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FLAWED REGULATORY POLICY: THE FUTURE OF FANNIE AND FREDDIE

Nationalization, De-Nationalization, Re-Nationalization: Some Historical and Comparative Perspective

Mark A. Edwards*

Introduction

> Banks, savings banks, insurance companies . . . because of their great needs, were foreclosing mortgages, calling loans, refusing credit. . . . We were faced by a condition and not a theory. . . . It was clear that mere appeals from Washington for confidence and the mere lending of more money to shaky institutions could not stop this downward course. A prompt program applied as quickly as possible seemed to me not only justified but imperative to our national security.[1]

The quote above might have come from President Obama, explaining his recently enacted fiscal stimulus bill,[2] but it did not. It came from Franklin Roosevelt during his second "fireside chat" radio address on May 7, 1933. That it seems so apt today may be startling, but it should not be. As this Article

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1. Franklin D. Roosevelt, U.S. President, Fireside Chat on Banking Crisis (May 7, 1933), *available at* http://www.mhric.org/fdr/chat2.html.

2. American Recovery and Reinvestment Act, Pub. L. No. 111-5, 123 Stat. 115 (2009) (signed by President Obama on February 17, 2009).

argues, we have been down this road before several times and are likely to go down it several more times in the future.

It is difficult to remember it now, but there was once a time, not so long ago, when the economic crisis now engulfing the world was known as "the subprime mortgage crisis."[3] That description of the crisis now seems about as apt as calling the Chernobyl disaster "the stuck cooling rod incident": accurate, in its way, but missing some rather important details about the chain reaction that followed.[4] What started as a domestic problem with irrational lending secured by obscure mortgage instruments[5] has spread with such force and power that the most powerful banks in the world,[6] not to mention several nations,[7] stand on the brink of economic collapse.

It is inevitable, therefore, that the scope of analysis of what went wrong must expand with the crisis. But it is also appropriate to remind ourselves that this mess started with the seemingly mundane act of buying houses. Particularly in the United States, lending and housing are bound together; difficulties in one mean difficulties in the other. And, because housing is particularly bound up with the idea of "the American dream," a crisis in banking may uniquely challenge the American sense of self-identity.

The difficulty of memory haunts this crisis in other ways as well. The failure of policy-makers to remember history is a direct cause of their inability to come to terms with the crisis. One goal of this Article is to address the history of the relationship between societies and their lending institutions,

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3. *See Senate OKs Bill to Ease Homeowners in Crisis*, MSNBC, Dec. 14, 2007, http://www.msnbc.msn.com/id/22261449/ ("The legislation, approved 93-1, is the Senate's first attempt to deal with the looming subprime mortgage crisis . . . .").

4. See GRIGORI MEDVEDEV, THE TRUTH ABOUT CHERNOBYL 73-91 (Evelyn Rossiter trans., Basic Books, Inc. 1991) (1989), for an overview of the Chernobyl disaster.

5. Danielle DiMartino & John V. Duca, *The Rise and Fall of Subprime Mortgages*, ECON. LETTER, Nov. 2007, *available at* http://www.dallasfed.org/research/eclett/2007/el0711.pdf.

6. *See, e.g.*, Neil Irwin & David Cho, *A New Architecture for the Financial World*, WASH. POST, Sept. 15, 2008, at A01 (noting the imminent collapses of major banks).

7. *See, e.g.*, Daniel Gros, *Iceland on the Brink? Options for a Small, Financially Active Economy in the Current Financial Crisis Environment*, CENTER FOR EUR. POL'Y STUD., Apr. 2008.

and, in particular, the central role of housing in that relationship. Like many social relationships, the relationship between housing, banking, and society has been defined, imperfectly, by law.

When I proposed this Article topic to the editors of this symposium, it was a little extreme to speak of nationalization, at least as that term is commonly defined in the popular imagination. No more. A survey of headlines from the news sources[8] for the past months makes the point: increasingly, popular discourse has begun to grapple with a concept that seems—but, as I argue below, only seems—unprecedented in the history (and antithetical to the ideology) of our capitalist economy.

Part I of this Article reviews the long and tumultuous history of nationalization, de-nationalization, and re-nationalization of the financial and housing finance industries in the United States, from their earliest days to the present. That review leads to two conclusions. First, "nationalization" is a weak description, at best, which encompasses a wide range of government interactions with private industry. While the degree of intervention fluctuates through time in response to various crises, it is useful to recognize that it is almost never accurate to characterize financial and housing finance industries as either fully nationalized or fully de-nationalized. Second, extensive government intervention in those industries in the United States has occurred repeatedly.

Part II briefly examines the policy responses to the current crisis from both the Bush and Obama administrations. Part III examines the relationship between the financial and housing finance industries in several other countries with diverse

8. Edmund L. Andrews, *Rescue of U.S. Banks Hints at Nationalization*, N.Y. TIMES, Jan. 16, 2009, at B1; *Bank Nationalization Speculation Prompts Confusion, Fear*, CNN MONEY, Feb. 20, 2009; Editorial, *Nationalizing the Bank Problem*, N.Y. TIMES, Jan. 22, 2009, *available at* http://roomfordebate.blogs.nytimes.com/2009/01/22/nationalizing-the-bank-problem/; Neil Irwin & David Cho, *A New Architecture for the Financial World*, WASH. POST, Sept. 15, 2008, at A01; Paul Krugman, Opinion, *Banking on the Brink*, N.Y. TIMES, Dec. 3, 2009, at A27; Gretchen Morgenson, *The End of Banking as We Know It*, N.Y. TIMES, Jan. 18, 2009, at BU1; David E. Sanger, *Nationalization Gets a New, Serious Look*, N.Y. TIMES, Jan. 26, 2009, at A1; Mike Soraghan, *Bank Nationalization Attracts GOP Support*, THE HILL, Feb. 15, 2009, *available at* http://thehill.com/leading-the-news/once-radical-nationalization-attracts-gop-support-2009-02-15.html.

histories and systems of government. It reveals surprisingly similar patterns of government intervention in the industries across diverse political and economic systems. Part IV attempts to fashion a single explanation for both the strange history of banking and housing finance nationalization in the United States and the surprisingly similar histories of nationalization of those industries in diverse political and economic systems. This part also speculates on the future of the relationship between instruments of housing finance—specifically Fannie Mae and Freddie Mac—and the Federal Government.

I. De-Nationalization and Re-Nationalization of the Banking and Housing Finance Industries in the United States

The history of banking in the United States is really the history of competing impulses, one motivated by ideology, the other by pragmatism. Two ideological strains have combined to make the United States ever reluctant to embrace centrally planned intervention in the financial industries: the preference for federalism[9] and the preference for relatively laissez-faire capitalism.[10] Against these impulses, pragmatic responses to crises have led repeatedly to attempts at centrally planned regulatory intervention into lending. It is this dynamic that has produced a tumultuous and even schizophrenic relationship between American society and its banks. The difficulties of this relationship are especially acute with regard to housing finance.

