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Government Policy, Housing, and the Origins of Securitization, 1780 - 1968

by

Sarah Lehman Quinn

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requirements for the degree of

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in

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in the

Graduate Division

of the

University of California, Berkeley

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Professor Marion Fourcade

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Fall 2010

Abstract

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In 1968 the Johnson Administration transformed Fannie Mae, the federal agency responsible for supporting the nation's secondary mortgage market, into a privately owned but federally supported company called a *Government Sponsored Entity*. The Administration also implemented a policy that promoted mortgage-backed securities (MBS), a financial technology that would eventually revolutionize global finance. This dissertation investigates the origins of those Johnson Administration policies. Drawing from original archival research and the secondary literature on housing and credit in the U.S., I show that a long history of government officials acting like agents in U.S. housing and credit markets contributed to the rise of the U.S. securitization market.

The dissertation first describes the deeply rooted historical forces that affected the 1968 mortgage finance reforms. These forces include: a set of contradictions in the field of housing that began in the revolutionary period; government officials' tendency to use indirect policy tools, like federal credit aid programs, to manage housing and credit markets, and; since the 1930s, the use of increasingly complex debt instruments to manipulate the federal budget. Having outlined these forces, and discussed how they came to a head in the midst of the 1960s, I next investigate the mechanisms through which the Johnson Administration came to choose to spin-off Fannie Mae and promote the MBS market. I find that contentious budget politics were especially important in directing the policy. I conclude that in the 1960s these policies were adopted because (i) they promised to help solve long-standing problems in the housing market, and (ii) because they helped President Johnson manage a budget deficit already extended due to the combination of the Vietnam War and the Great Society programs.

This dissertation joins a growing body of scholarship that challenges the notion that America has a weak state and laissez-faire economy. Building on this literature, I argue that (i) federal credit programs are an important but often-overlooked point of federal intervention into the economy, and that (ii) the structure of federal budget politics is one important reason why federal intervention in the economy often remains indirect and complex. Through this case study, I argue that a sprawling and fragmented political structure, combined with the use of indirect policy tools, are important reasons why U.S. government programs tend to be easily misrecognized or overlooked.

Table of Contents

LIST OF FIGURES AND TABLES	II
LIST OF ACRONYMS	III
ACKNOWLEDGEMENTS	V
CHAPTER 1: INTRODUCTION	1
UNDERSTANDING AMERICAN STATES AND MARKETS	4
FEDERAL CREDIT PROGRAMS	15
A CRITICAL CASE STUDY.....	18
OVERVIEW OF THE DISSERTATION	19
CHAPTER 2: THE PROPERTY FRONTIER, 1780S TO 1900.....	22
FEDERAL LAND POLICY: THE POLITICS AND IDEOLOGY OF HOMEOWNERSHIP	25
URBANIZATION AND THE CULT OF HOMEOWNERSHIP	30
SPECULATION & INSTABILITY: HOW CREDIT MARKETS SHAPED LAND DEVELOPMENT.....	33
THE STRUCTURE OF A PATCHWORK MARKET.....	35
HOMES & CONTRADICTIONS	49
CHAPTER 3: THREE EXAMPLES OF TRANSITION, 1900S TO THE 1930S.....	51
CHANGING MARKET AND STATE RELATIONS IN THE U.S.....	52
FARMS AND FEDERAL AID	56
GOVERNMENT PLANNING AND THE REAL ESTATE LOBBY IN WORLD WAR I.....	62
SKYSCRAPERS AND MORTGAGE BONDS	64
CONCLUSION.....	75
CHAPTER 4: THE RISE OF THE CREDIT STATE, 1930S TO THE 1960S	76
THE RISE OF THE FEDERAL CREDIT STATE IN THE NEW DEAL	77
FEDERAL CREDIT, HOUSING, AND THE NEW DEAL.....	80
FARM CREDIT AND THE NEW DEAL.....	88
FEDERAL CREDIT IN THE POSTWAR ERA: GROWTH AND GUARANTEES	90
THE IMPACT OF THE FEDERAL CREDIT PROGRAMS	94
STRUCTURING THE POSTWAR HOUSING MARKET	99
CONCLUSION.....	105
CHAPTER 5: TRANSFORMATION, 1960-1968.....	108
THE 'NAMELESS REVOLUTION' IN BUDGETING	112
HOW HAVE FEDERAL CREDIT PROGRAMS AFFECTED THE FEDERAL BUDGET?	113
THE CONTROVERSY OVER FEDERAL PARTICIPATION CERTIFICATES.....	122
CONCLUSION.....	129
CHAPTER 6: CONCLUSION	131
LOOKING AHEAD	133
BIBLIOGRAPHY	138
APPENDIX A: ARCHIVAL RESEARCH	154
APPENDIX B: THE HOUSING MARKET, 1869-1952	156
APPENDIX C: SECURITIZATION	158
APPENDIX D: GLOSSARY	160

List of Figures and Tables

FIGURE 1.1: TYPES OF FEDERAL CREDIT AID	16
FIGURE 2.1: U.S. HOMEOWNERSHIP RATES IN THE TWENTIETH CENTURY, BY DECADE.....	23
FIGURE 2.2: PROPORTION OF AMERICANS LIVING IN URBAN AREAS.....	32
FIGURE 2.3: RESIDENTIAL (NON-FARM) MORTGAGE DEBT BY HOLDERS IN 1896 (MILLIONS).....	38
FIGURE 3.1: PROPORTION OF RESIDENTIAL NONFARM MORTGAGE DEBT (HELD OUTSIDE OF REAL ESTATE BONDS) BY HOLDER, SELECTED YEARS, 1896-1930	67
FIGURE 3.2: REAL ESTATE BONDS AS A PORTION OF OUTSTANDING NONFARM (RESIDENTIAL AND COMMERCIAL) MORTGAGE DEBT, 1896-1952	72
FIGURE 4.1: RECONSTRUCTION FINANCE CORPORATION, SELECTED DISBURSEMENTS UNDER HOOVER AND ROOSEVELT, FEBRUARY 1932 THROUGH JUNE 1935 (MILLIONS).....	78
TABLE 4.1: SUMMARY OF SELECTED HOUSING PROGRAMS, 1932-1938.....	81
FIGURE 4.2: DIRECT AND INSURED LOANS AS A PORTION OF FEDERAL CREDIT AID, 1932-1950 (IN BILLIONS)	92
FIGURE 5.1: ACTUAL DISBURSEMENTS VERSUS REPORTED EXPENDITURES OF CREDIT PROGRAMS, 1961-1966 (MILLIONS)	120
FIGURE B.1: PROPORTION OF RESIDENTIAL NONFARM MORTGAGE DEBT HELD BY TYPE OF DEBTOR, 1896-1952 (EXCLUDES MORTGAGE BONDS).....	156
FIGURE C.1: EXAMPLE OF A SECURITIZATION STRUCTURE	158
TABLE 2.1: AMERICAN LAND ACQUISITIONS.....	25
TABLE 2.2: U.S. NON-FARM MORTGAGE DEBT, 1896-1900 (MILLIONS)	37
TABLE 3.1: PROPORTION OF RESIDENTIAL NONFARM MORTGAGE DEBT (HELD OUTSIDE OF REAL ESTATE BONDS) BY HOLDER, SELECTED YEARS, 1896-1930	66
TABLE 3.2: REAL ESTATE BONDS AS A PORTION OF OUTSTANDING NONFARM (RESIDENTIAL AND COMMERCIAL) MORTGAGE DEBT, SELECTED YEARS.....	71
TABLE 4.2: FEDERAL CREDIT AID BY SECTOR, PROGRAM TYPE, AND PERIOD (IN MILLIONS)	89
TABLE 4.3: MORTGAGES FOR EXISTING HOMES BY MATURITY AND LOAN-TO-VALUE RATIO, SELECTED YEARS	98
TABLE 4.4: MORTGAGE DEBT BY TYPE OF HOLDER, SELECTED YEARS, 1940-1970 (BILLIONS).....	100
TABLE 4.5: THE STRUCTURE OF FANNIE MAE, 1954-1968.....	104
TABLE 5.1: GOVERNMENT-SPONSORED ENTERPRISES	117
TABLE 5.2: COMPARING GOVERNMENT POOLS AND EARLY MBS.....	128

