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Abstract

Scholars currently debate the causes and consequences of the financial, housing foreclosure, and economic crises that are spreading globally to transform cities and international relations. This article develops the heuristic device *crisis-policy nexus* to identify and explain the policy drivers of the subprime mortgage crisis. I argue that the generation and regulation of capital flows through state policies systematically produces and exacerbates crisis tendencies – the accumulation of capital is associated with the accumulation of crises. Against conventional forms of Marxist theorizing, this article suggests that the metamorphosis of the subprime mortgage crisis into the global financial crisis reflects sociopolitical contradictions of previous state policies, and not the contradictions of capitalist accumulation per se.

Keywords

crisis, finance, housing, policy, real estate

Introduction

In recent years, the notion of ‘crisis’ has attracted widespread attention from scholars and researchers interested in understanding the spiraling financial, housing, economic, health care, and urban crises that are transforming cities and metropolitan life. The 9/11 and the Hurricane Katrina disasters, the Asian tsunami, the Mumbai attacks, and the implosion of the financial system suggest that the world of crises and disasters is changing. In a globalized world defined by massive upheavals of international and national relations, academics and policy makers are increasingly recognizing that crises are becoming more frequent, intense, interconnected, and consequential. Castells’s (1996) notion of the network society draws attention to the ways in which small disturbances and threats can propagate rapidly through dense and dispersed networks that constitute the ‘space of flows’. The routinization of risk in these complex and tightly coupled networks invariably breeds

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'normal accidents' that may be catastrophic (Perrow, 1984, 2007). Boin (2009) argues that today's 'transboundary crises' transcend time barriers, lack clear beginnings and ends, travel through political boundaries with intense velocity, and can jump across different socio-spatial systems to cause maximum destruction. In addition to direct physical damage, a transboundary crisis can cripple critical infrastructures and undermine the legitimacy of governments, the 'legitimation crisis' in Jurgen Habermas's (1976) famous thesis on the crisis tendencies of advanced capitalism.

This article adds to the burgeoning empirical and theoretical research on the causes and consequences of crisis by examining the ways in which state policies and actions operate as major crisis generating and exacerbating processes. In recent years, mounting foreclosures and widespread job losses have caused major fiscal crises for local and state governments, destabilized communities, and spread financial havoc around the world. Since 2006, homeownership rates have been falling while more than a million American families have already lost their homes to foreclosure. Across the country, foreclosure notices and boarded houses are appearing on once stable blocks while media outlets announce almost daily massive government cutbacks at the state and local levels to compensate for lost revenue. New home sales for all of 2009 fell by almost 23 percent to 374,000, the worst year on record. A record 2.8 million properties reported foreclosure filings in 2009, a 21 percent increase from 2008 and a 120 percent increase from 2007. Of all US housing units, 2.21 percent (one in 45) received at least one foreclosure filing during the year, up from 1.84 percent in 2008, 1.03 percent in 2007 and 0.58 percent in 2006.¹ In short, the mortgage crisis has mushroomed into a global finance crisis that has had devastating consequences on families, communities, and state and local governments. A major goal of this article is to identify the causal forces and consequences of the mortgage crisis in an effort to deepen sociological understanding of the policy and institutional drivers of crisis, the linkages between human agency and crisis, and the increasing destructiveness and territorial spread of crises.

In this article, I develop the concept of *crisis-policy nexus* to illuminate the ways in which state policies generate, exacerbate, and respond to various political, economic, and financial crises. My argument is that state housing finance policies are major crisis management and displacement strategies that reflect and reinforce patterns of financial profiteering and exploitation that constitute contemporary capitalism. The concept of crisis-policy nexus directs attention to the contradictions and irrationalities of state actions and regulatory strategies that are direct responses to the problems generated by previous state policies. Following Jones and Ward (2002), I view crisis as a process of creative destruction that is associated with periods of disruption and transformation. Against 'capital logic' approaches that locate crises in the contradictions of capitalism, I argue that state policies and socio-legal regulations are the underlying drivers of the housing and foreclosure crises that have diffused globally. This argument builds on the theoretical work of Gottdiener (1994), Gottdiener and Feagin (1988), Feagin (1998) and other urban scholars who emphasize the contingency of urban development and the important role of human agents in the generation and management of crisis. A core assumption, quoting Feagin and Parker (1990: 12), is that crises and their socio-spatial manifestations 'do not develop out of an inevitable and unalterable structural necessity, but rather in a contingent manner; they result from the conscious actions taken by individual decision makers in various class, race, gender, and community-based groups, acting under particular historical circumstances.' This emphasis on human agency brings people back into the analysis and emphasizes the centrality of social action and conflict in determine the timing, intensity, and extensiveness of crisis.

I use the term 'cascading crises' to refer to political, economic, social, cultural, and environmental forms of social breakdown, destabilization, and disruption that cause widespread havoc and disruption to communities and livelihoods. Importantly, struggles between different fractions of

capital, competitions over the allocation of resources, and conflicts among government agencies, state managers and capitalists all influence the meaning and construction of crisis, and the selection of different policies and laws to respond to crisis conditions. Thus, the human response to crisis can be direct or indirect and take the form of destructive, creative, innovative, and transformative events and actions (by individuals, corporations, and governments) that can have far reaching and long-lasting consequences for people in distant places. The notion of cascading crises implies chains or sequences of disruptive events and actions that have increasingly negative impacts and effects over time. Particularly relevant is the insight that policy attempts to create rationalizing safeguards often breed dysfunctional and irrational consequences that in turn often prove self-defeating, or worse, can have catastrophic outcomes. Such a conception recognizes the blurring of distinctions between different crises and directs attention to the social processes underlying what Edward Soja calls the 'cluster of major crises affecting the entire world economy' (Soureli and Youn, 2009: 53)