A. *Nationalization: The First Bank of the United States*

To begin at the beginning: at the urging of Alexander Hamilton, and with considerable opposition from opponents of

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9. *See generally* William N. Eskridge, Jr. & John Ferejohn, *The Elastic Commerce Clause: A Political Theory of American Federalism*, 47 VAND. L. REV. 1355 (1994); Harry N. Scheiber, *Redesigning the Architecture of Federalism – An American Tradition: Modern Devolution Policies in Perspective*, 14 YALE L. & POL'Y REV. 227 (1996).

10. *See generally* THE STATE AND FREEDOM OF CONTRACT (Harry N. Schreiber ed., 1998).

federal power, led prominently by Thomas Jefferson, the First Bank of the United States was chartered in 1791.[11] Jefferson was deeply suspicious that a national bank in general—and Hamilton in particular—would be tempted to amass power.[12]

The Bank's largest shareholder was the United States, which held a 20% interest.[13] The Bank played an important role in financing the Federal Government, but it was considerably less important to the economic life of the country than were the numerous banks chartered in the individual states.[14] Those banks issued their own notes, which became the bulk of the United States money supply.[15] Opposition from states-rights advocates led to the dissolution of the National Bank when its first twenty-year charter expired.[16]

B. *De-Nationalization: Washington is Burning*

A year later, in 1812, a crisis that makes the current one look relatively trivial caused the nation to reconsider its distaste for central banking. The United States found itself in a war in which Washington itself was burned to the ground by an invading army.[17] That happened in part because the Federal Government had no easy way to borrow money to finance a war effort.[18] Moreover, the unregulated state and private banks were of no help; they turned out to be issuing notes without sufficient reserves to cover them.[19]

C. *Re-Nationalization: The Second Bank of the United States*

By 1816, the Second National Bank of the United States

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11. *See, e.g.*, JOHN STEELE GORDON, AN EMPIRE OF WEALTH 78-79 (2004).

12. *Id.*

13. EDWARD S. KAPLAN, THE BANK OF THE UNITED STATES AND THE AMERICAN ECONOMY ix (1999).

14. Warren E. Weber, *Early State Banks in the United States: How Many were There and Where did they Exist?*, 30 FED. RES. BANK OF MINN. Q. REV. 28 (Sept. 2006).

15. *See* KAPLAN, *supra* note 13, at 27.

16. *Id.* at 32-33.

17. *See generally* JOHN K. MAHON, WAR OF 1812 (1991).

18. *See* KAPLAN, *supra* note 13, at 38.

19. *Id.* at 38-43.

was born of necessity.[20] Moreover, the first federal attempts to intervene in the management of the banking industry resulted in tighter restrictions on the ability of state and private banks to issue notes.[21] By 1816, the relationship between the United States and its banks had already assumed some of the character it retains today: ideological preferences for weak federal power giving way to the necessity of greater regulation in response to a crisis.

D. *De-Nationalization: The Free Banking / Intermittent Panic Years*

The Second National Bank, like the First, did its job well enough that it soon put itself out of business.[22] Stability returned to the financial system,[23] and the apparent need for an ideologically offensive central federal banking authority melted away with the crisis it had corrected. Indeed, it was during this period that the first depositor insurance system was enacted in New York, protecting deposits in the event of bank failure through an assessment on banks.[24] State banks were sound again, and ideological preference against central authority was no longer an unaffordable luxury. In 1836, the Second Bank died, like the First, at the age of twenty.[25]

For the next thirty-five years, the United States did without either a central planning authority or significant federal regulatory oversight of private banks.[26] All banks were chartered by the states, largely under their own changing standards.[27] Almost immediately after the Second Bank was dissolved, the country suffered a banking crisis, known as the Panic of 1837.[28] State banks failed and state governments

20. *Id.* at 49-55; s*ee also* Hugh Rockoff, *Banking and Finance, 1789-1914*, *in* 2 THE CAMBRIDGE ECONOMIC HISTORY OF THE UNITED STATES: THE LONG NINETEENTH CENTURY, at 643, 647-49 (Stanley L. Engerman & Robert E. Gallman eds., 2000).

21. *See* KAPLAN, *supra* note 13, at 69-70.

22. *Id.* at 160.

23. *Id.*

24. *Id.*

25. *Id.*

26. *See, e.g.*, GORDON, *supra* note 11, at 113-31.

27. *See, e.g.*, *id.* at 122.

28. *See id.* at 130.

defaulted on their debts.[29] Foreign investment in the United States suffered, and the economy did not recover for several years.[30] Nonetheless, the ideological preference for de-centralized economic authority was strong enough that the national bank was not revived.

In the ensuing years, until the Civil War forever re-wrote the relationship between the states and the Federal Government, economic and financial authority remained decentralized on the federalist model.[31] These years were marked by intermittent panics that caused some state bank failures, but also by general economic development caused by westward expansion and the growth of the industrial base in the Northeast.[32]

The Civil War dramatically altered both the Federal Government's need for central banking[33] and the power of the Federal Government in relation to state banks.[34] With the most ardent states-rights supporters gone from the scene because they had actually seceded from the Union (the ultimate assertion of states-rights), Congress passed the National Bank Act, which, as amended, imposed taxes on state banks that virtually forced them to re-charter as national banks, thus submitting themselves to federal regulatory supervision.[35] However, even in the absence of the most ardent states-rights supporters, Congress did not create a central bank subject to federal control, such as a Third National Bank. Instead, it merely increased both the number of de-centralized banks subject to federal regulatory oversight and increased the degree of regulation over those banks. The result was a more stable banking system, but one without a central planning

29. *See, e.g.*, *id.*

30. *Id.* at 131.

31. *See id.* at 191-204 (discussing the Civil War and its impact on the American economy).

32. *See id.*

33. KAPLAN, *supra* note 13, at 1. Lacking a central bank from which to obtain funding for the war, the Federal Government simply printed more currency, causing a sharp increase in inflation and lowering the value of that currency. *Id.*

34. *See* RICHARD H. TIMBERLAKE, MONETARY POLICY IN THE UNITED STATES 84-103 (1993).

35. National Bank Act, ch. 58, 12 Stat. 665 (1863). *See generally* Veazie Bank v. Fenno, 75 U.S. 533 (1869).

authority.

Following the Civil War, the federalist impulse toward decentralization returned. State banks were freed from onerous federal tax burdens and reserve requirements.[36] The return of decentralization and less intrusive regulation also brought back the intermittent crises and panics that had characterized previous eras.[37] In a now familiar pattern, the less-regulated banks were discovered to have lent money too freely and to have maintained insufficient reserves.[38] Once again, the country experienced an epidemic of bank collapses.[39] And, once again, as a result, the country was prepared to partially set aside its ideological distaste for central authority and laissez-faire economics.