List of Acronyms

Government Related

BOB	Bureau of the Budget
CEA	Council of Economic Advisors
CCC	Commodity Credit Corporation
CBO	Congressional Budget Office
HOLC	Home Owners Loan Corporation
FCA	Farm Credit Administration
FDIC	Federal Deposit Insurance Corporation
FFLA	Federal Farm Loan Act
FHA	Federal Housing Administration/Federal Housing Agency
FHLB	Federal Home Loan Bank system
FHLBB	Federal Home Loan Bank Board
FICB	Federal Intermediate Credit Banks
FmHA	Farmers Home Administration
Fannie Mae (FNMA)	Federal National Mortgage Association
FSLIC	Federal Savings and Loans Insurance Corporation
GAO	Government Accounting Office
Ginnie Mae (GNMA)	Government National Mortgage Association
GSE	Government Sponsored Enterprise
NHA	National Housing Act
OMB	U.S. Office of Management and Budget
PCBC	President's Commission on Budget Concepts
REA	Rural Electrification Administration
RFC	Reconstruction Finance Corporation
SBA	Small Business Administration
Sallie Mae (SLMA)	Student Loan Marketing Association
USAID	U.S. Agency for International Development
USDA	U.S. Department of Agriculture
USHCBC	U.S. Congress, House Committee on Banking and Currency
USSCBC	U.S. Congress, Senate Committee on Banking and Currency

Other

AIB	American Institute of Banking
LTV	Loan-to-value ratio
MBB	Mortgage-backed Bonds
MBS	Mortgage-backed security
NAHB	National Association of Home Builders
NAREB	National Association of Real Estate Brokers
PC	Participation certificate
S&L	Savings and loans
SPV	Special purpose vehicle
USBLL (USSLL)	U. S. Building and Loan League/ U.S. Saving and Loan League

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Chapter 1: Introduction

Lewie Ranieri was the wild and wooly genius, the Salomon legend who began in the mailroom, worked his way onto the trading floor, and created a market in America (and was starting a similar one in Britain) for mortgage bonds.

Michael Lewis, 1989¹

In addition, the purchase authority of [Fannie Mae] would be expanded to include certain mortgage-backed securities guaranteed by [Ginnie Mae] . . . the committee feels that if such securities become well enough established so that many private issuers are issuing them, they could constitute a significant factor in attracting investment funds to the field of mortgage investment.

U.S. House Committee Report, 1968²

In 1967 a group of governmental housing experts convened as the Mortgage Finance Task Force in order to devise a better housing market in the U.S. Their goal was to help more Americans become homeowners. To do that, they needed to solve a set of longstanding problems with mortgage finance. And they needed a solution that would not add to a budget also strained by the Vietnam War and Great Society programs. Among the many policy changes weighed by the Task Force, two stand out in retrospect. First, the members of the Task Force helped devise a plan reorganize the federal housing agency Fannie Mae as a privately owned but government supported corporation. Second, they helped devise a plan to use complex debt instruments to attract more investors into the field of housing finance. In 1968, the Johnson Administration “spun off” Fannie Mae from the U.S. government, and authorized it to use mortgage-backed securities (MBS) to sell American mortgages. The foundation was laid for a revolution in global credit markets.

By the end of the 1980s, MBS had successfully transformed mortgages from idiosyncratic, hard-to-sell, long-term commitments that many investors disliked, into a homogenous product that could be readily traded in global markets. By bundling

¹ See p. 77 in Lewis, Michael. 1989. *Liar's Poker: Rising Through the Wreckage on Wall Street*. New York: Norton.

² See p. 68 in USHCB. 1968. *Housing and Urban Development Act of 1968. Report of the [Subcommittee on Housing] Committee on Banking and Currency, House of Representatives, Ninetieth Congress, second session, together with minority views, on H.R. 17989*. Washington: U.S. Government Printing Office.

mortgages into a pool that served as collateral for bonds (and pairing that pool with special guarantees and credit protections), a middleman could now spin mortgages into exchangeable securities. A Wall Street trader named Lewis Ranieri would later name this process “securitization” (Ranieri 1996).

Following further technological, legal, and cultural innovations by businessmen and government officials, securitization ballooned into a multi-trillion dollar industry. By the end of the 1980s, government sponsored housing enterprises had issued a combined \$111 billion of securitized bonds. By 2005 the market was reaching new heights. Over two-thirds of new home loans that year were pooled and repackaged into bonds that were sold off in the securitization market (Simon and Hudson 2006), with government agencies issuing \$1.3 trillion dollars and private firms issuing over \$645 billion in MBS.

By 2006 total outstanding MBS had reached nearly \$4 trillion, while another \$2.1 trillion of other kinds of outstanding securitized bonds were backed by assets derived from other kinds of debt, like credit cards, school loans, auto loans, corporate debt, and even music royalties (SIFMA 2007). Banks had stopped holding all of their loans on their books; instead they funneled debts into financial instruments that were then telegraphed out into the capital markets. As a result, obligations spread out between hundreds or thousands of investors who each owned a fraction of many different loans and obligations.

This financial structure was the machinery behind our now-burst housing and credit bubbles. It fueled an increase in lending that, by the middle of the 1990s, was pumping large sums of money into U.S mortgage markets, including to people with low credit ratings and high debt levels. Americans became more highly leveraged than they had ever been. For a time, overextended debtors could rely on rising housing prices as a kind of safety net; they could just sell or refinance whenever debt threatened to overwhelm them. Behind the scenes, financial firms were also becoming more highly leveraged, and holding less collateral relative to both what they actually owed to other companies and to the high values they reported on their balance sheets.