Crisis Theory and the Crisis-Policy Nexus

Over the past several decades, scholars and researchers have theorized the political, economic, and organizational sources of different crises in relation to changes in profitability, business cycles, economic growth, and notions of over-accumulation and under-consumption. Early work by Poulantzas (1978), Offe (1984), O'Connor (1973), Bowles and Gintis (1982), and Wolfe (1977) stressed the ways in which the logic of capital constrained state action and systematically generated periodic economic crises. A core assumption of this 'capital logic' perspective is that the state is faced with contradictory tasks: on the one hand it must sustain the process of capital accumulation, since its own survival depends on a continuous flow of revenue; on the other hand, the state must preserve the belief in itself as a neutral arbiter of divergent societal interests to legitimate its power (O'Connor, 1973; Offe, 1984). The state cannot effectively secure the market conditions necessary for capitalist accumulation unless it can conceal its class bias behind the cloak of democratic legitimacy. In so far as the state is increasingly called upon to compensate for the failures of market mechanisms without infringing on the primacy of private production, the state will face a fiscal crisis (O'Connor, 1973), a crisis of administrative rationality (Offe, 1984), and a crisis of legitimacy or mass loyalty (Habermas, 1976).

While early Marxian political economy accounts located the origin and development of crises in the contractions of the accumulation process, more recent theories examine the impact of state interventions and policies on the nature, intensity, and extensiveness of crises. In this conception, the policies of the capitalist state are shaped not by the structural imperatives of a capitalist economy but by the outcomes of political struggles between classes and class fractions. This socio-spatial approach rejects a conception of the state as a thing-instrument or a unified subject. In contrast, the socio-spatial approach views the state as a 'strategic battlefield' of intersecting power networks, which both articulate and exhibit mutual contradictions, intense conflicts, and internecine struggles. Eschewing static perspectives, the socio-spatial approach examines the historical roots of crises and acknowledges that human actions and decisions generate crises but these actions occur within a framework of unacknowledged conditions and unforeseen consequences. Thus, a socio-spatial approach locates the timing, pace, and magnitude of crisis in the actions of state officials, political and economic elites, and powerful organizations that control financial resources.

Understanding the crisis generating aspects of state intervention suggests a multidimensional conception of state policy and action that sensitizes us to the ways in which multiple contradictions

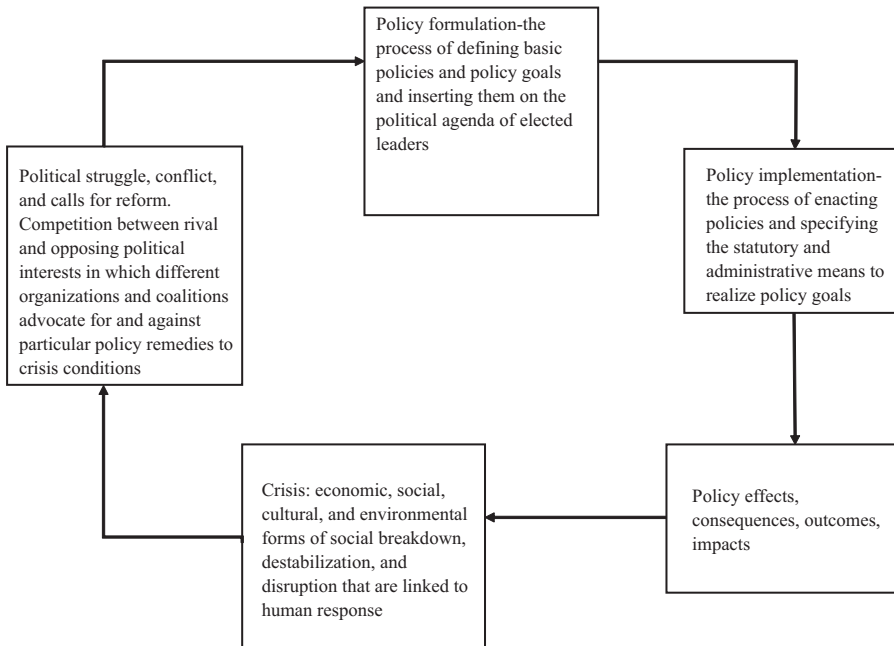


Figure 1. Crisis-policy nexus

are managed by the state as a consequence of its ongoing involvement in the production and regulation of capitalist development. Figure 1 shows the conceptual heuristic crisis-policy nexus to illuminate the multifarious modes of state intervention and policy repertoires that invariably generate geo-political contradictions that lead, in turn, to conflicts and struggles, and eventually new policies and regulatory strategies to address crisis conditions. The crisis-policy nexus consists of five phases in a process of policy transformation and impact – policy formulation, implementation, policy impacts, and policy crisis and debate. There is no beginning or end to this circuit of policy transformation and each moment constitutes a particular piece of the whole process. Policy formulation is a process of defining the goals of major policy innovations and including them on the political agenda for debate, negotiation, and compromise. Policy implementation is the process of specifying the statutory and administrative means to realize these goals and defining which agencies and bodies have authority to execute the policy. Once policies are implemented they can have widespread *effects* on the everyday decisions and behavior of individual households, businesses, and government agencies. Policies can set in motion long-term developmental trajectories through which various lock-in mechanisms – e.g. hierarchies, networks, institutional patterns, power relations, and decision making – sustain and reinforce dominant processes of financial exploitation and development.

