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Credit markets and federal policy: studying history to guide the future

Modern economists are aware of the power of John Maynard Keynes's ideas about public investment, and they study Milton Friedman's views on the proper use of monetary policy. Indeed, both public investment and monetary policy contribute to the fundamental structure of economic policy. Yet if we look at the patterns characterizing the U.S. economy over the last two centuries, we can identify an additional means of supporting that structure and achieving economic balance. In *American Bonds: How Credit Markets Shaped a Nation*, Sarah L. Quinn examines the historical development of financial instruments and federal credit policy, emphasizing the "sheer magnitude of America's mortgage markets." Policy related to credit has caused markets to, on the one hand, grow and become unmanageable and, on the other, adjust and take off again in the hope of meeting the needs and expectations of each new era.

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Quinn identifies the federal government and its interaction with credit markets as a third means of implementing economic policy. In her book, we see mortgage and credit markets developing alongside railroad investment, farming, and the exploration of the American west. As the United States became a modern nation, its farmers had to face formidable challenges: land speculators, swindlers, loans based on inflated land valuations, and, finally, a bursting economic bubble as grand promises faded away. Over time, fear grew among small farmers and investors as they saw interference from domestic and foreign big-money interests concerned solely with windfall profits and other lucrative financial returns. In coping with these realities, farmers adopted new means of protecting themselves by inventing new financial instruments, and politicians liked the idea of protecting farmers' interests through innovative legislation. Early in the 20th century, members of the U.S.

Treasury Department traveled to Europe to study European credit policy, learning that they could use proven credit policy techniques to pool farmers' resources, lower the cost of lending, and diversify risk.

As presented in the book, the history of American mortgage markets is filled with examples of policy successes, failures, and lessons learned. The key point of this discussion revolves around the role that new business played in formulating new credit practices and the political response to those practices. Ideas about banking innovation led to the adoption of the Federal Reserve System Act of 1913, just as ideas about farm financing led to the Federal Farm Loan Act of 1916. With these new laws, banks became for-profit banks and farmers could join farmer-owned cooperatives with access to credit.

Several problems then came up in the World War I era. At the outset of the war, many smaller cities suddenly had to accommodate war factories that attracted many workers and caused housing shortages. Three main wartime housing efforts followed, with the Army Ordnance Department planning residential communities for manufacturers in remote areas, the Emergency Fleet Corporation providing mortgages to shipping companies for land they already owned, and the United Housing Corporation serving as a direct housing program under which the U.S. government built and owned homes. Herbert Hoover played a leading role in federal housing programs, including in launching the Building and Housing Division within the Commerce Department during his tenure as U.S. Secretary of Commerce.

The administration of Franklin D. Roosevelt built on some of Hoover's contributions, including those Hoover made as President. Credit again found its way into ideas about shared risk, this time in the form of mortgage bonds. A typical bond was backed by a first mortgage sold in denominations of $100, $500, or $1,000, and some bonds were even sold as "baby bonds" in monthly installments of $10. However, although the shared risk offered by bonds made them a popular investment in the 1920s, their reputation was seriously damaged with the onset of the Great Depression. Given that the housing industry was central to the U.S. economy, both as a major employer and as the third-largest industry in the country, other financial instruments related to mortgages had to be developed.

A new direction was charted by turning real estate investment into the ideal of home ownership. Quinn quotes a 1935 speech by David Saperstein, the director of the Trading and Exchange Division of the U.S. Securities and Exchange Commission, in which he told members of the National Association of Real Estate Boards that the small investor "lacked confidence in real estate securities" and the "task of winning the investor back to belief in real estate as a medium of investment is in no small measure, your own." This new attitude opened an era of advancements, setbacks, and lessons learned. It set the stage for the introduction of federal credit programs that eventually enabled the post-World War II golden age of home building and home ownership in the United States. Federal Housing Administration (FHA) loans, as well as loans guaranteed by the U.S. Department of Veteran Affairs (VA), played a big part in enabling historic levels of home ownership. Besides FHA and VA loans, lending was also provided by other, newly born federal credit agencies, including the Small Business Administration and the Student Loan Corporation (Sallie Mae).

Throughout its history, the United States has balanced the economic interests and actions of the central government with those of private citizens. Can policymakers maintain that balance going forward? In the next several years, Americans will have to tackle problems related to infrastructure, energy, the environment, and eldercare, and they will have to face a large segment of the workforce going into retirement. By presenting lessons learned from the checkered history of U.S. credit policy, *American Bonds* can certainly show how informed economic policy can help confront those challenges.