The system began to crumble visibly in the summer of 2007. Rising interest rates triggered a massive increase in many adjustable rate mortgages at the same time that housing prices started to drop. Homeowners could no longer rely on the once surefire solution of just selling or refinancing, and without that safety valve, they were stuck holding onto debts they could not manage. Defaults rose. Some experts warned the housing market might be in worse shape than anyone really knew. Lenders started to stem the flow of credit. Wanting to limit their exposure to potentially weak links in the financial system, firms started to lend more conservatively, and asked each other to post more and more collateral to cover their debts. The June 2007 collapse of two massive hedge funds at Bear Stearns that specialized in risky housing bonds definitively announced that the markets had turned. Government officials assured the nation that the economy was taking a hit that it could weather. A year later, when investment banks started falling like dominos, there would be no denying that we were weathering the worst financial crisis since the Great Depression.

The U.S. government was instrumental in pioneering the use of this financial technology. In the middle of the twentieth century government officials deliberately set out to promote new ideas and tools for risk management in mortgage finance. Government institutions were not just used to regulate this market – they were deployed

to reorganize market activity. And they succeeded. According to Carruthers and Stinchcombe (1999), the U.S. government's promotion of a shared set of understandings about the value of mortgages helped stabilize the secondary market for mortgages. Yet while we know that the government was extensively involved in this market, we nevertheless only have partial, fragmented, piecemeal accounts of how the government came to be involved in this in the first place. One problem is that existing depictions of the rise of securitization overwhelmingly emphasize the importance of Wall Street hotshots.³ Michael Lewis's colorful account of Salomon Brothers in *Liar's Poker*, for example, gives credit for the creation of the entire market to a single trader in the 1980s (Lewis 1989: 77). Other accounts have recognized that the state was involved in the market before the 1980s, but tended not to ask many questions about how government officials came to adopt these policies in the first place (see, for example, Carruthers and Stinchcombe 1999; Gotham 2006; Klink 1985; Sellon and VanNahmen 1988). This means we are left with a deeply political story that was devoid of any real detail about the mechanisms that had driven and organized these events: the reasons why the U.S. government was in the business of developing this new financial technology; the process through which it came to understand its various options for intervention in the housing market at the close of the 1960s; the actual steps the government took down this path, and why some options were chosen and others refused.

This dissertation addresses that gap. Using archival research and the secondary literature on housing and federal credit programs, I have retraced the steps that led to the transformation of housing finance in 1968. Doing so, I found that in the 1960s a set of escalating problems in the housing market collided with a budget crisis caused by the expensive combination of the Vietnam War and Lyndon B. Johnson's Great Society programs. Combined, these forces created a political crisis that spurred President Lyndon Johnson to reorganize Fannie Mae and back a private secondary mortgage market – that is, a market where existing mortgages can be bought and sold with ease – organized around securitization.

Below I lay out the theoretical debates about the relationship between the market and the state in the U.S. that inform my analysis. Since federal credit programs are important for both understanding this relationship, and for understanding the turn towards securitization, I next pause to define and explain what those programs do. At the close of this chapter I briefly discuss my case and research process, and conclude by laying out the argument through an overview of the dissertation.

While this study ultimately seeks to understand the mechanisms by which government officials helped transform housing finance at the close of the 1960s, this dissertation is nevertheless largely descriptive in the first four chapters. That is because before we can understand *why* officials acted the way they did in the 1960s, it is first necessary to understand the nature of longstanding problems with housing, credit, and budgeting that they sought to resolve.

³ In the last few years this literature on securitization and related financial technologies has exploded, largely in response to the housing and credit crisis. See Lewis (2008), Morris (2008), Ranieri (1996), and Tett (2009) for good examples of how the role of private industry may be emphasized and the role of the state underplayed.

Understanding American States and Markets

The emergence of securitization from federal credit programs at the close of the 1960s is interesting, not just because it tells an important lost chapter of our economic history, but also because it provides a window into the complex interaction between markets and states in America. The U.S. government is widely thought to be the most hands-off, the most laissez faire, and the least interventionist of all industrialized nations. The predominant explanation for this has been articulated in the “American Exceptionalism” literature. The theory is that a lack of a feudal past in America combined with the revolutionary experience to create a community that rejected aristocracy in favor of equality of opportunity, individualism, liberty, and most important for the purpose of this study, a love of unbridled market competition (Hartz 1943; Hartz 1952; Lipset 1996: 19). These values then were built into a set of institutions – notably, the separation of powers, “a weak and internally conflicted” state structure that pitted governmental branches against each other – that continually reproduced a laissez-faire sensibility and distrust of concentrated power (Lipset 1990; Lipset 1996; Lipset 2003: 39). “From the Revolution on,” writes Seymour Lipset, “it was the laissez faire country par excellence.” (Lipset 1996: 54).⁴ This notion has been used by Lipset and others to account for a range of characteristics that distinguish the U.S. from other industrialized countries, including America’s lack of a strong socialist movement, its anemic welfare state, and its unusually high level of devoutness for an industrialized country (Gerber 1997; Hamilton and Sutton 1989; Lipset 1990; Lipset [1963] 2003; Quadagno 1999; Voss 1993; Zelinsky 2001).

But a growing body of scholarship has questioned some of the basic tenets of this theory – especially the notion that America has a weak government that does not intervene in its markets. This new scholarship has shown that in a variety of fields and over a great many years, the U.S. government has been actively involved in its markets (Kammen 1993; Novak 2006; Novak 2008). Legal historian William Novak has been at the forefront of a wave of revisionist historians who contend that “[t]he American state is and has been consistently stronger, larger, more durable, more interventionist and more redistributive” than the predominant model has assumed (Novak 2006: 197). Novak himself has pierced the myth of a stateless past by detailing extensive governmental intervention in all areas of life – including markets – in nineteenth century America (Novak 1996: 7). In Philadelphia’s High Street Market, for example, the local government regulated everything from product to seller to price through a special department of markets and 150 regulations between 1789 and 1889 (Novak 1996: 97-98).

This revisionist scholarship turns scholarly debates about American states and markets on their head. From the point of view of American Exceptionalism, the key puzzle to work out is why the U.S. is so different from other similar nations: why its markets are so free and its government so weak. For the revisionists, the key puzzle is why and how the significant role of the U.S. government has remained hidden. In other words, the key point is not to understand American statelessness, but to understand

⁴ Note, however, that Lipset in his 1963 book *The First New Nation* ([1963] 2003: 48-54), recognizes that there was a good deal of economic intervention on the state level in the nation’s early years, and that the hands-off stance of the federal government was mostly a function of states’ rights and not a function of laissez faire values, which followed the rise of the dominant economic interests. This insight has, however, fallen out of his later work.

America's *seeming* statelessness. From this perspective, the driving questions are: How does the U.S. government participate in the market? And why is it so often overlooked?

