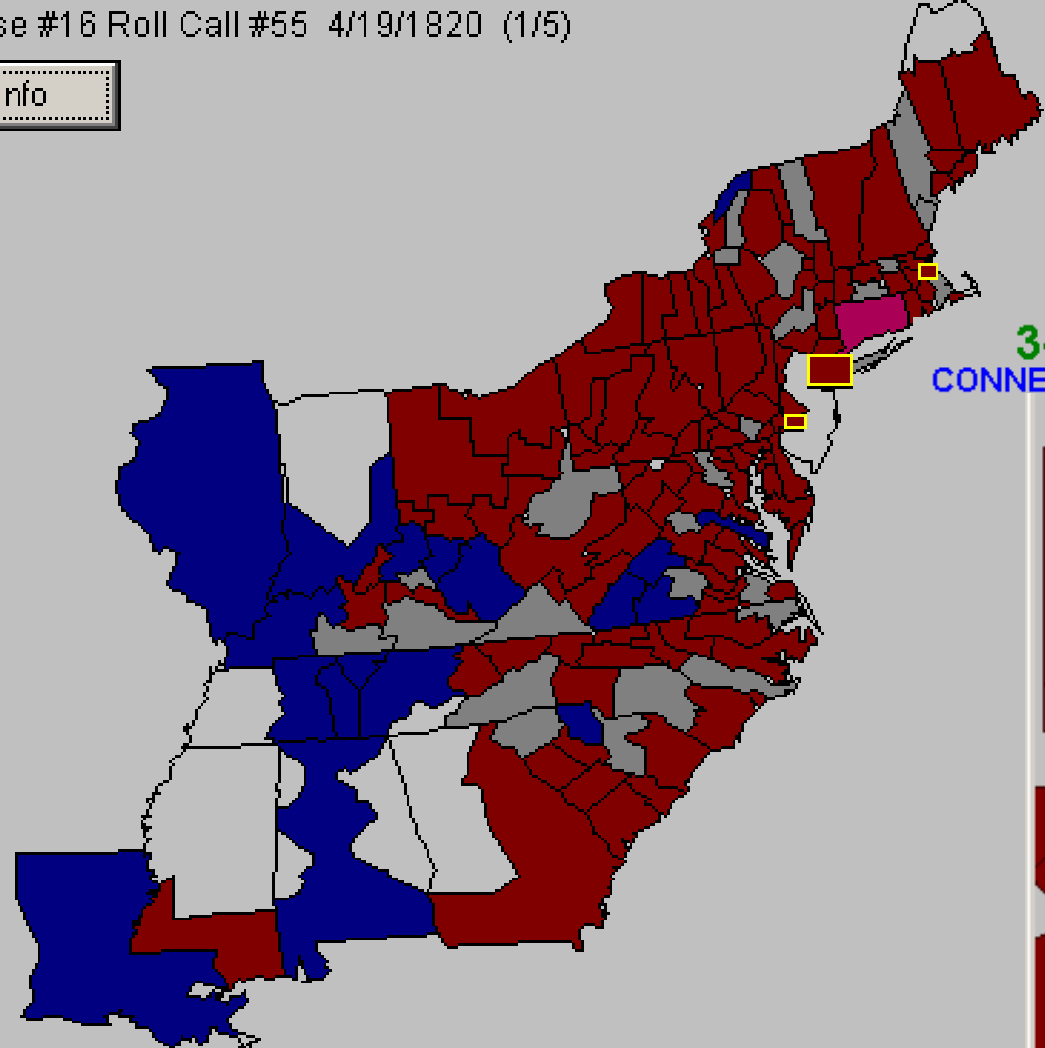
A-37- -263 J 16-2-164 S S162011

**LOWRIE, PA.**

TO AMEND S. 16 (3 STAT. 612, 3/2/1821), A BILL TO RELIEVE THE PURCHASERS OF PUBLIC LANDS PRIOR TO 7/1/1820, BY REDUCING THE DISCOUNT TO BE ALLOWED FOR PROMPT PAYMENT FROM 37 1/2% TO 25% ON PUBLIC LANDS. (P.263)

Shown

Info



3-1  
CONNECTICUT



Roll Call Information

Year: 135  
 Nay: 19  
 N/A: 48  
 Errors: 18  
 P.R.E.: .053

Details

A 36- -1896    J 16-1-431    S18    H161055

ANDERSON JR., KY.