E. *A Little Re-Nationalization: The Creation of the Federal Reserve*

In 1913, after several years of wrangling, Congress enacted the Federal Reserve Act (the "Act").[40] The Act created the basic Federal Reserve structure that exists today. The Federal Reserve Board ("Federal Reserve") would not have the centralized power of a central bank based upon European models, but it carried considerably more federal regulatory authority than had existed since the demise of the Second National Bank.[41] The Federal Reserve would oversee a network of twelve regional or District Federal Reserve Banks ("District Banks"), private corporations run by appointed private citizens.[42] The District Banks, in turn, would act as *the*

36. *See, e.g.*, John Steele Gordon, *A Short Banking History of the United States*, WALL ST. J., Oct. 10, 2008, at A17.

37. Crises, panics, and collapses occurred in 1873, 1884, 1893, and 1907. Elmus Wicker, *Banking Panics in the US: 1873-1933*, EH.NET ENCYCLOPEDIA, Sept. 4, 2001, http://eh.net/encyclopedia/article/wicker.banking.panics.us.

38. *Id.*

39. *Id.*

40. Federal Reserve Act, ch. 6, 38 Stat. 261 (1913). *See generally* ALLAN H. MELTZER, A HISTORY OF THE FEDERAL RESERVE, 1913-1951 (2003); DONALD R. WELLS, THE FEDERAL RESERVE SYSTEM (2004).

41. See MELTZER, *supra* note 40, at 65-73, for a discussion of the passage of the Federal Reserve Act.

42. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FEDERAL RESERVE SYSTEM: PURPOSES AND FUNCTIONS 3, 6-11 (9th ed. 2005), *available at* http://www.federalreserve.gov/pf/pdf/pf_complete.pdf.

banks' bank, issuing currency and lending money to member banks at a rate determined by the Board.[43] The District Banks were also authorized to buy and sell United States debt obligations, enabling the Federal Government to borrow money and further enabling the District Banks to influence banks' lending activities.[44] Member banks were subject to regulatory oversight.[45]

In the words of the Federal Reserve itself, it became "an unusual mixture of public and private elements" that together produced a "decentralized central bank."[46] Conservatives denounced the Act, and the authority it created, as a government takeover of private industry.[47] The editorial board of the New York Times gave clear voice to that concern:

> [P]olitical control over the banking system of the country is secured. . . .
>
> . . . If anything is lacking to the completeness of this centralized control it must be in respect to some detail that escaped the attention of the authors of the bill.
>
> . . . .
>
> . . . It reflects the rooted dislike and distrust of banks and bankers that has been for many years a great moving force in the Democratic Party . . . . The measure goes to the very extreme in establishing absolute political control over the business of banking.[48]

In its initial years, the Federal Reserve worked well enough, along with general economic prosperity that resulted from supplying European powers at war with raw materials

43. *Id.* at 6-11, 16.

44. *Id.* at 37-38.

45. *Id.* at 4-5.

46. Federal Reserve Education, The Federal Reserve Structure Tour, http://www.federalreserveeducation.org/fed101_html/structure/tour/tour.htm (last visited Nov. 21, 2009).

47. Similar arguments, of course, are common-place today. *See, e.g.*, Mark Leibovich, '*Socialism!' Boo, Hiss, Repeat*, N.Y. TIMES, Mar. 1, 2009, at WK 1.

48. Editorial, *A Radical Banking Measure*, N. Y. TIMES, June 21, 1913, at 8.

and manufactured goods, that it fell into the same conundrum that helped kill the Second National Bank: it did not seem particularly necessary to cede power to an ideologically distasteful central regulatory authority. As a result, the District Banks were reluctant to tighten lending to member banks despite their speculative lending and investments and despite low bank capitalization and reserves.[49]

The relatively weak position held by the Federal Reserve would soon come to haunt it.[50] Speculative investments and poorly secured debt triggered a stock market crash, which led to decreased consumer spending, thus leading to high unemployment and, finally, to further decreased consumer spending and massive loan defaults.[51] Those loan defaults, together with speculative investing and low cash reserves, combined to trigger an epidemic of bank failures, which impoverished depositors and led to yet more loan defaults.[52] The result was an economic crisis that engulfed the world.[53]

F. *A Lot More Nationalization: New Dealing with the Once and Future Crisis*

1. Banking Reform

Faced with the greatest economic collapse in the nation's history, the Hoover Administration found itself paralyzed by its ideological opposition to central planning and regulatory authority.[54]

a. *The Reconstruction Finance Corporation*

Hoover and his administration reluctantly created the Reconstruction Finance Corporation ("RFC"), but saw it as

49. MELTZER, *supra* note 40, at 248-52.

50. *See id.* at 264-65.

51. *See generally* ELMUS WICKER, THE BANKING PANICS OF THE GREAT DEPRESSION (2000).

52. *Id.* at 46-47.

53. *Id.*

54. *See* ARTHUR M. SCHLESINGER, JR., THE AGE OF ROOSEVELT: THE COMING OF THE NEW DEAL 477 (1958) (noting that Hoover regarded the New Deal as antithetical to "the whole philosophy of individual liberty").

"primarily a psychological weapon" designed to restore public confidence, rather than as an actual instrument of policy.[55] Under Hoover, the RFC's function was strictly limited to making small emergency loans for banks and insurance companies only if the companies could provide adequate collateral security.[56] Secretary of the Treasury Ogden Mills did not bother to try to disguise his distaste for the institution, reassuring conservatives that "the sooner it is created . . . the less use we will have to make of it."[57] President Hoover shared the Secretary's discomfort; when Congress attempted to expand the lending powers of the RFC, Hoover denounced the idea in terms that made it clear that he found central planning and federal regulatory authority abhorrent: "Never before," he claimed, "has so dangerous a suggestion been seriously made to our country."[58]

By the time President Roosevelt was inaugurated in 1933, ideology was a luxury neither policy-makers nor the public could afford. Pragmatism was again a necessity. The post-ideological pragmatism of the New Deal was perhaps best embodied in the flamboyant figure most responsible for the implementation of the evolving finance system: Jesse Jones. Jones once claimed that the three most important ingredients for his happiness were "family, religion and money,"[59] although, as historian Arthur Schlesinger wryly noted, "[s]ome might wonder whether this accurately stated the priority."[60] Roosevelt placed Jones at the head of the RFC, where, with expanded powers, he had a great impact.[61] Schlesinger's description of Jones warrants quotation in full:

> He was profane and taciturn in the Texas manner, loved power, was indifferent to ideology, never read books, had no sentimental illusions about the underdog, and kept his word. He could do business with anybody, even New Dealers,

55. *Id.* at 426-27.
56. *Id.* at 427.
57. *Id.* (quoting Secretary of the Treasury Ogden Mills).
58. *Id.* (quoting President Herbert Hoover).
59. *Id.* at 426 (quoting Jesse Jones).
60. *Id.*
61. *Id.* at 427, 430.

even Wall Street.[62]