Understanding America's Seeming Statelessness

The answer to these questions lies in understanding how certain characteristics of the U.S. government are easily interpreted as weakness and statelessness. Here the revisionists agree with the American Exceptionalism scholars that a fragmented state structure is extremely important for understanding the American case. But they draw different conclusions about the implications of that fragmented structure. In order to understand those differences, it is helpful to go into further detail about three characteristics of the fragmented American government: its sprawling form, its fractured center, and the proliferation of indirect policy tools.

In the following paragraphs I discuss each of these three characteristics in more detail. The first two – a sprawling structure and a fractured center – both have to do with organizational structure. The third is a strategy of governance. In practice, forms of governmental complexity in the U.S. combine and intensify one another, and it is this combination of fragmented structure and fragmented policy that together add up to a fragmented, complicated, and hard to read form of government (Clemens 2006: 188). The discussion that follows is not intended as an exhaustive catalogue of the sources of governmental complexity, so much as an introduction to some of the complex forms of statehood and statecraft that are especially useful for situating my case.

A Sprawling Structure. In the U.S., authority is spread out among the federal government, states, and local governments, leading to what Novak (2008: 766) calls a “characteristic sprawl” made up of nearly 90,000 governmental units spread over 3,000 counties, 19,000 municipal governments, 16,000 townships, 37,000 special districts, and 13,000 school districts in the 50 states. This “complex welter of institutions, jurisdictions, branches, offices, programs, rules, customs, laws, and regulations” is a main reason why the government's power is hidden (Novak 2008: 765).

This tendency to spread out government power among local branches – and the subsequent tendency of Americans to mistake the *diffusion* of state power for a *lack* of state power – has its roots early in American history (Skowronek 1982: 23). This is especially true in the years before the Civil War when the federal government regularly took a back seat to state and local governments (Dunlavy 1992; Skowronek 1982). Since each state had broad authority to govern, many different systems emerged, creating what Scheiber (1975) has called a “mosaic” wherein each state government developed its own style. This sprawling structure continues to check the expansion of federal authority in the U.S. For even after the federal government expanded its power (a process that started during the Civil War but accelerated during the Progressive Era and New Deal), it still had to reckon with state and local governments as independent loci of political authority (Scheiber 1975: 108).

A Fractured Center. America's federal government does not just share power with the states. With three distinct branches of the federal government established explicitly to balance power, it is also internally fragmented and conflicted by design. The executive, checked by both the courts and the legislature, started off extremely constrained on a variety of fronts. Notably, the President was largely shut out of creating the national budget until 1921 (Ippolito 2003). Congress, long the operational center of the federal government, was itself divided into two chambers. As for the courts, Skowronek (1982: 23-27) has called them "naturally passive" because their power is only activated externally. It gets more complicated from there: there are 435 congressional districts and 94 judicial districts, in addition to over two hundred congressional committees and over a hundred federal agencies (Novak 2008: 765). Thus with American Federalism the same diffusion of power across the states was reproduced within the structure of the federal government. One result was that the federal government was not just fractured but actively contentious, since groups had so much ground to contest and so many opportunities for conflict (Shafer 1989). Both its complexity and its contentiousness make the American government difficult to analyze and, as I show below, this seems to have encouraged the use of complex policy tools.

Indirect Policy Tools. Across time periods and levels of government, American officials have drawn from an intricate set of indirect policy tools that make the federal system of checks and balances seem positively straightforward in comparison (Clemens 2006: 187). Elisabeth Clemens compares the U.S. government to a "Rube Goldberg" contraption, wherein the government seeks to exercise its will by inducing other forces into taking desired actions. For Clemens (2006), these indirect means of governance are an important part of the fragmented nature of American governance, which amounts to "an immensely complex tangle of indirect incentives, cross-cutting regulations, overlapping jurisdictions, delegated responsibility, and diffuse accountability. Simply put, the American state is a mess." (Clemens 2006: 187). Building off this insight, I define indirect policy tools as government programs that function by *inducing* another entity into action toward a desired end. Below I discuss the various attributes of indirect policy tools and provide examples in more detail.

Clemens herself focuses on the use of indirect tools internally within the government, as when the federal government uses incentives like matching financial or land grants to steer the states towards desired actions. Other scholars have shown how this happens *externally*, as when officials collaborate with private organizations to develop and implement policy. An excellent example of this is Greta Krippner's (2007) study of how government officials since the 1970s devised indirect ways of directing monetary policy that they did not have to take political responsibility for (for example, announcing plans for adjusting interest rates, in lieu of actually implementing them). Another illumination comes from the work of Fred Block (2008), who has argued that since the 1970s a "developmental network state" emerged in the U.S., wherein government officials directed technological advances not by undertaking research but by acting like a broker or financier for private companies.

One indirect tool commonly used by American officials is the use of *collaboration with private companies*. Here again Novak (2008: 769) offers a lucid

analysis: “rather than monopolize power, property, and policy in the hands of a central public sovereign, the American state less visibly distributed public goods and powers widely through the private sector—enforcing its public capabilities, expanding its jurisdiction, and enhancing its legitimacy in the process.” This collaboration can involve loans to private companies, or partnerships with private companies to help design and implement policy. David Freund (2007) had argued that these kinds of public-private partnerships are the hallmark of U.S. housing policy, and in Chapters three and four I will discuss this in greater detail.

A strategy that is closely related to a general pattern of collaboration is the use of hybrid organizational forms that straddle the boundary between public and private. One example of this that I will discuss in great detail throughout this dissertation is Fannie Mae, or the Federal National Mortgage Association. Fannie Mae was created as a government agency in 1938. Its job was to inject money into the housing market at times of need by buying up mortgages, and then to sell the mortgages back to private investors in better times. From the beginning, Fannie Mae had close ties with private companies, and in 1954 Fannie Mae was allowed to issue its own debt, making it partially privately owned. In 1968 most of Fannie Mae turned into a Government Sponsored Agency (GSE). A GSE is a company that receives privileges, like federal lines of credit and special regulatory considerations, in exchange for following a government charter. In the case of Fannie Mae, a government charter directed the company to support the nation’s secondary mortgage market. Private shareholders owned Fannie Mae after 1968. However, investors around the world nevertheless still believed that the U.S. government implicitly backed Fannie Mae because it retained certain privileges.⁵ And in 2008, when it was on the brink of collapse, the U.S. government moved to protect the corporation by taking it into conservatorship, suggesting that the assumption of an implicit guarantee was correct. Fannie Mae is just one example of many government owned, sponsored, or supported corporate forms in the U.S. Throughout the dissertation I will discuss other hybrid organizations like the Federal Land Banks and the Commodity Credit Corporation in more detail.