TO CONCUR IN THE REFUSAL OF THE COMMITTEE OF THE WHOLE TO ELIMINATE THOSE SECTIONS OF S. 18 (APP. 402401820), A BILL PROVIDING FOR THE SALE OF PUBLIC LANDS, WHICH REQUIRE CASH PAYMENT FOR LAND PURCHASES



# Concession to the Wicked Witch of the East

- **Federal gov't. no longer sells land on credit.**
  - ▣ Bye bye to the Fannie, FHA, etc. of the 19<sup>th</sup> century.
- This restriction on government credit removed the moral hazard problem.
- Did it facilitate development and growth?
  - ▣ Settlement of the frontier decelerates after the Panic of 1819.
  - ▣ After Maine (1820), Missouri (1821) no new states admitted until Arkansas (1836), Michigan (1837).
    - 1830 pop. Arkansas 30,388, Michigan 31,639
    - 60,000 requirement for statehood.

# But do just debtors win or does everybody win?

- 1933: FDR has Congress repudiates gold clauses in industrial bond contracts to allow for devaluation of dollar with respect to gold. (Kroszner, Zingales)
- Kroszner: prices of all securities (and not just equities) go up as macroeconomic crisis lessened. Exception: gold indexed government bonds. **Everybody wins.**
- Also, 21 states vote farm mortgage moratoria (Alston). **Obama's proposal of Oct. 14 for 3 month moratorium.**
- Repudiation and moratoria both appear to violate contracts clause of Constitution but Supreme Court upholds both in 5-4 decisions.
- If everybody wins, why are these measures subject to sharp political divisions?

Num	Party	Yea	Nay
65	Democrat	43	2
38	Northern Democrat	23	1
27	Southern Democrat	20	1
37	Republican	4	18
1	Farmer-Labor	1	0