The RFC's goal was to have banks lend to businesses again. In order to lend, banks needed capital, obtained not through loans that further weakened their balance sheets, but through the issuance and sale of preferred stock to the RFC.[63] Banking industry leaders, resisting the "threat of government control of the banking system," at first refused to sell equity interests to the RFC.[64] Jones warned that if the banks refused to cooperate, the Federal Government would begin loaning to businesses directly, bypassing banks entirely and thereby destroying private commercial banking.[65] In essence, the Roosevelt Administration presented the banking industry with a choice: partial nationalization of banks through preferred stock purchases or complete nationalization of banks' lending function.[66] Faced with that choice, bankers chose partial nationalization and sold preferred stock to the RFC.[67]

b. *The Federal Deposit Insurance Corporation*

To restore public confidence in banks and stem the cycle of panicked depositor bank runs, the Banking Act of 1933 created the Federal Deposit Insurance Corporation ("FDIC"), guaranteeing the availability of retail deposits.[68] With that guarantee, however, came much greater regulatory oversight.[69] In addition, banks were required to separate their commercial and investment bank functions.[70] Within two years, the

62. *Id.* at 426.
63. *Id.* at 427-28.
64. *Id.* at 428.
65. *Id.* at 428.
66. *Id.* at 428-29.
67. *Id.* at 429-30.
68. Banking Act of 1933, ch. 89, 48 Stat. 162 (1933). The Banking Act was commonly known as the Glass-Steagall Act. *See, e.g.*, N.Y. Times, Glass-Steagall Act (1933), http://topics.nytimes.com/top/reference/timestopics/subjects/g/glass_steagall_act_1933/index.html (last visited Oct. 17, 2009) [hereinafter Glass-Steagall Act (1933)]; MURRAY N. ROTHBARD, A HISTORY OF MONEY AND BANKING IN THE UNITED STATES: THE COLONIAL ERA TO WWII, at 342-43 (2002).
69. *See, e.g.*, Glass-Steagall Act (1933), *supra* note 68; ROTHBARD, *supra* note 68, at 342-43.
70. *See, e.g.*, Glass-Steagall Act (1933), *supra* note 68.

Banking Act of 1935 again broadened the powers of the Federal Reserve, increasing both its supervisory regulatory power over banks and its ability to use interest rates on loans to banks to control commercial lending practices.[71]

2. Housing Finance Reform

The Roosevelt Administration soon turned its focus to the housing finance system.[72] One pernicious effect of the banking crisis was the paralysis of housing finance.[73] Similar to the current crisis, the Great Depression was preceded by an unprecedented spike in home prices and the accumulation of mortgage debt, both fueled by lax lending standards.[74] Defaults and foreclosures increased dramatically, and banks simply stopped lending for home purchases.[75] The Roosevelt Administration devised a number of pragmatic responses to the problem, which were revised in accordance with their effectiveness in practice.[76]

a. *The Federal Home Loan Bank System and the Federal Savings and Loan Insurance Corporation*

The Roosevelt Administration recognized that credit was frozen for home lending institutions such as savings and loans and mutual savings banks.[77] It empowered the Federal Home Loan Bank ("FHLB"), created in 1932, to provide loans to these institutions, so that they in turn could lend to home buyers.[78]

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71. Banking Act of 1935, ch. 88, 49 Stat. 684 (1935). *See also* JANE W. D'ARISTA, THE EVOLUTION OF U.S. FINANCE: FEDERAL RESERVE MONETARY POLICY, 1915-1935, at 182-94 (1994).

72. David C. Wheelock, *The Federal Response to Home Mortgage Distress: Lessons from the Great Depression*, FED. RES. BANK OF ST. LOUIS REV., May/June 2008, at 137, *available at* http://research.stlouisfed.org/publications/review/08/05/Wheelock.pdf.

73. *Id.*

74. *Id.*

75. According to statistics cited by Wheelock, an astounding "43.8% of urban, owner-occupied homes" subject to first mortgages were in default by January 1, 1934. *Id.* at 138.

76. *Id.* at 140.

77. *Id.* at 141.

78. *Id.*

In 1934, Congress passed the National Housing Act,[79] which, among other things, created the Federal Savings and Loan Insurance Corporation ("FSLIC") as an arm of the FHLB, which essentially served as an FDIC for home lending institutions.[80] It provided insurance for retail deposits at those institutions so that consumers would have the confidence to make deposits, which could then be loaned out for housing purchases.[81] Together, the FHLB and the FSLIC worked to increase liquidity at home lending institutions in order to trigger a chain reaction that would reverse the epidemic of foreclosures.[82] The greater availability of loans from home lending institutions could lower the cost of borrowing for home buyers. More home buyers could create demand in the housing market and slowly raise home values, which had plummeted. Rising home values could allow some homeowners to refinance their mortgage loans to avoid foreclosure.

b. *The Home Owners' Loan Corporation*

Many delinquent mortgages could not be saved by refinancing if home owners had to wait for home values to rise.[83] In response, the Roosevelt Administration created the public/private hybrid Home Owners' Loan Corporation (financed publicly, in part, and partly through tax-favored private investment) in 1933.[84] This institution had a simple but crucial mission: buy delinquent mortgages from home lending institutions, and then work with home owners to refinance them on less risky and more responsible terms.[85] As a result, banks were able to sell the mortgages that they wanted to get rid of the most, which reduced their bad debt and increased their liquidity.[86] For homeowners, short-term, adjustable rate, and balloon mortgages were converted to long-

79. National Housing Act, ch. 847, 48 Stat. 1246 (1934).
80. Wheelock, *supra* note 72, at 141.
81. *Id.*
82. *Id.* at 140.
83. *Id.* at 141.
84. *Id.*
85. *Id.* at 142.
86. *Id.*

term, fixed-rate mortgages.[87] In order to qualify for the restructured loans, borrowers were required to present proof of sufficient income relative to their debt.[88] In 1934, HOLC activity dwarfed private home finance lending activities.[89] At the height of its activities, the HOLC held almost 20% of all home mortgages in the United States.[90] In other words, an agency of the Federal Government held the mortgage to one-in-five homes in the country.[91]

c. *The Federal Housing Administration*

In addition to the creation of the FSLIC, the National Housing Act of 1934 had two other major impacts on the structure of housing finance in the United States. First, it created the Federal Housing Administration ("FHA").[92] To encourage responsible lending standards by home lending institutions, the FHA offered to insure mortgage loans that met its quality and risk standards.[93] The FHA required that the loans it insured were fixed-rate, long-term, and had a maximum loan-to-value ratio of 80% (in other words, home buyers were required to make a 20% down payment).[94]

d. *The Federal National Mortgage Association*

The last major impact of the National Housing Act of 1934 was that it authorized the creation of an agency to purchase mortgages from home lending institutions and sell them to investors. Jesse Jones and the RFC stepped in at the request of President Roosevelt and created the Federal National Mortgage Association ("FNMA"), now known, of course, as Fannie Mae.[95] The FNMA created a secondary market in which home lending institutions could sell mortgages that met FNMA quality standards.[96] In other words, the FNMA would

87. *Id.*
88. *Id.*
89. *Id.* at 142-43.
90. *Id.* at 142.
91. *Id.*
92. *Id.* at 144.
93. *Id.*
94. *Id.*

buy mortgage loans from home lending institutions at some percentage of their present value.[97] The lenders would receive a one-time cash payment and be relieved of any risk from the home buyer's potential default.[98] That risk was transferred to the FNMA.[99] Not only did banks receive a great incentive to increase their home lending activity, the FNMA was able, through its purchase standards, to impose quality standards that lasted for decades.