Over the last several decades, a neoliberalized market paradigm has been driving and constraining the processes of US state policy formulation and implementation as elected officials and elites have engaged in relentlessly intense destructive competition to attract jobs and capital to revive their cities and transform space. Several components characterize ‘ideal type’ neoliberalism.² First, because the desire for individual and social betterment drives human productivity, the market should encourage and reward competitiveness and profit. Second, the marketplace is the most effective and efficient mechanism for allocating goods and delivering services since it reconciles

individual self-interest with society's collective development. Non-market considerations in the allocation of resources are fundamentally illegitimate because they represent a threat to individual freedom, liberty, and choice.

At the heart of this 'market paradigm', according to Fasenfest et al. (1997), is the view that non-price/non-market allocation of resources makes communities worse off. Too much regulation (tax, zoning, health, and safety) stifles initiative, breeds inefficiency, distorts markets, and corrupts democracy. To maximize private profit and nurture societal development, governments must adopt a 'hands-off' (*laissez faire*) approach to governance and policy that honors private property, holds individual rights sacred, and bolsters and supports market processes. As a political strategy, neoliberalism advocates market-based solutions to social problems and reflects a range of policies to engineer economic growth, privatize public services and assets, and intensify inter-urban competition for capital investment. In policy making debates, valuable societal outcomes – such as equality, democracy, and justice – that have no price are marginalized as 'non-market' issues and dismissed entirely because they are not deemed as legitimate considerations in the formulation and implementation of policies.

While there are cross-national similarities and generalized features of neoliberal regulatory strategies and policies, the crisis-policy nexus emphasizes the specificity of the USA. The heuristic device directs analytical attention to the ways in which US state policies and socio-legal regulations constitute crisis management and displacement strategies to address the multiple contradictions, irrational effects, and unforeseen consequences of ongoing government involvement in housing and finance markets. Claus Offe (1984) argues that the state policies and programs will frequently not be a response to economic crises *per se*, such as a crisis of Fordist/Keynesian accumulation, but to crises in the disruptive and dysfunctional consequences of state action. Crises in state regulation and intervention occur because the increasing complexity and specialization of state functions generate coordination problems among the different levels of government (Jones and Ward, 2002: 133). Because state actions and policies breed unforeseen consequences, which intensify the contradictions of accumulation and aggravate social problems, the state becomes entangled in a 'crisis of crisis management' (Offe, 1984).

The essence of the crisis-policy nexus is that the implementation of urban policy is accompanied by a set of complex and contradictory responses that feed back to the policy making process to generate future transformations and crises. The impacts of state policies may not be immediately observable or predictable and, importantly, some policies and strategies may counteract the effects of others. While some policies may temporarily mitigate crisis tendencies, for example, other policies may exacerbate current crises and/or generate new crises. Once policies are implemented they can have widespread effects on post-crisis restructuring by limiting choices, discouraging some forms of decision making, and encouraging other actions on the part of individual households, businesses, and government agencies. Past state policies and legal/regulatory reforms feed forward in time to constrain policymaking, influence social action, and shape the pace and trajectory of societal development.

In short, political conflicts and struggles influence the construction of crisis and the selection of some policies rather than others to respond to crisis. That is, crises are not the automatic outcome of the 'logic' of capital accumulation. The legacies of past trends and historical continuities always constrain the restructuring process, a condition that expresses Karl Marx's (1978 [1852]) famous statement that 'men make their own history but they do not make it as they please; they do not make it under self-selected circumstances, but under circumstances existing already, given and transmitted from the past.' As a matter of patchwork reform rather than deep structural change, state policies and interventions ultimately create a 'catch 22 loop' whereby 'old' policies produce

crises that inevitably bring forth calls for 'new' policies that, once implemented, create further contradictions and crises, a situation that then generates a new round of calls for 'reform'. Thus, the politics of crisis take place on an aggressively contested institutional landscape in which past socio-spatial inequalities and regulatory arrangements interact with current political conflicts and struggles to shape patterns of uneven development and the organization of cities and the built environment. The notion of crisis-policy nexus draws attention to state policies and regulatory strategies as major elements of a volatile socio-spatial restructuring process that is always unpredictable and deeply contested.

Securitization and the Rise of the Secondary Mortgage Market

The subprime mortgage crisis and its spread to global financial markets has historical roots in a series of state actions and policy decisions taken in the 1970s and later to remedy past economic crises and stimulate investment in urban housing markets. On 15 August 1971, President Nixon imposed wage and price controls in an effort to contain spiraling inflation. A slowing economy and the oil crisis of 1973 brought stagnant wages and high inflation – i.e. stagflation – throughout much of the world for the rest of the decade. Soaring oil prices compelled most American businesses to raise their prices, with inflationary results. Manufacturing industries began to decline with the USA running its last trade surplus (as of 2009) in 1975. Facing fiscal crisis and bankruptcy, cities such as Cleveland and New York reduced their workforces, cut the public payroll, closed hospitals, and slashed social spending as the route to fiscal solvency. Tax revolts and revenue limitations such as Proposition 2½ in Massachusetts and Proposition 13 in California imposed major fiscal constraints on municipal governments, whose revenues had already been reduced significantly during the 1970s. Exacerbating these economic and fiscal crises were skyrocketing mortgage interest rates that hovered for years in double digits, a condition that reflected and reinforced the inflationary surge of the 1970s and early 1980s.