Tax expenditures – that is, special tax deductions, exemptions, and credits or rebates – are the final indirect policy tool commonly discussed by academics. Government officials may use tax expenditures as an alternative to direct spending. For example, housing-related tax expenditures amounted to \$156 billion in uncollected taxes in 2007 (Jaffee and Quigley 2007: 123). Howard and other scholars have argued that even though not all expenditures target the wealthy, tax expenditures overwhelmingly benefit them, and that they make up half of a two-tiered system of social welfare in the U.S. (Conley and Gifford 2006; Fischer et al. 1996; Howard 1997; Prasad 2006). By this argument, federal subsidies to poorer people are more likely to take the form of direct spending programs (like Aid to Families with Dependent Children), which are frequently stigmatized as a government hand-outs, and so are especially vulnerable to being cut. Subsidies to wealthier Americans, however, are more likely to take the form of tax expenditures, which frequently interpreted as the *absence* of the government, rather than

⁵ I have greatly simplified the nature of Fannie Mae’s relation to the U.S. government for the sake of clarity here, but see the end of Chapter four and also Chapter five for a more detailed account of Fannie Mae’s hybrid public-private status.

as a different sort of benefit. As a result, that assistance tends to be overlooked, taken-for-granted, and remarkably resilient.⁶

An additional indirect policy tool is the use of federal credit programs to support and direct lending. In this dissertation I argue that *credit support* is a very important indirect policy tool used by the federal government to intervene in the economy. Because of its centrality to my argument, I will return to this point in greater detail below.

A Closer Look at Why Indirect Policy Tools are Used

There are many reasons why indirect policy tools are used. One reason is that government officials can turn to them when they lack the capacity to act directly (Clemens 2006: 191-193). For example, government officials may want a region to have a railroad line but not have the money to build it directly. In this case they could work in partnership with private firms to share the costs of building, and then share the income generated by the railroad (see Dobbin 1994: 147-157). Clemens points out that we should see indirect programs originating wherever a given state's capacity is weak or still developing, if this is indeed a motivation behind the use of indirect forms of governance.

One possibility is that these tools are a response to the sprawling, fractured, and conflict-ridden governmental structure. The idea here is that indirect tools are particularly good ways of getting around veto points that crowd a fragmented and contentious political landscape (Clemens 2006; Immergut 1990: 193). For example, Howard (1997: 10) concludes that tax expenditures have flourished because they are easier to pass through Congress and then retain once in place (in large part because only two congressional committees have jurisdiction over them). Clemens suggests that when indirect means are a response to controversy and conflict, we should see them proliferating in situations where governing officials are pursuing unpopular policies. Similarly, the more veto points in a political structure, the more indirect policies we would expect to see.

An alternative explanation is that governing officials turn to indirect policy tools specifically to get around culturally driven, rather than structurally driven, constraints. By this logic, the American government likely has so many indirect policy tools because American people are more likely to be suspicious of concentrated state power, and so officials shy away from openly governing (Clemens 2006: 193). Moss makes a similar point when he posits that one of the reasons the government so often chooses to support the market by implementing risk-management programs is "to reconcile [American's] laissez-faire and anti-statist sentiments with their pragmatic inclination to employ state power to solve social problems" (Moss 2002: 319). Krippner, studying the Federal Reserve policies of the 1970s and 1980s, makes a similar claim. She observes that laissez faire ideals put a great deal of pressure on politicians not to intervene in the economy (Krippner 2007). However, we know from Polanyi and others that all economies need managing (Block and Evans 2003; Carruthers and Stinchcombe 1999; Fligstein 2001;

⁶ However, Prasad (2006) argues that we should not conclude from these kinds of examples that the United States is particularly conservative, but instead we should recognize that a contentious political structure leads to dramatic swings between progressive and conservative policies.

Krippner 2007; Polanyi 1957; Tilly 1990).⁷ She therefore concludes that officials used indirect means to get out of this bind (which she calls the “Neoliberal Dilemma”), and that these indirect means had the added benefit of helping officials avoid political accountability for anything that might go wrong with the economy.

Thus several mechanisms could be at work here. In some cases, politicians who want to enact a more direct policy may find themselves blocked by ideologically driven opponents, or may fear the general population will be offended if they overreach. It could also be that governing officials are more likely to use indirect means, not because they are avoiding a fight, but because they are doing what they think is right in view of shared norms. Or it could be that politicians just want to avoid accountability.

That the same things that caused the fractured sprawling state also directly cause politicians to veer towards the use of indirect tools makes a good deal of sense. If Americans do not like state power or federal intervention in markets, then this could influence behavior directly through the ideas of actors and indirectly do so through institutional hurdles. A great example of this is Weir and Skocpol’s (1985) analysis of why a commercial-oriented Keynesianism originated in the U.S. (as opposed to the social Keynesianism that developed in Sweden). They look at both Franklin Delano Roosevelt’s ideas and sources of political conflict as possible explanations for the policy, and conclude that neither was, on its own, sufficient to explain the form it took. That is, only a combination of ideas and political structures could explain the policy. Especially in the early years of his presidency, Roosevelt was reticent to add to the deficit; in later periods, he ran up against political resistance.

It may well be that all the reasons listed above are correct. Certainly evidence for each emerges at different points of this dissertation. In World War I, when the federal government did not have much administrative capacity, it borrowed the expertise of homebuilders to manage a housing shortage for workers (see Chapter two). In the New Deal, Roosevelt used credit programs to support housing because he believed that running a large unbalanced budget was dangerous (see Chapter three). And President Johnson turned to a more collaborative system of housing finance organized around a “private” Fannie Mae and mortgage-backed securities in part because he was avoiding veto points around the budgeting process (see Chapter five). It is also possible that these reasons frequently coincide. Politicians may at once want to borrow capacity, avoid

⁷ Sociological accounts of markets follow the work of economic historian Karl Polanyi (1957) who warned that the idea of a self-regulating market was a dangerous fantasy that ignored important historical facts, namely that the state had played a key role in establishing modern industrial economies, and these economies veered towards dangerous extremes whenever the governments that championed them stopped also checking their worst excesses. Scholars have built on this insight to show that modern states and markets have grown up together. States benefit from the revenues generated by markets, while markets benefit from the stability and protection offered by states (Block and Evans 2003; Tilly 1990; Fligstein 2001). Moreover, people have a hard time identifying their interests and how to pursue them, and so will often rely on habit, deference, and mimicry when deciding how to act (DiMaggio and Powell 1983). State regulations are among many institutions that have evolved to promote predictability and the flow of good information in markets, which help people better pursue their interests and behave more rationally (North 1990). Government offices can play a central role in establishing the shared understandings that people need to act in an otherwise confusing context (Carruthers and Ariovich 2004; Fligstein 1996; Stinchcombe and Carruthers). Regulations also curtail predatory competition, and so help create the stability that markets need in order to thrive (Fligstein 2001).

controversy, and get around veto points. One appeal of indirect policy tools is that they simultaneously address many of these issues.