Not only did the discreet agencies fulfill their individual functions well, but they also operated well together as a housing finance system. The FHLB provided liquidity,[100] the HOLC purchased and refinanced delinquent mortgages,[101] the FHA insured quality mortgages,[102] and the FNMA created a secondary market on which quality mortgages could be sold, increasing lender liquidity, removing risk, and standardizing quality.[103] In many ways, the FNMA was the most spectacular success of all the housing finance reforms. It not only contributed to housing finance stabilization, it actually created a massive and thriving secondary market in mortgages that became the principle engine of the post-war "American dream" of home ownership.[104]

G. *Post-Depression De-Nationalization: The Long March from Economic Crisis to Deregulation to Economic Crisis*

The New Deal housing finance system worked so well in the years following the Depression that three things happened.

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95. *Id.* at 145.

96. *Id.*

97. *Id.*

98. Daniel J. McDonald & Daniel L. Thornton, *A Primer on the Mortgage Market and Mortgage Finance*, FED. RES. BANK OF ST. LOUIS REV., Jan./Feb. 2008, at 31, 36, *available at* http://research.stlouisfed.org/publications/review/08/01/McDonald.pdf.

99. *Id.*

100. Wheelock, *supra* note 72, at 140.

101. *Id.*

102. *Id.*

103. *Id.*

104. In fact, Fannie Mae's headquarters are located on American Dream Way in Reston, Virginia. Fannie Mae in Reston, Va., http://www.superpages.com/bp/Reston-VA/Fannie-Mae-L2041630424.htm (last visited on Nov. 8, 2009).

First, access to home ownership increased dramatically and came to be thought of as a critical component of the American dream of middle-class prosperity.[105] Second, many people forgot that the system was there, even as it continued to function. Indeed, continuing popular confusion about the control of, and roles played by, Fannie Mae and Freddie Mac may owe itself, to a large extent, to the invisibility of the secondary mortgage market they created.[106] Third, to those for whom central planning and extensive regulatory oversight was ideologically distasteful, it no longer seemed very necessary.[107] In a *Groundhog Day*[108]–like repeat of the past, as the crisis receded from memory, regulatory oversight and central planning were scaled back.[109]

The HOLC was the first victim of its success. It had played a major role in ending the foreclosure epidemic, as it acquired an enormous percentage of private home lending institutions' delinquent loans, "toxic assets" in today's terminology, and restructured them into performing assets.[110] But those performing assets were a tremendous temptation to the now-rescued lenders, and they put intense pressure on Congress to require HOLC to liquidate, selling its assets at fire sale prices to the lenders it had once rescued.[111] HOLC resisted, but many were sympathetic to the bankers, since the massive presence of a government agency, now essentially in competition with private industry, struck many in Washington as ideologically abhorrent.[112] As the National Bureau delicately but aptly summarized the debate:

105. *See, e.g.*, BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, TRACKING THE AMERICAN DREAM: FIFTY YEARS OF HOUSING CHANGES (1994), *available at* http://www.census.gov/apsd/www/statbrief/sb94_8.pdf.

106. *See* FREDDIE MAC, FOCUS ON: FREDDIE MAC (2003) ("For the most part, what we do is invisible to consumers."), *available at* http://www.freddiemac.com/mbs/docs/fs_freddiemac.pdf.

107. *See* McDonald & Thornton, *supra* note 98, at 35 (noting that the secondary mortgage market became increasingly attractive to private competitors throughout the late twentieth century).

108. GROUNDHOG DAY (Columbia Pictures 1993).

109. *See* Wheelock, *supra* note 72, at 139-45.

110. *Id.* at 141-44.

111. *See* C. LOWELL HARRISS, HISTORY AND POLICIES OF THE HOME OWNERS' LOAN CORPORATION 159-81 (1951) (discussing the "[f]inancial [l]iquidation of the Home Owners' Loan Corporation").

112. *See, e.g.*, *id.*

> While private agencies were understandably attracted to the HOLC's assets, the Corporation opposed the principle of transferring its mortgages to private institutions. . . .
>
> . . . Not the least was the question of the proper relationship between public and private institutions in the financial system, and whether an agency set up to aid private finance in time of economic depression was justified in holding on to the assets so acquired until their final liquidation in an improved economic climate. This question was raised directly or implicitly throughout the discussions. There was generally an acceptance of the principle that, other things being equal, private facilities should be used in preference to government. The fact that the government through the HOLC had materially assisted the nation's financial institutions was pointed out, presumably with the inference that these institutions would be inconsistent (and ungrateful) if they forced the HOLC to terminate its activities.[113]

Inconsistent and ungrateful or not, in 1943 the lenders got their wish as Congress passed a bill requiring HOLC to liquidate and sell its assets. HOLC was completely liquidated by 1951.[114]

During the 1950s, the FHA also began to lose its influence.[115] Home lenders began to offer loans with lower down-payment ratios than the FHA would insure.[116] But the FHA's refusal to insure the loans did not curtail risky loan origination, as it had been designed to do; instead, private insurers entered the market offering to insure those loans.[117] Over time, the percent of home loans insured by the FHA

113. *Id.* at 173.

114. *Id.*

115. *See* John M. Quigley, *Federal Credit and Insurance Programs: Housing*, FED. RES. BANK OF ST. LOUIS REV., July/Aug. 2006, at 281, 283-84.

116. *Id.* at 285.

117. *Id.*

steadily decreased as low down-payment, adjustable-rate loans became more and more commonplace.[118]

In 1968, Fannie Mae was nearly fully privatized; it became a "government-sponsored entity," or GSE, meaning it retained certain tax and borrowing privileges, but its stock was now held by private investors.[119] Fannie Mae continued to purchase mortgage loans from their originating lenders and sell them on the secondary market. In 1970, Congress created a second GSE, Freddie Mac, to create a parallel secondary market for mortgages originated by savings and loans.[120] It too was owned by private investors. Although Congress retained some persuasive power over the GSEs through the threat of revoking or curtailing their privileges, the corporations were now independent of any direct or indirect government control. After privatization, both Fannie Mae and Freddie Mac began to securitize pools of mortgages and sell those securities on the secondary market.[121] These instruments became known as MBSs.[122]

Finally, the FSLIC and the FHLB, as insurers to savings and loans, became insolvent as a result of the wave of savings and loan failures in the 1980s.[123] Congress declined to rescue them, and by the 1990s most of the New Deal institutions had been either fundamentally altered or disbanded entirely.