By this time, policy makers recognized that the main financing tool for housing production and residential development – the 30-year fixed-rate mortgage originated by small, localized savings and loan (S&L) banks and depository lenders – had become a drag on investment and a barrier to capital accumulation. Relying on short-term deposits to fund long-term mortgage lending made it difficult for S&Ls to tap into extra-local sources of investment to finance new mortgages, thereby constraining profit making. During the late 1960s and the 1970s, the Federal Reserve implemented a series of regulations allowing inflation to rise, an action that contributed to increases in nominal interest rates and intensified financial volatility. Increases in short-term nominal rates not matched by contractually set rates on existing mortgages exposed the Achilles heel of the US system of housing finance, namely, the maturity mismatch between long-term mortgage credit and the short-term deposits that S&Ls used to finance mortgage lending. To combat the negative consequences of high inflation, banks and other mortgage originators increasingly 'front loaded' the interest rates on new fixed-rate mortgages. This front-loading of interest payments reduced affordability and further limited the extension of mortgage credit, thereby restricting construction activity. Reflecting these factors, housing construction experienced a series of pronounced boom and bust cycles from the early 1960s through the mid-1980s, which contributed in turn to substantial swings in overall economic growth.

The crisis generating and exacerbating problems associated with relying on short-term deposits to fund long-term mortgages mobilized policy makers and elected officials to implement several policies to restructure the housing finance system and expand investment in the secondary mortgage market. In the 'primary' mortgage market, borrowers obtain loans from local banks and

mortgage originators. In the 'secondary' mortgage market, investment banks, financial institutions, and the two major Government-sponsored enterprises (GSEs) – the Federal Home Loan Mortgage Corporation (FHLMC, nicknamed Freddie Mac) and the Federal National Mortgage Association (FNMA, or Fannie Mae) – repackage mortgages as securities to sell to institutional investors in national and global capital markets (Gotham, 2006). The Housing Act of 1968 split Fannie Mae into two agencies: the Government National Mortgage Association (Ginnie Mae) and the re-chartered Fannie Mae, which became a privately owned GSE, authorized to operate in the secondary market to enhance the exchangeability of mortgages. Two years later, Congress created Freddie Mac to compete with Fannie Mae in the secondary market and both GSEs together pioneered the first mortgage pass-through security, a pool of mortgage loans that are standardized and packaged for sale to institutional investors. In the early 1980s, Freddie Mac introduced collateralized mortgage obligations (CMOs), which separated the payments from a pooled set of mortgages into 'strips' carrying different effective maturities and credit risks (for an overview, see Stuart, 2003).

In 1980, Congress passed the Depository Institutions Deregulation and Monetary Control Act (DIDMCA), which abolished interest rate ceilings on first mortgages for residences, and the Alternative Mortgage Transactions Parity Act (AMTPA) of 1982 that pre-empted state laws to enable the national use of variable-rate terms, balloon payments, and negative amortization of both first and subordinate lien loans. The DIDMCA ended state usury caps that had limited the interest rates banks could charge on primary mortgages and, in the process, gave banks more incentive to make home loans to consumers with less-than-perfect credit. The significance of the AMTPA was that it allowed banks to pioneer new and exotic mortgage financing tools, especially the Adjustable Rate Mortgage (ARM). A third act was the passage of the Secondary Mortgage Market Enhancement Act of 1984 (SMMEA) that helped create a market for buying and selling private mortgage-backed securities. Congress designed this legislation to expand investment opportunities in the secondary mortgage market and thereby to increase the supply of funds available to mortgage borrowers. In turn, these policy actions provided incentives to mortgage brokers to increase the production of mortgages and thereby to develop new and innovative techniques to market home loans to consumers (Gotham, 2009).

Overall, these banking reforms were carried out under the banner of 'deregulation' which included a lessening of exchange controls, removing institutional barriers that protected the S&L industry from competition, and enmeshing the housing finance sector within broader credit markets. Throughout the decade, leading 'think tanks' in Washington DC, including the Brookings Institution and the American Enterprise Institute (AEI), were active in holding seminars and publishing studies advocating deregulatory initiatives. Large financial firms supported by the Business Roundtable and Trilateral Commission lobbied aggressively to develop and enact legislation to roll back existing regulations on commercial investment in housing, and expand interstate banking. By 1980, when Citicorp President Walter Wriston was named co-chairman of the Business Roundtable, a powerful team of explicit deregulation advocates from financial firms such as Bank America, Morgan Guaranty, Prudential, Metropolitan Life, and Merrill Lynch had become members of the Roundtable's 40-person policy committee (Florida, 1986: 141).

Representatives of large financial institutions worked aggressively to influence the content and form of legislation to eliminate interest rate ceilings, increase opportunities for diversified savings portfolios, and legitimize calls for sweeping deregulation. Representatives of the real estate and home building sectors including the National Association of Realtors (NAR), the National Association of Home Builders (NAHB), the National Lumber and Building Materials Dealers Association, and the AFL-CIO construction trades vehemently opposed financial deregulation. For these groups, the entry of large financial institutions into the housing and real estate

sector, rate decontrol, and diversification signaled a massive transfer of funds away from local institutions and mortgage finance. These otherwise diverse organizations together supported efforts to maintain a steady flow of housing credit. In addition, many real estate interests and members of the NAR and NAHB sat on the boards of local S&Ls, a relationship that helped nurture a political alliance of national real estate lobbying groups with localized S&Ls dedicated to preventing large national banks from entering the housing finance sector heretofore controlled by S&Ls (Florida, 1986: 129). In the end, however, the interests of the S&Ls did not prevail in battles over financial regulatory reform. The inability to muster resources to influence reform efforts combined with their decentralized organization and regionally dispersed networks put S&L interests in a disadvantaged position compared to the powerful assets that large national firms could generate to influence political debate and control the policy agenda.