On The Relationship Between Government, Complexity and Power

The complexity resulting from a sprawling structure, a fractured center, and indirect policy tools means that the American government can be easily misrecognized. Like a chameleon or camouflaged soldier, the U.S. government frequently blends into the community around it. This allows the state to seem like it is not interfering in society in general or the market in particular. Novak (2008) asserts that this multifaceted fragmentation is one of the primary reasons why scholars have failed to correctly gauge the strength of the American state: it did not conform to an existing model of statehood based on centralized European governments that exercised despotic power. Scholars concluded that America was stateless, when they should have adjusted their model to recognize how governments may use “infrastructural” power that more subtly spreads out and colonizes its subjects. Viewed this way, the very diffusion of power through a fragmented system so often mistaken for weakness is in fact the great strength of the American state. Put differently, if we call the U.S. government weak, we conflate the diffusion of power with the lack of power, and this may be exactly the opposite of how we should be thinking of things. It causes us to miss how a capacity to branch out, to incorporate private groups in the rule of law, and to seed desired action rather than just taking it, is precisely what makes the U.S. government so powerful. Novak explains:

The American system of government, with its peculiar array of distributive technologies of state action — divided sovereignty, separation of powers, federalism, delegation, incorporation, and the rule of law — allows for an extraordinary penetration of the state through civil society to the periphery. It also allows for a popular and legal legitimation of rule that has evaded some of the most centralized despotisms. (Novak 2006: 767)

This makes a great deal of sense, according to many critical models of power. Foucault’s theory of disciplinary power, Bourdieu’s symbolic domination, and even Gramsci’s theory of hegemony all share a common insight: power is at its most effective when it is most taken for granted, when it disappears so fully into the social world that it seems to be the natural order of things or in the best interests of all involved (Bourdieu and Wacquant 1992; Foucault 1995; Gramsci, Hoare, and Nowell-Smith 1971).⁸ Here the work of Timothy Mitchell can be very useful (Mitchell 1991). Mitchell builds on the insights of Foucault to argue that all nations have webs of social networks through which government-related action is organized, and that one of the things people do is classify parts of those networks as either inside or outside the state. For Mitchell, the interesting question is how people define and make sense of the boundaries of the state, and what that tells us about the social world: “In a given area of practice,” he asks, “how is the

⁸ Of course, these works build on the foundation of classical theories of power: Weber’s work on legitimate authority and Marx’s work on alienation and the commodity fetish, which suggests that the structure of material practices may serve to mask underlying relations of social domination.

effect created that certain aspects of what occurs pertains to society, while others stand apart as the state?” (Mitchell 1991: 89) His point is not that the state doesn’t exist – on the contrary, he stresses that in practice there is something that we can all recognize as the state. His point is rather that scholars should pay close attention to the process of determining boundaries so as to better understand how people continually recreate what the state is, and how that varies over time and space.

There are two important insights to take away from Mitchell’s argument. First, he reminds us that the questions of complexity, indirect policy tools, and collaborations are to some extent issues that should occur in many states and at many points in history. We should not assume that this is limited to the U.S., or even to a particular time period in the U.S. Second, to the extent these forms seem to be relatively prolific in the U.S. (in different arenas or persisting over time), we can use that to understand how power is at work here. If we apply this understanding of power to the use of indirect tools, the key analytical question is not just why people use indirect policy tools, but also how people make sense of the boundaries of the state and market in view of those tools, and what this tells us about the exercise of power in a given social arena.

Unusual but Not Weak: Making Sense of American Statecraft

In many ways the U.S. government is surprisingly quiet and subtle for a nation known for its brashness. I have argued above that the U.S. government is sprawling, fractured, and collaborative, and that as a result it is a tremendously flexible, complex, and plastic government. I have discussed evidence that shows that the U.S. state is stronger, and its markets less laissez-faire, than many historical accounts suggest. Nevertheless, the structure and strategies of the American government suggest that Americans are indeed ambivalent about federal intervention into the market and the exercise of power in the federal government. The values of federalism infuse both government institutions and the stories Americans tell about themselves. In her comparative study of the discipline of Economics in three countries, Marion Fourcade (2009) argues that it is through political culture – that is, through the institutions that define the role of states and markets – that people in different nations construct their sense of who they are. Here she builds on one of the core insights of sociology: that people understand themselves in terms of larger, but still local, communities (Durkheim 2001). When we study states and markets, we therefore learn something about what people believe about themselves and the world. That insight applies here. The proliferation of indirect tools suggests at once that America is not laissez faire *and* that many Americans believe that it is; that Americans have an interventionist federal government *and* that interventionism is deeply suspect; that the legitimate exercise of power in America resides outside of the state, and that as a result those who wish to exercise power have found ingenious ways of classifying their action as something private and not governmental. Fourcade (2009: 35) writes that “Americans see competition and freedom of enterprise as more than just the ingredients of good institutional design; these concepts have real moral force being inextricably linked to a vision of the good society that goes back to the early days of the American republic.” The proliferation of indirect tools does not undermine the insight that government structures are related to unique ways that people in different places make sense of being in the

world. Instead, they show us some of the ways that Americans have reconciled the values of federalism and their identity as free individuals with the exercise of power.

We might say that everywhere the boundary and definition of the state is a high stakes game. That Americans rely heavily on indirect policy tools that appear as private mechanisms is revealing: it shows that in the U.S., more than other places, you win the game by classifying a set of practices as “not state” – that indeed, as many have argued, individuals are seen as a more legitimate source of authority than a centralized government, especially in the twentieth century. One implication of Mitchell and Fourcade’s work is that the classification of indirect policy tools as “private” is not just some kind of shallow trick that gives officials leeway to act. It is part of the process by which Americans come to understand themselves as Americans – as free individuals, unencumbered by the state, making their own way in the marketplace, and holding true to the nation’s Revolutionary roots. It is through these indirect tools, these diffuse practices, that Americans at once define the exercise of state power and their own subjectivity.

Seymour Martin Lipset has written that “America has been the purest example of a society which has followed market norms” (Lipset 1996: 154). I believe he is correct, but not for the reason he thinks. One of the enduring lessons from Karl Polanyi is that *laissez-faire* was always a utopian dream, that the separation of the market from the state was at most approximated, never quite achieved (Polanyi 1957). Every society turned away from the brink of unbridled capitalism when things got bad enough. The real uncertainty was how a given society might turn away from the brink and how destructive that process would be: whether a nation turned to colonialism or fascism, socialism or social democracy. From Polanyi we learn that the point is not to be *laissez-faire*, but to *appear* to be *laissez-faire*. If the U.S. government is the most capitalist of countries, it is because it achieved so well this sleight of hand. It excels at quiet, indirect forms of intervention. One result of this pattern is that it has allowed Americans to believe that they are unfettered by government power.

Building on the Literature: The Role of Credit Programs and the Federal Budget

I hope it is clear at this point why the rise of securitization is sociologically interesting. The path to securitization traveled through the blurry spaces between public and private enterprise. Almost all of the action happened in the domains that were at once the state and the market. The move to support securitization was itself a form of indirect policy. It was further incubated within federal credit programs that were themselves indirect policy tools. Moreover, as I will argue in Chapters two and three, these tools were part of a general effort to use indirect means to manipulate the housing sector, which itself was envisioned as an indirect means of promoting a complex array of desired economic and political outcomes. This case is therefore well positioned for an analysis of the complex relationship between the U.S. government and its market.