Red = For Cancellation

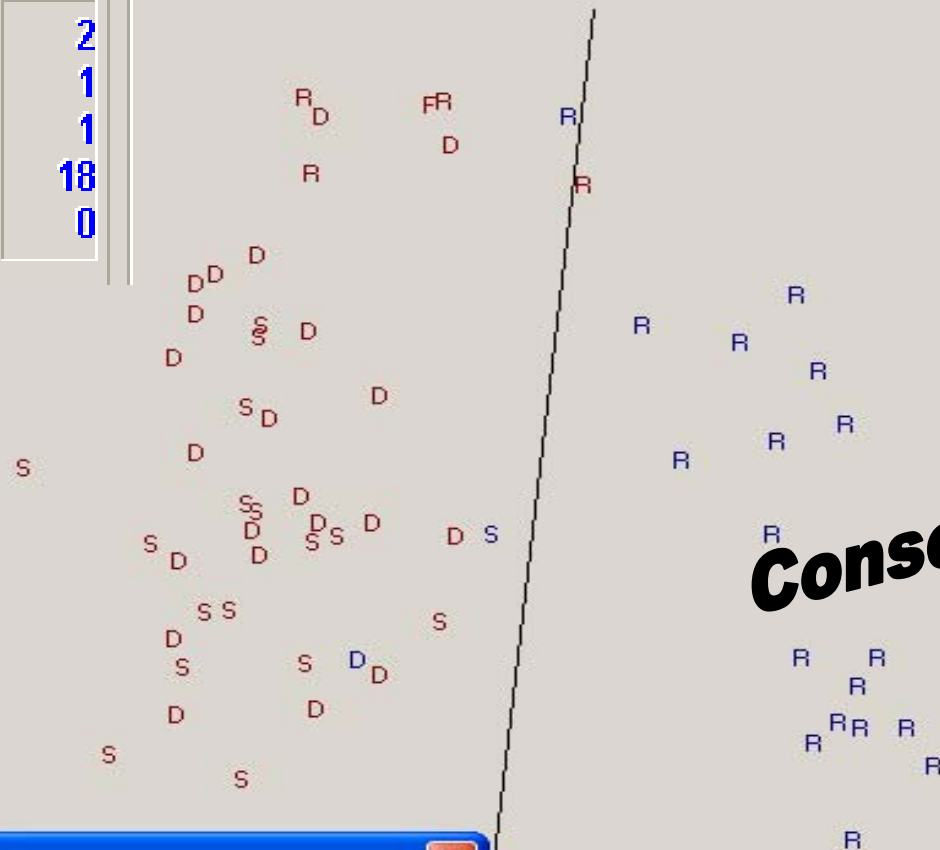
Blue = Against

D = Democrat

R = Republican

**Liberal**

**Conserv.**



**Roll Call Information**

Roll Call Information: Yea: 48, Nay: 20, N/A: 35, Errors: 4, P.R.E.: 8

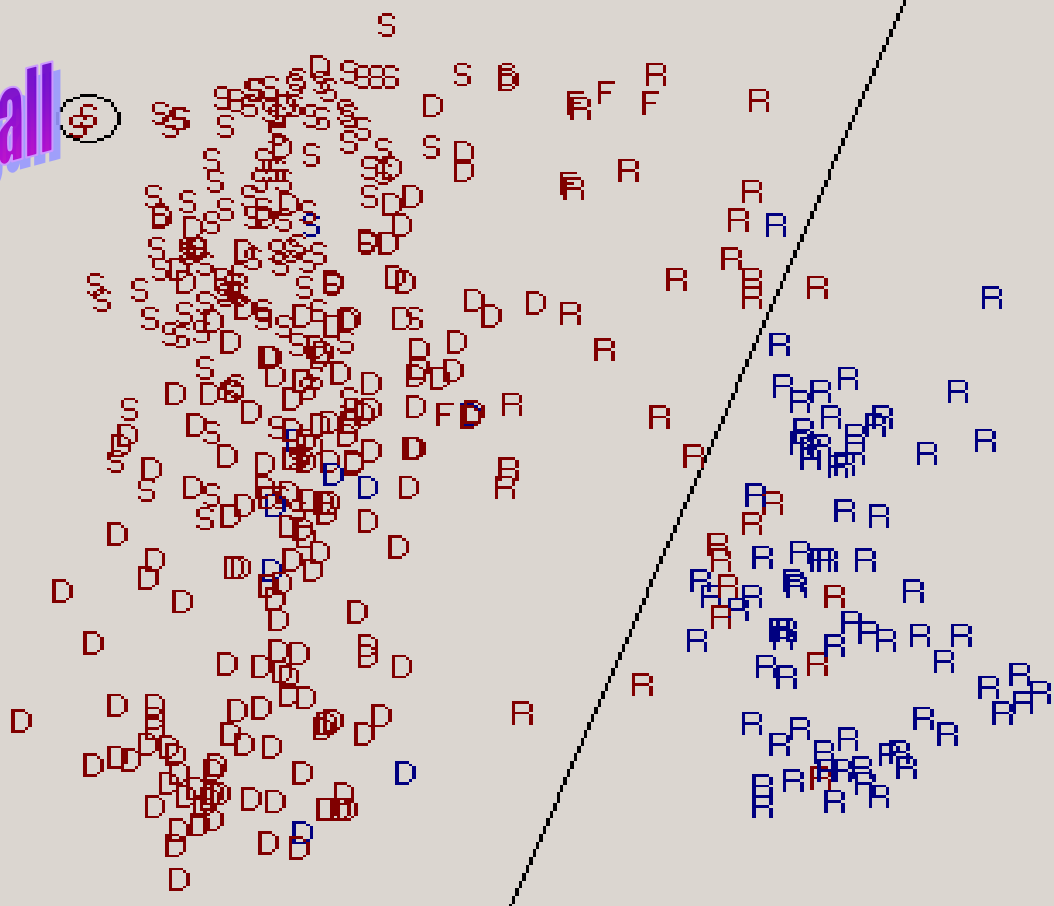
Details: CR-77-5-4929 J 73-1-224C HJR192 S731074