Rather than remedying the crises of the housing and real estate sectors, however, legislation passed in the 1980s heightened financial volatility and paved the way for the S&L crisis. Defaults and insolvencies rose dramatically after Congress removed deposit ceilings, lifted interstate banking restrictions, and began allowing S&Ls to invest in risky ARMs. From 1980 to 1994, more than 1600 FDIC-insured commercial and savings banks were closed or received Federal Deposit Insurance Corporation (FDIC) financial assistance. This number was 9.14 percent of the sum of all banks existing at the end of 1979 plus all banks chartered during the subsequent 15 years. The comparable figure for the preceding 15-year period (1965–79) was 0.3 percent (FDIC, 1997: 13). In response to the catastrophic failures of the S&Ls, Congress passed the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) which established the Resolution Trust Corporation (RTC) to resolve the insolvent S&Ls (US House of Representatives, 1989a, 1989b). One of the primary goals of the FIRREA, and later amendments, was to bolster the supply of mortgage credit by requiring S&Ls to sell mortgages held in portfolio to the secondary mortgage market. Congressional legislators and policy makers looked upon securitization as a policy remedy to the traditional S&L model, as it further enhanced the commodification and exchangeability of mortgages.

Using the crisis-policy nexus framework in Figure 1 we can view the development of securitization, a major policy outcome that emerged through intense political struggles and conflicts over the problems and limitations of the S&L model of housing finance. Economic instability and an elite sense of crisis created opportunities for powerful financial institutions to control the debate over financial reform and influence the content of legislation to ‘reform’ the S&L system. As a process of creative destruction, we can view the expansion of securitization as a moment of disruption and transformation within the housing finance sector. On the one hand, securitization represented a reactive policy response to the falling rate of profit occurring within the S&L industry. On the other hand, securitization was an important expression of proactive efforts undertaken by large, national financial institutions and the federal government to restructure the housing finance sector and dismantle previous patterns of accumulation dominated by the S&L model.

Early on, Karl Marx pointed to capitalism’s contradictions of over-accumulation and devaluation being temporarily ‘switched’ or ‘displaced’ through financial and monetary arrangements, or credit systems, that help preserve capital for future use. In Volume 3 of *Capital*, Marx (1981 [1894]) argued that development of credit systems temporarily addressed the problem of underconsumption by extending purchasing power. Developments in money and credit thus express systems of temporal crisis displacement that are constituted by state policies and regulatory arrangements. In the case of US financial reforms during the 1980s and 1990s, securitization operated as a political mechanism of crisis displacement, a financial technique to address the problem of housing devaluation caused by the S&L crisis, and a mechanism for both preserving and enhancing flows of capital investment in the housing finance sector.

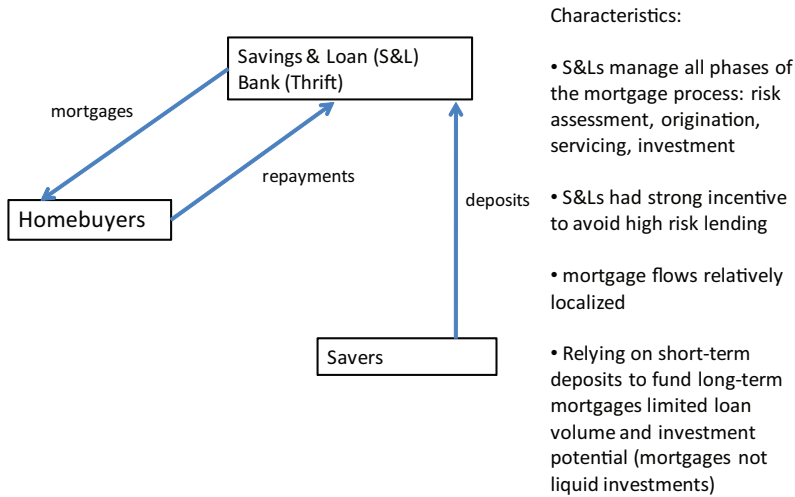


Fig 2. Saving and Loan-based housing finance system, 1930s-1980s

From the Subprime Crisis to the Global Financial Crisis

Overall, state actions and policies to expand the secondary mortgage market represented a series of crisis-induced, trial-and-error efforts to decouple mortgage lending from local networks of accumulation via small banks and integrate mortgage lending into global circuits of accumulation. Securitization reflected and reinforced a dramatic restructuring of the US housing finance system. From the 1930s through the 1980s, the process of originating, servicing, and investing in mortgages involved either a single institution (in the case of loans held in portfolio by depository institutions) or a couple of institutions (in cases where loans were sold into the secondary market through the GSEs or federally insured programs) (see Figure 2). In this depository system of housing finance, S&Ls managed all phases of the mortgage process – i.e. risk assessment, origination, servicing, and investment. Because S&Ls kept the loans they made on their own books (holding them in portfolio for a long period of time), they had strong incentives to avoid high risk lending, underwrite carefully, and to invest time and resources in gathering information about borrowers and communities. Since S&Ls originated and held the mortgage loan (and risk), they were financially liable if the borrower defaulted on the mortgage. Thus, S&Ls were structurally constrained to engage in strong quality control over the production of mortgages and the ability of buyers to pay off the mortgages.