Delving into this story specifically sheds light on two understudied facets of this literature. First, it shows that the manipulation of credit allocation is a major indirect policy tool used by the federal government, and is deserving of further study.⁹ While

⁹ But see Freund (2008: 35). Freund recognizes that the housing programs are part of “a much larger revolution in U.S. housing and credit markets.” However, he does not provide much in the way of detail about the other kinds of federal credit programs outside the housing sector.

some scholars have pointed to the importance of credit aid as a means of market intervention, we are a long ways from a sustained analysis of this phenomenon (see, for example, Freund 2007; Howard 1997). Take Novak, for example, who illustrates the “disjunction between historical perception and political reality” of government intervention with a quote from Democratic Senator Ernest “Fritz” Hollings (D-SC). Hollings complains that:

a guy who came home from the Korean War, went to college on a form of the GI Bill, opened a business with a Small Business Administration loan, made sure his parents’ farm was adequately wired through Rural Electrification and irrigated with assistance from the Army Corps of Engineers, saw his kids get subsidized school lunches at a school that received lab equipment from a National Science Foundation grant, got his mortgage from the FHA and hurricane disaster relief from FEMA, and one day, took AMTRAK to Washington to complain to his congressman about getting big government off people’s backs. (quoted in Novak 2008)

What Novak fails to note, and what is important to add for our purposes, is that almost all those forms of support are kinds of *credit support*. This is not trivial. In Chapter four I argue that credit support is an important form of indirect intervention for many of the same reasons that other indirect policy tools are used: they are subtle, they can mean many things to many people, they are politically easier to pass than some kinds of direct intervention, and they tend to proliferate once created because they generate constituencies who defend them. Unlike direct expenditures, the costs of credit support programs can be hard to pin down, which makes them hard to measure, observe, and understand. I go beyond this in showing that credit programs are effective ways of developing and integrating credit markets, and that they are especially useful for politicians because they allow them to circumvent the budgetary process.

This leads me to the second theoretical contribution. This dissertation calls attention to the federal budgeting process as a key institution that shapes government strategy in general, and that specifically compels policy makers to choose indirect policy tools. Here I follow Wildavsky and Webber’s (1986) insight that budgets are much more than budgets: they are also points of balance in the social order that reveal underlying patterns in social relations. When people establish formal and informal rules for budgeting, people constitute rules for what Fourcade (2009: 11) refers to as “the exercise of public power.” America’s fragmented and contentious government structure is very much reproduced in the structure of the federal budget. For example, Gilded age patronage politics were facilitated by a diffuse budgeting process wherein appropriations were spread across committees, and the executive had little say. When the federal government consolidated power in the Progressive Era, more budgetary authority was given to the executive. As that power expanded, norms about balancing the budget that served to constrain federal action receded. Throughout this dissertation I will describe how the major shifts in the organization of the U.S. government have been accompanied by shifts in the budgeting process. In Chapters 4 and 5, I will show how a fractured budgeting process in the U.S led officials to repeatedly chose indirect policy tools, like

credit programs, and how the use of credit guarantees arose in the postwar era as an extensive but hidden means of economic aid.

In the 1980s John Padgett laid out the case for looking at budgets to better understand “the articulation between state and society” and the distribution of governmental resources (Padgett 1980; Padgett 1981). The rules that order the budgeting process are, in his words, “historical residues of past political struggles and structural relationships.” (Padgett 1981: 82) From this perspective, any given budget line is the result of a multilayered process by which rules and relationships between different levels of government offices – from the President to a midlevel official – negotiate and coordinate the governing of the nation. One implication is that we can use the budget as a diagnostic tool that tells us something about past and current power relationships.¹⁰

Padgett’s work on the budget models how people who govern, having already set a fiscal target, decide where to distribute limited funds. He takes fiscal goals and policy structures as given or static, and then examines what determines which programs are funded or cut. Interestingly, Padgett looks at changes in the budget at the same time period and programs I examine closely in this dissertation: the Department of Housing and Urban Development during the high-pressure years of the Vietnam War. Padgett finds that programs that are low priority and have controllable funds are at risk for cuts, and concludes that “[i]n an autonomous bureaucratic system, like the state, social control of expenditures operates not directly or self-consciously but indirectly through structural parameters or underlying premises of organizational decision making.” (Padgett 1981: 121). That is, in times of fiscal crisis, the rules for budgeting and material constraints of programs are what determine how money is allocated.

In recognizing the flexibility of policy tools, my project calls attention to a different aspect of budgeting. When faced with a fiscal crisis, officials do not just decide whether to make cuts: they sometimes change accounting rules or develop entirely new policy tools in order to circumvent the budget. In the case of Johnson’s Vietnam-era budget crisis, government officials tried first changing accounting standards. When Johnson’s political opponents were able to stop him from doing that, the Johnson administration used a different, less direct strategy: they drove Fannie Mae further into the classificatory no-man’s-land between public and private sectors, and once there, officially classified the entity as “private.” They also devised new kinds of government guarantees of debt instruments. Thus the conflict-ridden political structure resulted in the creation of new indirect policy tools, and renewed efforts to redefine the boundaries between state and market in the U.S. In this case, budget politics mattered not just because they affected the distribution of economic resources, but also because they affected the strategy of governance used to exercise power in a given sector. When faced with a political and fiscal crisis, politicians do not just negotiate the distribution of dollars and cents – they may also try to innovate new forms of governance, or to redraw the boundaries of the state.

¹⁰ Using Bourdieusian (1992) language, we can say that the budget is one place where symbolic capital is converted into economic capital, in that it is one place where groups that have political power can transform that advantage into monetary gain.