TO ADOPT H.J.RES. 192.

House #73 Roll Call #46 5/29/1933 (2/2)

# House Vote on Cancellation of Gold Clauses

Steagall



# Why did the Republicans Oppose?

- Pure Ideology (beliefs never update, as Phil Gramm with “whiners”).
  - “The problem within the Fed was largely doctrinal: Fed officials appeared to subscribe to Treasury Secretary Andrew Mellon’s infamous “liquidationist” theory that weeding out “weak” banks was ... harsh but necessary.”—Ben Bernanke, 2002.
- Commitment to always support contracts, reject intervention (Mian, Sufi, and Trebbi)
- Signaling—they knew the bill would pass and were indicating that intervention of this sort should only be used in exceptional (Bolton and Rosenthal) circumstances.
- Incorrect expectations of economic effects.
  - There is much uncertainty on votes on economic policy. Paulson has not used the \$700B as some thought. So it may be hard to match ex ante perceived interests on a bill with ex post payoffs to constituents.

# Fast Forward to Crisis of 2008

- Excellent paper by Mian, Sufi, Trebbi on House votes on:
  - ANRPFA in July
  - EESA in October
  - Use data on mortgage default rates by zip code to assess constituency interests
- Similar analysis of EESA by McCarty without default data.

# Ideology, Constituent Interests, Campaign Contributions and Roll call Votes-I ?

- AHRFPA – redo mortgages, potential direct beneficiaries borrowers
- Results (from MST):
  - ▣ All Democrats vote for
    - Ideology probably important, variation in default rates unimportant for Democrats, point glossed by MST.
  - ▣ Republicans
    - Ideology (DW-NOMINATE) score important
    - Mortgage default rate (especially that of likely Republican voters)
    - More sensitivity to mortgage default rate in competitive districts.
    - Financial services industry contributions unimportant.

# Ideology, Constituent Interests, Campaign Contributions and Roll call Votes-II ?

- ESSA – Paulson’s blank check
- MST results for all representatives (D & R)
  - Ideology, conservatives oppose ✓
  - Recipients of Financial Industry contributions favor ✓
  - MCs from high income districts favor ✓
  - MCs with high financial industry employment favor ✓
  - Mortgage default rates no effect



# McCarty's results

Variable	Democrat	Republican
Ideology	--	<b>Conservatives oppose</b>
Financial Services Contributions	<b>For</b>	<b>For</b>
Financial Services Committee Member	--	<b>Against (diehard deregulators)</b>
Vulnerable Incumbent	<b>Against</b>	<b>Against</b>
Retiring Incumbent	N.a.	<b>For</b>
New York state	<b>For</b>	--
High Income district	<b>For</b>	--

Original bill would have passed if all Dems on Financial Services had voted for.

Original bill likely to have failed because of preelection jitters.

# Conclusion

- ▣ Tilt to debtors in macroeconomic crisis
- ▣ Ideology, as well as economic interests, is important.
- ▣ Good news: Political intervention in crises not as bad as people may fear.
- ▣ Bad news: Timely intervention by regulators unlikely to be effective given political pressures and politicians' inclination to pander.
- ▣ Way forward?: create a constituency that has an incentive to implement good regulations (Skeel, 1998, example of bankruptcy bar)