Securitization has been the primary political mechanism for off-loading mortgage risk to third parties and has catalyzed the transformation of the US housing finance system from a system organized by networks of small S&Ls to a system dominated by large, private investment banks and institutional investors. Securitization expresses the disembedding of mortgage origination from mortgage financing as the various steps in the process have become unbundled and organized among different specialized groups. Figure 3 shows the system of housing finance in the 1990s and later with the different key actors, flows, and networks of housing activity. In this system of buying mortgages to sell, S&Ls or mortgage lenders originate loans and process mortgage applications. Wall Street investment firms, large mortgage banking organizations and the GSEs purchase loans and aggregate them into pools. In turn, the GSEs and other investment banking firms issue securities based on these pools, and investors from around the world purchase the mortgage-backed

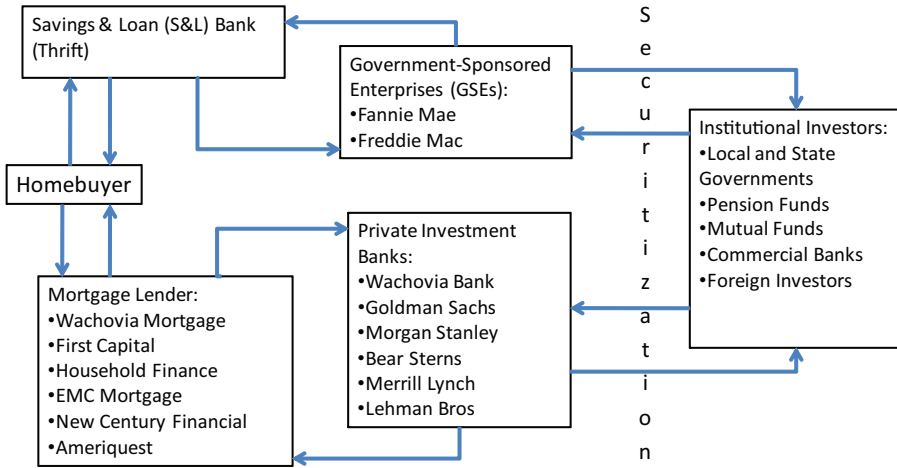


Figure 3. Mortgage flows in the US housing finance system, 1990s to present

securities. Unlike the older system of housing finance in which lenders originated mortgages and held them for long periods, the logic and rationale of today’s housing finance system is to originate mortgages and sell to investors in order to realize profits as soon as possible. As this system developed in the 1980s, the shift from reliance on specialized portfolio lenders (S&Ls) financed by deposits to a greater use of capital markets for financing mortgages represented a state strategy to mitigate the deleterious consequences of recurring financial crises and increase the buying and selling of mortgages through securitization (Florida, 1986; Florida and Feldman, 1988).

Over the last decade, securitization has nurtured new and lucrative opportunities for investing in subprime lending via the marketing loans to low-income people and to areas that had previously been redlined by banks. Subprime lending is the practice of making loans to people with impaired or limited credit histories in return for higher rates and fees. Before the 1990s, subprime lending was virtually non-existent, but expanded tremendously from the late 1990s up through 2006 as national banks and their operating subsidiaries originated subprime mortgage loans, and purchased and securitized these loans in capital markets (Dymski, 2009; Immergluck, 2008, 2009; US Congress Joint Economic Committee, 2007; US Department of Housing and Urban Development, 2009; Williams et al., 2005; Wyly et al., 2006, 2008, 2009; for an overview, see Aalbers, 2009). The sustained rise in house prices along with aggressive marketing of new mortgage financing tools made subprime borrowers – previously shut out of the mortgage markets – attractive customers for mortgage lenders. In particular, subprime mortgage lenders predominantly originated and sold risky non-traditional mortgage products – for example, ‘interest only’ mortgage loans, ‘payment-option’ adjustable-rate mortgages and 2/28 adjustable-rate mortgages (‘hybrid 2/28’) – based on low introductory teaser rates, little or no down payment or verification of borrowers’ income, and inadequate disclosures. All of these ‘exotic’ mortgage options carried high interest rates far above what prime lenders charged customers with better credit. After 2003, greater numbers of subprime loans were either ARMs, no-doc loans, or other exotic loans. Three years later, 92 percent of all securitized subprime mortgages originated in 2006 were adjustable-rate mortgages (DiMartino and Duca, 2007).

The unbundling of mortgage finance from local S&Ls, the growth of new and innovative mortgage financing options, and rising competition among subprime mortgage lenders worked in tandem to encourage subprime lenders to invent increasingly ingenious ways to qualify more

homebuyers for loans and make more loans. Bolstered by profit making opportunities and federal calls to expand homeownership, subprime lenders rapidly increased their operations and aggressively marketed their products to unsuspecting consumers through predatory lending. As a form of financial exploitation, predatory lending is a process of aggressively marketing credit to blemished borrowers without regard to the ability to repay and predominantly relying on the liquidation value of the collateral (Squires, 2004; Wyly et al., 2006). Predatory lenders are a specific type of subprime lender who makes a profit by stripping equality and wealth from borrowers in formerly redlined neighborhoods through high-cost refinance loans.

One distinctive institutional feature of the US financial system that helped generate the subprime mortgage crisis was the parent-subsidiary structure of national banks and their operating subsidiaries, a structure that emerged as a result of the Tax Reform Act 1986.³ During the height of subprime lending in 2006, some of the largest subprime mortgage institutions including Wachovia Mortgage, First Capital, Household Finance, EMC Mortgage, and many others originated subprime mortgage loans and sold them to their parent bank (see Figure 3). The parent bank, in turn, securitized these loans and sold them in capital markets. Many large, national banks such as Wachovia Bank, Goldman Sachs, Morgan Stanley, Bear Sterns, Merrill Lynch, and Lehman Bros, among many others, recognized that they could make huge profits in this risky business, while dispersing high risks to investors through the securitization of subprime mortgages (see Figure 3).