H. *Preliminary Conclusions*

From this review of the history of the cyclic ebb and flow of central planning and federal regulation over the banking and housing finance industries, two conclusions are apparent. First, the concept of nationalization itself is not particularly

118. *Id.* at 285-87.

119. *Id.* at 294.

120. *Id.*

121. *See, e.g.*, Leland C. Brendsel, *Securitization's Role in Housing Finance: The Special Contributions of the Government-Sponsored Enterprises*, *in* A PRIMER ON SECURITIZATION 19-22 (Leon T. Kendall & Michael J. Fischman, eds., 2d prtg. 1997).

122. *See, e.g.*, *id.*

123. Both were ultimately abolished under the Financial Institutions Reform Recovery and Enforcement Act of 1989. Pub. L. No. 101-73, 103 Stat. 183, tit. IV, sec. 401 (1989).

useful and may do little more than stir ideological opposition.[124] It is much more useful to think of central planning and regulatory control as a continuum along which the United States has moved back and forth. The banking and housing finance industries of the United States have never been either completely under Federal Government control or completely free of its control.

Second, if we define "nationalization" to mean fairly extensive government intervention in the banking and housing finance industries, it is not as foreign a concept as it may appear. In fact, it is a consistently recurring phenomenon throughout the United States' history, often for very good reason. The shock and wonder expressed by some politicians and commentators at the prospect of extensive intervention, e.g., nationalization, reveals a lack of historical perspective.[125] Like Miranda in *The Tempest*,[126] many have failed to realize that this is not a brave new world; it is new only to them.

II. Re-Nationalization: Dealing Again with the Former and Present Economic Crisis

My purpose here is to review only very briefly the causes of the current crisis and the plans currently being enacted to combat it. The focus here is to make the case that both the crisis and the proposed responses to it were foreseeable because they fit well within the pattern of de-nationalization and re-nationalization of the banking and housing finance industries that runs throughout the history of the United States.

The 1990s saw rapid growth in the number of barely regulated private enterprises, such as Countrywide, offering "subprime" lending to homebuyers who could not have qualified

124. Speaker of the House of Representatives Nancy Pelosi recently asked rhetorically, "Would we have ever thought we would see the day when we'd be using that terminology? 'Nationalization of the banks?'" David E. Sanger, *Nationalization Gets a New, Serious Look*, N.Y. TIMES, Jan. 26, 2009, at A1. But as Representative Maxine Waters recently warned, "The word 'nationalization' scares the hell out of people." Soraghan, *supra* note 8.

125. Others, however, have recognized that "nationalization" has played a recurring role in the American banking and housing finance industries. *See, e.g.*, Krugman, *supra* note 8 ("[I]sn't nationalization un-American? No, it's as American as apple pie.").

126. WILLIAM SHAKESPEARE, THE TEMPEST act 5, sc. 1.

for either an FHA-insured mortgage or Fannie Mae purchase-eligible mortgage.[127] Moreover, these lenders found it lucrative to securitize packages of the mortgages they originated and sell them to investors, such as commercial banks, investment banks, and mutual funds.[128] As Fannie Mae's share of the secondary mortgage and MBS market fell in the face of such competition, it lowered its quality standards to recapture market share lost to the subprime lenders.[129]

From 2000 until 2005, "home prices rose at an annual rate of 11.4 percent."[130] Thereafter, home prices began to fall and some borrowers, particularly those in the subprime holding short-term mortgage loans, found that their homes were now worth less than they owed, making refinancing the full amount owed impossible.[131] Unable either to refinance the loan or pay the amount owed in full, foreclosure rates began to skyrocket.[132] As foreclosure rates increased, the quality of MBSs decreased.[133] Large institutional investors, including commercial and investment banks, found that large percentages of their MBS assets had been rendered worthless.[134] Lending dried up as a result,[135] which led to greater economic slowdown and more foreclosures, and the cycle began to repeat.[136] That is largely where we find ourselves today.

127. Charles Duhigg, *Pressured to Take More Risk, Fannie Reached Tipping Point*, N.Y. TIMES, Oct. 5, 2008, at A1.

128. *Id.*

129. *Id.*

130. McDonald & Thornton, *supra* note 98, at 31.

131. Dina ElBoghdady & Sarah Cohen, *The Growing Foreclosure Crisis*, WASH. POST, Jan. 17, 2009, at A01.

132. *Id.*

133. *See* Posting of Price Fishback to Freakonomics, http://freakonomics.blogs.nytimes.com/2009/05/12/the-financial-meltdown-now-and-then/ (May 12, 2009, 14:31 EST).

134. *Id.*

135. Bryan Keogh, *Libor Rises, Commercial Paper Slumps as Credit Freeze Deepens*, BLOOMBERG, Oct. 2, 2008, http://www.bloomberg.com/apps/news?pid=20601087&sid=azi5ZFVQ4iic.

136. Fishback, *supra* note 133.

A. *The Bank Bailouts*

1. Bailout I: TARP

The Bush Administration, like the Hoover Administration before it, found its ability to react to the developing crisis hamstrung by ideology. Central planning and government investment in private enterprise were simply not tools that neo-conservatives could bring themselves to wield. Lacking the will to intervene systematically in the banking industry, yet unable to avoid responding to the deepening crisis, the Bush Administration seemed to adopt an ad hoc approach. The Troubled Asset Relief Program ("TARP") embodied this approach. As first proposed by former-Treasury Secretary Henry Paulson in a three-page bill submitted to Congress on September 21, 2008, the program envisioned the Treasury wielding the power to purchase mortgage-backed securities by spending up to $700 billion in emergency funds with complete and unreviewable discretion.[137] In essence, Paulson seemed to have been assigned the role of Mary Bailey during the bank run scene from *It's a Wonderful Life*[138]: rushing into the crisis with a wad of cash in time to prevent an immediate collapse of lending institutions, but with no plan for the future.

As noted above, Paulson first indicated that the Treasury would use TARP funds to purchase bad debt, or toxic assets, from lenders, thereby removing the assets from banks' ledgers and freeing them to begin lending money again—much as the HOLC had done during the Great Depression.[139] Then, he seems to have reversed course, intent instead on infusing lenders with liquidity in order to spark lending activity to

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137. *Text of Draft Proposal for Bailout Plan*, N.Y. TIMES, Sept. 20, 2008, *available at* http://www.nytimes.com/2008/09/21/business/21draftcnd.html. As originally proposed, Paulson would have been empowered "to purchase, and to make and fund commitments to purchase, on such terms and conditions as determined by the Secretary, mortgage-related assets from any financial institution having its headquarters in the United States." *Id.* He also would have been empowered to designate "financial institutions as financial agents of the government," and all of his decisions were to have been "non-reviewable and committed to agency discretion" and could "not be reviewed by any court of law or any administrative agency." *Id.*