One of the most important advantages of the parent-subsidiary form is to insulate the national bank from the risky business practices of the subsidiary because the subsidiary has a separate legal status under state corporate laws. The parent-subsidiary form immunizes national banks from litigation if a law firm brings a suit against the subsidiary company for predatory lending. By conducting subprime mortgage business through their operating subsidiaries, national banks are able to avoid financial loss, or a decline in their customer base. Moreover, the operating subsidiary in itself, as a non-bank mortgage company, is not subject to the bank regulations including safety and soundness regulations, such as the capital requirements applicable to the parent bank. In short, national banks played crucial roles in encouraging subprime lending because they could generate massive profits by securitizing subprime loans without being directly involved in their origination. The operating subsidiaries of parent banks handled the exploitative and victimizing process of selling subprime loans to homebuyers and then passed these loans to their parent banks to securitize in capital markets.

During the 2000s, a series of intense power struggles occurred on the national level between interest groups lobbying for enhanced power to originate and sell subprime mortgages versus those who argued that increased regulation over the housing market was prudent and useful to enhancing national prosperity (for an overview, see Immergluck, 2009). Large mortgage finance companies and national banks such as Countywide, New Century, Option One, Fremont, Washington Mutual, First Franklin, RFC, Lehman Brothers, WMC Mortgage, and Ameriquest – i.e. firms that accounted for 59 percent of all subprime loans, totaling \$284bn in 2006 – all lobbied for an end to state and federal regulations restricting subprime lending. In contrast, consumer groups – e.g. Association of Communities for Reform Now (ACORN), the National Community Reinvestment Coalition, the Greenlining Institute, Neighborhood Housing Services, and the Center for Responsible Lending – argued that existing regulations were not strong enough to curb predatory lending. These groups called for increased financial oversight to protect consumers from exploitative lending practices and for prosecution against predatory lenders for unscrupulous and illegal activities.

In response to consumers' complaints against predatory lending, in the early 2000s, state governments vigorously investigated exploitative lending practices and brought lawsuits against national banks and their operating subsidiaries for violations of fair lending practices. In 2001, for

example, North Carolina forced Associate First Capital, a non-bank affiliate of Citigroup, to pay \$20m to settle allegations of predatory lending practices. A year later, California attempted to enforce its real estate mortgage laws against Wells Fargo Home Mortgage, Inc. and National City Mortgage Co. which were operating subsidiaries of Wells Fargo National Bank and National City Bank of Indiana. Other large national banks – for example, Bank of America, Citibank, Bank One, J.P. Morgan Chase and Wells Fargo – and their operating subsidiaries or affiliates were involved in suits charging predatory lending practices. In 2002, Citigroup agreed to pay \$240m to settle predatory claims filed by the Federal Trade Commission (FTC) and customers against Associates First Capital. By 2003, state attorneys general had filed more than 20 predatory suits against national banks and their operating subsidiaries or affiliates for violations of state consumer protection laws (Kim, 2009).

National banks and their subsidiaries recognized that state government regulations and litigations were crippling their ability to accumulate profits within the subprime mortgage market, and they lobbied intensively to compel the federal government to neutralize the enforcement effects of state laws against predatory lending. In 2001, 2003, and 2004, the Office of the Comptroller of the Currency (OCC) promulgated a series of new regulations to pre-empt state government enforcement of predatory lending laws and remove restrictions against the ability of national banks and their operating subsidiaries to engage in subprime lending. Executive Branch officials were philosophically opposed to increased federal intervention into the mortgage market and the Department of Housing and Urban Development (HUD) supported policy and regulatory efforts to increase low-income homeownership through subprime mortgages. Bolstered by support from the federal government, the OCC argued that state government regulations were stifling federal efforts to encourage lending to subprime borrowers and reverse decades of redlining in urban communities.

Thus, policy makers sought to expand securitization to the subprime mortgage sector to increase homeownership opportunities for low-income people and thereby ameliorate housing inequalities. For Bush Administration officials, aggressive, pre-emptive, and market-oriented policies could remove the institutional barriers that locked the poor out of housing markets and thereby have beneficial trickle-down effects in the form of increased wealth creation through homeownership. Guided by national policy they helped lobby for, financial institutions like Wells Fargo, Countrywide, Wachovia, and others pushed their operating subsidiaries to step up investments in the subprime mortgage market during the first half of the decade. OCC regulations effectively eliminated the ability of state governments to enforce their consumer protection laws and, in the process, freed the operating subsidiaries of large national banks to engage in predatory lending practices in the subprime mortgage sector (Kim, 2009).

In short, the decisions of the OCC to pre-empt state consumer protection laws that policed and regulated the operating subsidiaries of national banks unleashed a tidal wave of predatory lending that fueled a dramatic expansion of the subprime mortgage market. During these years, subprime lenders argued that they were ‘democratizing credit’ by encouraging millions of borrowers to assume high-risk loans and refinance their existing homes to free up cash for other purchases. The combination of the OCC’s regulations and Congress’s intent to expand the secondary mortgage market provided new opportunities for lucrative investment in subprime lending while dispersing high risks to investors through the securitization of subprime loans. In 2006, subprime mortgages made up 20 percent of the \$3 trillion mortgage market, according to Inside Mortgage Finance (Zarrol, 2007). A year later, in 2007, bankruptcies were mounting for subprime lenders as delinquency and foreclosure rates began to increase, housing prices stagnated, and the safety and soundness of subprime lenders worsened. Since early 2007, the subprime mortgage crisis has

imperiled the entire global financial system and contributed to the worse financial crisis since the Great Depression.