138. IT'S A WONDERFUL LIFE (Liberty Films II 1946).

139. Fishback, *supra* note 133.

businesses, similar to the function once provided by the FHLB, but directed at insurers, investment banks, and commercial banks rather than home lending institutions.[140] However, the banks infused with cash were not, in fact, required to lend it.[141] Acting rationally in the absence of such a requirement and in the face of a grave economic crisis, they instead held the cash in reserve, protecting their shareholders but defeating the purpose of the cash infusion.[142]

2. Bailout II: CAP

The Obama Administration, through the Treasury Department, has begun implementation of the Capital Assistance Program ("CAP") for faltering lenders.[143] The CAP program differs from the cash infusion program under TARP in at least two important ways, both of which increase the relative "nationalization" of the industry. First, CAP requires that applicants undergo an examination of their books before receiving investment, thereby increasing the amount of federal regulatory oversight of the institutions.[144] Second, it requires the institutions to issue preferred stock in exchange for the investment, thereby increasing government ownership of formerly private enterprises.[145] In short, CAP moves the relationship between American society and its banks a little further along the nationalization continuum, increasing the historically ideologically distasteful role of the federal

140. *Id.*

141. Editorial, *Loans? Did We Say We'd Do Loans?*, N.Y. TIMES, Oct. 29, 2008, at A30. AIG, Citigroup, Bank of America, JPMorgan Chase, Wells Fargo, Goldman Sachs, and Morgan Stanley are among the insurers, commercial banks, and investment banks that have received cash infusions under the TARP program. Participants in Government Investment Plan, Washington Post, http://online.wsj.com/public/resources/documents/st_BANKMONEY_20081027.html (last visited on Nov. 8, 2009).

142. *See* Editorial, *supra* note 141.

143. *See, e.g.*, U.S. DEP'T OF THE TREASURY, THE CAPITAL ASSISTANCE PROGRAM AND ITS ROLE IN THE FINANCIAL STABILITY PLAN (2009), *available at* http://www.ustreas.gov/press/releases/reports/tg40_capwhitepaper.pdf; FinancialStability.gov, Capital Assistance Program, http://www.financialstability.gov/roadtostability/capitalassistance.html (last visited Oct. 8, 2009).

144. FinancialStability.gov, *supra* note 143.

145. *Id.*

government in central planning and regulatory oversight. In fact, many formerly staunch free-market supporters are now urging the Obama Administration to assume controlling interests in the banks that may be beyond saving through cash infusions and greater regulatory oversight,[146] and we have already begun state ownership of massive parts of the formerly privately-owned banking and housing finance industries.[147] The United States is now the largest shareholder in both Citigroup and Bank of America.[148]

B. *Housing Finance Reforms*

1. Re-Nationalization of Fannie Mae and Nationalization of Freddie Mac

On September 6, 2008, Fannie Mae, burdened by its disastrous foray into subprime lending and on the brink of total collapse,[149] was re-nationalized.[150] Similarly, Freddie Mac was nationalized.[151] Now controlled by the Obama Administration as agents of its housing finance reform agenda, their missions have been substantially revised.[152] They are now charged with

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146. In the tongue-in-cheek words of economist Paul Krugman, "Comrade Greenspan wants us to seize the economy's commanding heights." Krugman, *supra* note 8. *See also* Matthew Richardson & Nouriel Roubini, Outlook, *Nationalize the Banks! We're all Swedes Now*, WASH. POST, Feb. 15, 2009, at B03 ("As free-market economists teaching at a business school in the heart of the world's financial capital, we feel downright blasphemous proposing an all-out government takeover of the banking system. But the U.S. financial system has reached such a dangerous tipping point that little choice remains.").

147. *See, e.g.*, Participants in Government Investment Plan, *supra* note 141.

148. Eric Dash, *U.S. is Said to Agree to Raise Stake in Citigroup*, N.Y. TIMES, Feb. 27, 2009, at A1; Eric Dash, Louise Story & Andrew Ross Sorkin, *Bank of America to Receive Additional $20 Billion*, N.Y. TIMES, Jan. 16, 2009, at B1.

149. In 2008, Fannie Mae lost more than its net profit for the previous sixteen years combined. Charles Duhigg, *U.S. Likely to Keep the Reins on Fannie and Freddie*, N.Y. TIMES, Mar. 3, 2009, at A1.

150. Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Titans*, N.Y. TIMES, Sept. 8, 2008, at A1.

151. *Id.*

152. Duhigg, *supra* note 149.

implementing the Making Home Affordable program, restructuring mortgages to prevent foreclosures much in the manner of the HOLC program during the Great Depression.[153] Much like HOLC in 1934, Fannie Mae and Freddie Mac now find themselves as dominant and absolutely critical participants in the housing finance system.[154] It seems that ideological distaste, which led to HOLC's liquidation, again has given way to pragmatic necessity.

III. De-Nationalization and Re-Nationalization in Other Countries: A Comparative Perspective

It is interesting to compare the United States' relationship with its banking and housing finance systems with the relationships of other nations with their own systems. What the comparison reveals is that even though different nations may start with remarkably different ideological biases, their relationships with banking and housing finance industries exhibit the same tumultuous dynamic that characterizes the United States. In times of crisis, ideology gives way to pragmatic necessity. When the pragmatic steps necessary to end crises succeed, ideological bias re-emerges until the next crisis.

A. *Canada*

The Canadian banking system has weathered the current economic crisis remarkably well. According to the World Economic Forum, the Canadian banking system is the soundest in the world.[155] Ironically, the strength of the Canadian system stems largely from the fact that it was modeled on the Hamiltonian, centralized United States national bank

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153. *See* FinancialStability.gov, Making Home Affordable, http://www.financialstability.gov/roadtostability/homeowner.html (last visited July 16, 2009).

154. *See id.*; *see also* Edmund L. Andrews, *Mortgage Plan Targets up to Four Million Homeowners*, N.Y. TIMES, Mar. 5, 2009.

155. WORLD ECON. FORUM, GLOBAL COMPETITIVENESS REPORT 2008-2009, at 129 (2008), *available at* http://www.weforum.org/documents/GCR0809/index.html.

system.[156] Unlike the United States, however, Canada was not persuaded by the ideological distaste for central planning that led the United States to jettison the Hamiltonian system. Canada, of course, has major private lending institutions, but they are all chartered by the national government and regulated accordingly.[157]

A major aspect of that regulation concerns home lending. Most Canadian home mortgage loans are short-term and have adjustable rates; however, unless they are insured under the National Housing Act, they require a 20% down-payment at origination.[158]

The Canadian government pragmatically restricted the riskiest home financing activities at the time those activities were flourishing in the United States.[159] Three factors in particular led Canadian banks to avoid originating subprime mortgage loans.[160] First, Canadian banks, like British banks, fund mortgage loans largely through deposits rather than capital obtained in secondary markets.[161] Second, Canadian banks are required to keep higher capital reserves than their American counterparts, reducing the capital on hand to lend and increasing the incentive to lend it well.[162] Third, Canadian banks keep mortgage loans "in-house" rather than securitize and sell them to others.[163] As a result, Canadian banks had little incentive to lend unwisely. Despite the fact that most Canadian home mortgage loans are short-term and have adjustable rates,[164] the Canadian bank and home financing systems have emerged as the soundest in the world during the

156. Theresa Tedesco, Op-Ed., *The Great Solvent North*, N.Y. TIMES, Feb. 28, 2009, at A23.

157. *Id.*

158. FIN. CONSUMER AGENCY OF CAN., THE ABCS OF MORTGAGES, http://www.acfc-fcac.gc.ca/eng/publications/mortgages/DownPayments-eng.asp (last visited Nov. 10, 2009).