Conclusion

This article has examined the policy drivers of the subprime mortgage crisis and focused on the ways in which state policies and socio-legal regulations generate, reproduce, and exacerbate crisis conditions. Today, scholars, journalists, and pundits debate whether increased financial turbulence is generally driven by the failures of regulatory oversight, excessive investments in complex mortgage-backed securities, or over-reliance on the evaluations of the credit rating agencies. While some explanations locate the crisis in technological innovations especially the advent of automated underwriting software, other accounts embrace 'individualistic' explanations that focus on the actions of irresponsible and confused borrowers, the profiteering activities of mortgage lenders (greed, fraud, unscrupulous and unethical business practices), or foreign demand for securities. None of these explanations, however, get at the policy roots of the crisis. As this article has pointed out, the global financial crisis has its origin in the development of state policies and socio-legal regulations that encouraged the origination and financing of subprime mortgages in global capital markets. State policies provided incentives to purchase and invest in subprime mortgages, loosened lending standards in the subprime market, and provided disincentives to halting predatory lending practices. In short, state policies that generated the subprime mortgage crisis are the political mechanism of 'accumulation by dispossession' (Harvey, 2005), the exploitative extraction and transfer of financial assets from low-income homeowners to the wealthy and affluent.

The subprime mortgage crisis is instructive regarding the impact of state policies and socio-regulations in exacerbating the economic problems that they were supposed to remedy. Consequently, we should view state efforts to address the financial fallout of the subprime mortgage crisis not as coherent policy responses to crises of accumulation but as a series of deeply contradictory restructuring strategies that are significantly destabilizing past networks and patterns of investment within domestic and international mortgage markets. Today, the spreading global turmoil associated with investments in subprime mortgages expresses what Claus Offe (1984) calls the 'crisis of crisis management'. As active participants in promoting new financial innovations, banks and financial institutions have created new liquidity enhancement tools to increase the fluidity and velocity of market transactions and thereby encourage investment in the built environment. The commodification, rationalization, and differentiation of debt through securitization have made vast amounts of capital available to many real estate investors. Yet the negative consequences of securitization include greater instability and volatility in the mortgage market, greater speculative investment, and increased levels of indebtedness. As a consequence of the expansion of securitization, the US mortgage market is now densely interconnected into global circuits of capital circulation that reflect and reinforce contingency, discontinuity, and unpredictability. Thus, the policies and related socio-legal regulations that nurtured the development of securitization have thrust the state into the role of manager and arbiter of multiple and cascading crises that are threatening the global financial infrastructure and generating widespread calls for reform and restructuring.

The above points do not suggest that particular developmental patterns or policy outcomes evolve automatically and coherently in response to the limitations of previous policies, or that they are simple expressions of past trends. Rather crisis-generated restructurings emerge through the combined impacts of deliberate design, chance discovery, reactions to unforeseen consequences,

institutional learning, trial-and-error regulatory experimentation, and political compromises. As recognized by Gottdiener (1990), Gottdiener and Komminos (1989), and Jones and Ward (2002), while crises can be understood as a generalized feature of all capitalist societies, the particular form, intensity, extensiveness, and negative consequences of crisis derive from national institutional arrangements, cultural patterns and ideologies, and national and regional specific economic and financial relations and networks. In short, we cannot deduce particular policy outcomes in advance because they are the product of inter- and intra-class conflicts and political struggles over the formulation and implementation of state policy.

The findings of this article suggest that the crisis-policy nexus offers a powerful heuristic device for explaining how the various phases of formulating and implementing housing finance policy generate political struggle, conflict, and crises. In the case of the subprime mortgage crisis, the lobbying efforts and actions of large financial firms helped define the basic regulatory strategies and policy goals governing financial reform during the 1990s. Financial policies implemented in the 1990s and 2000s opened up new opportunities for parent banks and their operating subsidiaries to exploit consumers through predatory lending and the securitization of subprime mortgages. Over the last several years, the subprime mortgage crisis has resulted in widespread job losses, destabilization of neighborhoods, and the collapse of housing markets around the world. As a result, we witness intense political struggles and calls for reform from large financial institutions, affordable housing advocates, and elected officials concerned with eroding tax revenue. How different political interest groups and actors attribute blame and identify the causes and consequences of the financial crisis will have important implications for the formulation of future social policies to address problematic conditions.

Notes

- 1 Figures come from RealtyTrac. Available (consulted 21 June 2011) at: <http://www.realtytrac.com/contentmanagement/pressrelease.aspx?channelid=9&itemid=8333>
- 2 The literature on neoliberalism is vast. For important contributions, see Antonio and Bonanno (2006), Brenner and Theodore (2002), Fourcade-Gourinchas and Babb (2002), Harvey (2005), and Hackworth (2007).
- 3 The Tax Reform Act emerged as a result of the lobbying efforts of a political coalition of 250 large corporations, led by the Tax Reform Act Coalition. Among the most important effects of this lobbying effort was the elimination of taxes on capital transfers within a corporation, a law that the Franklin D. Roosevelt Administration had enacted during the 1930s to regulate the spread of financial transfers within and across corporations. Within a few years after the passage of the 1986 Tax Reform Act, the largest US corporations converted their divisions into subsidiaries with a parent company at the top of the corporate hierarchy and legally separate and independent subsidiary corporations (Prechel and Morris, 2010). Over the next two decades, the parent-subsidiary form would become the dominant corporate form and displace the corporate-division model that had dominated since the 1930s. In addition, as corporations adopted the parent-subsidiary model, they increased their size through mergers and acquisitions as well as the number of subsidiaries, a process that reflects and reinforces trends toward the differentiation and specialization of the parent-subsidiary form.

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