159. Tedesco, *supra* note 156.

160. *Id.*

161. *See* Pietro S. Nivola & John C. Courtney, *Know Thy Neighbor: What Canada Can Tell Us About Financial Regulation*, BROOKINGS INST., Apr. 23, 2009, *available at* http://www.brookings.edu/papers/2009/0423_canada_nivola.aspx.

162. *Id.*

163. Tedesco, *supra* note 156.

164. *See id.*

current crisis.[165]

B. *Sweden*

Sweden is the birth place of the (in)famous "Third Way" between capitalism and socialism.[166] Perhaps it should not come as a surprise then that the Swedish response to economic crises has been characterized by anti-ideological pragmatism. Today, many in the United States are calling for a response to the current economic crisis modeled on the pragmatic Swedish response to its crisis in the early 1990s.[167]

The Swedish model of nationalization is characterized by a complete government takeover of private institutions for the shortest amount of time as possible, after which they are returned to the private market.[168] When Swedish banks began to collapse under the weight of toxic assets, the national government established an institution called Securum, which became a holding tank for banks' toxic assets and, in some cases, for entire banks.[169] Banks were infused with capital so that they could resume lending activities now controlled by the national government.[170] The Swedish state assumed ownership of bank assets, wiping out existing shareholders, but returning proceeds from liquidation to the Swedish treasury.[171] Businesses that fell under government control, including industrial companies, were eventually de-nationalized and resumed private operations.[172]

C. *Britain*

If the United States is generally regarded as the most

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165. *See* WORLD ECON. FORUM, *supra* 155, at 129.

166. *See, e.g.*, PHILIP WHYMAN, SWEDEN AND THE "THIRD WAY" (2003).

167. *See* Richardson & Roubini, *supra* note 146 ("Basically we're all Swedes now. We have used all our bullets, and the boogeyman is still coming. Let's pull out the bazooka and be done with it.").

168. Carter Dougherty, *Sweden's Fix for Banks: Nationalize Them*, N.Y. TIMES, Jan. 23, 2009, at B1.

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

ardently free-market economy in the West, Britain is probably second. Although Britain's Labor Party has its historical roots in socialism, Britain is, in fact, a relatively consistent, when compared with much of industrial Europe, free-market economy, even under Labor Party leadership. And although the Bank of England is responsible for maintaining stability in the financial system as a whole, its relationship to its troubled banks has been relatively laissez-faire; it has been British policy for the past 150 years to let individual institutions "sink or swim" on their own.[173] The role envisaged for the Bank of England is to provide loans to prevent the contagion of failure from spreading to the banking system generally, but to let banks in trouble fail. Yet in response to the current economic crisis, the British government found itself, in the face of enormous controversy, saving several major banks, including Northern Rock, The Royal Bank of Scotland, and Barclays.[174] More may be on the horizon.[175]

Britain's housing finance system actually resembles the pre-Depression U.S. system: home loans are usually funded by deposits at banks rather than by capital obtained through selling mortgages on a secondary market.[176] In addition, most home mortgage loans are adjustable-rate rather than fixed-rate.[177] As lending has decreased in response to the current crisis, interest rates have increased, increasing the vulnerability of British homeowners to foreclosure.[178] As a result, similar to what has happened in the United States, the British government finds itself intervening to restructure mortgage loans.

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173. Alistair Milne & Geoffrey Wood, *Banking Crisis Solutions Old and New*, FED. RES. BANK OF ST. LOUIS REV., Sept./Oct. 2008, at 517, 524, *available at* http://research.stlouisfed.org/publications/review/08/09/Milne.pdf.

174. *UK Banks Receive £37bn Bail-Out*, BBC NEWS, Oct. 13, 2008, http://news.bbc.co.uk/2/hi/business/7666570.stm.

175. *See id.*

176. Richard K. Green & Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 J. ECON. PERSP. 93, 102 (Fall 2005), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=908976.

177. *Id.*

178. Julia Werdigier, *Foreclosures Force Britons to Ponder Shift to Fixed Rates*, N.Y. TIMES, Aug. 22, 2007, at C1.

D. *France*

Unlike either Canada or Sweden, but like Britain and the United States, France in the 1980s was motivated in its relationship with its banks primarily by ideology rather than pragmatism. When Francois Mitterrand led the Socialist party to control of the French government in 1981, he nationalized banks as a matter of ideological preference rather than in response to a particular crisis.[179] In fact, Mitterrand acknowledged that there was no purely economic justification for the nationalizations.[180] They were instead, he said, a matter of principle, and that principle was embraced by French policymakers on the Left.[181]

As in the United States, basing the nation's relationship with its banking and financing industries on the basis of ideology was untenable for France in the face of economic crisis.[182] France faced an acute economic crisis in the 1980s, in part because lending activity was driven by political, rather than economic, considerations.[183] By the late 1980s, in a pragmatic response to the economic crisis, most of France's banking system had been de-nationalized.[184]

IV. An Attempt at Conclusion and Explanation

Banking and housing are central to the life of any nation, and that is particularly so of the United States, where the idea of home-ownership is central to its self-image. As such, they are too important to the economic life of a nation to be left captive to ideology. Whether socialist or capitalist, societies pragmatically nationalize, de-nationalize, and re-nationalize in response to crises, then are swayed by ideology when they can

179. *See generally* David Cobham, *The Nationalisation of the Banks in Mitterand's France: Rationalisations and Reasons*, 4 J. PUB. POL'Y 351 (1984).

180. ALISTAIR COLE, FRANCOIS MITTERRAND: A STUDY IN POLITICAL LEADERSHIP 35 (1994).

181. *Id.* at 33-34.

182. *Id.*

183. *Id.*

184. William L. Megginson, *The Economics of Bank Privatization*, 29 J. BANKING & FIN. 1931, 1964 (2005). *See generally id.* (discussing "the empirical literature examining bank privatization").

afford it. Ideology, in other words, is a luxury. It is a luxury that we have repeatedly paid for in the United States, and at great cost.

Unfortunately, this cycle shows no signs of abating. Indeed, according to some commentators the question now is not whether to nationalize, but when to de-nationalize.[185] It would perhaps be wiser to adopt the pragmatic, non-ideological approach modeled in Canada, rather than continuously reverse course in the face of crises. If that happened, there might be fewer crises to face.

185. Posting of Simon Johnson to The Baseline Scenario, http://baselinescenario.com/2009/02/23/privatize-the-banks-already/ (Feb. 23, 2009, 22:28).