Federal Credit Programs

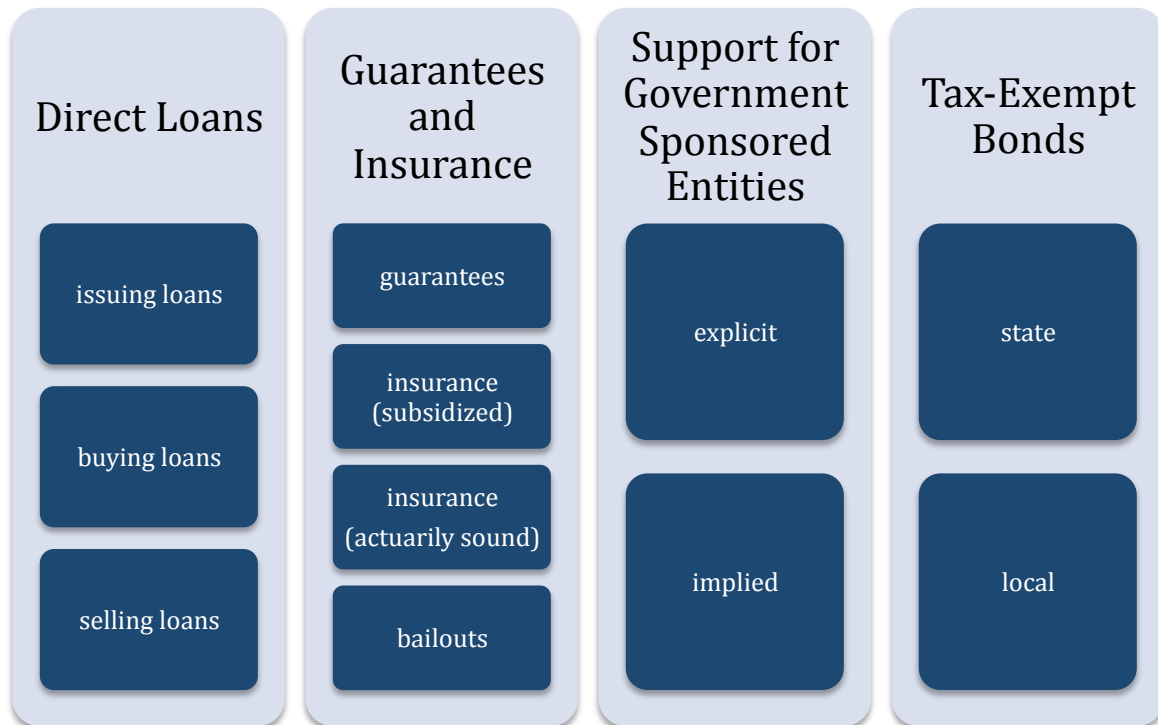
Since federal credit programs play a central role in this analysis, it is useful to define them before going any further. Federal credit programs issue, guarantee, insure, and buy and sell loans. These programs sometimes inject capital directly into markets by lending out money directly (in other words, by taking on credit risks that private lenders reject), and at other times encourage lending by allowing the government's credit to stand in for the borrowers' credit by issuing guarantees, or by allowing companies to issue bonds that have special tax privileges. With these programs "the government acts much like a bank, raising funds or directing their flow to provide credit on terms it specifies to borrowers it selects" (Bosworth, Carron, and Rhyne 1987: 1). They do this to promote shared goals like homeownership and higher education, as well as the more narrow "political interests" of specific groups, industries, and even corporations. Bosworth, Carron, and Rhyne (1987: 7) therefore identify the three nominal purposes for these programs: "to improve the efficiency of markets by correcting market imperfections and encouraging innovations, to reallocate resources towards activities that are judged to have a public value greater than that reflected in private decisions, and to redistribute income by providing a transfer to selected firms and individuals."

Federal credit programs have a close relationship with banking, monetary, and fiscal policies. However, while the latter are generally concerned with manipulating the *supply* of credit, the former are concerned with the *allocation* of credit. The Federal Reserve, for example, is primarily concerned with managing the amount of money in the U.S. economy. In contrast, federal credit programs like Fannie Mae work to direct the flow of credit to a specific sector of the economy (in this case, to certain kinds of mortgages). There are of course important points of intersection and overlap between them, but for the purposes of this dissertation I have focused on the credit policies, which have tended to be more often overlooked by sociologists. My hope is that laying out the development and working of the credit programs is a useful first step toward better understanding their place as part of a constellation of policies for managing the economy.

Figure 1.1 summarizes the various types of federal credit programs. Following Bosworth, Carron, and Rhyne (1987) and Ippolito (1984), I have classified federal credit programs into four main groups. I briefly outline them here, and will discuss many of these in more detail in Chapters four and five. The first kind of federal credit programs listed in the chart are direct loan programs, which issue, buy, and sell loans. These are the most basic type of credit support. Guarantee and insurance programs are the second type of programs listed (see the second column). These programs promote credit by either guaranteeing that a government agency will pay the debt if the borrower defaults (programs offered by the Veterans Administration are the most well known of this type) or by organizing insurance for loans (the Federal Housing Administration has programs that do this). Sometimes these insurance programs are actuarially sound, meaning that the programs cover their expenses by charging enough in fees and carefully managing who gets insurance. Other programs contain subsidies, meaning that governmental funds help make the insurance cheaper for the beneficiaries of the program. In cases where the government guarantees a loan after a company is in crisis, this can be a type of bailout. The third type of credit support is for Government Sponsored Entities (GSEs). GSEs are privately owned companies that have special government charters, and that benefit from

explicit federal support in the form of direct lines of credit from the federal Treasury. They also benefit from implicit federal support, in that market participants believe that the government would never let this special set of companies fail. The GSE I will talk most about in this dissertation is Fannie Mae, a company that buys, holds, and sells mortgages.¹¹ Fourth, sometimes state and local governments promote industry by issuing bonds on behalf of private companies. Since the bonds are effectively municipal bonds, the interest on them is exempt from federal taxation, and this special tax status helps the private company raise money more cheaply.

Figure 1.1: Types of Federal Credit Aid¹²



¹¹ More details on the GSEs are provided in Chapter five.

¹² This figure is adapted from typologies offered by Bosworth, Carron and Rhyne (1987) and Ippolito (1984: ch. 2).

Federal credit aid is made up of a complex web of programs, as I will detail in Chapters four and five. What unites all of these programs is that the government bears the risk of a default on a loan, either directly or indirectly.¹³ A government report on the state of federal credit lending explains:

... a Federal credit program arises when the Federal Government enters into the credit economy by interposing its own credit for that of various types of borrowers. . . Irrespective of the source of funding, the ultimate credit risk of any of these programs is borne by the Federal Government, even though as a practical matter, actual credit losses will, in most cases, be covered out of reserves for bad loans accumulated out of interest income or insurance premiums. (USHCBC 1964: 17)

Systematic federal government intervention into private credit markets began in the early twentieth century, with the creation of federal programs that organized mortgage loans to farmers in 1916 (I will discuss this in greater detail Chapter three). Over the next decade, fifteen additional programs were created to support key sectors like war finance, railroads, interstate commerce, and agriculture (USHCBC 1964). Before the Second World War, credit programs relied mainly on lending programs and purchasing loans. After the Second World War, the use of guarantees and insurance took over as the predominant mode of credit support, a policy driven to new heights largely through the expansion of guarantees for mortgages. These programs proliferated and became more complex over time. While there is a unity of purpose with these programs, and while the housing and agricultural sectors have been the predominant beneficiaries of these programs, there is nevertheless a great deal of diversity in their organization, structure, and goals. In Chapter four, I will outline the rise of these programs and consider their impact on American credit and housing markets, showing that they helped integrate national credit markets, helped create a stable structure for the housing market, and pioneered many of the tools used in credit markets today. I further consider how the structure of credit programs – which commonly involves public-private partnerships, hybrid organizational forms, and behind-the-scenes activities – meant that their results were easily mistaken for the activities of the private sector. In Chapter five, I further

¹³ Thus one way to think about federal credit programs is as a subset of an entire set of risk management programs run by the government, which include but are not limited to indirect policy tools. As I noted above, in the U.S., the government's efforts to regulate the economy trace back to colonial times (Novak 1996). Risk management is one of the most important and enduring strands of these efforts. In his historical investigation of state risk management programs, David Moss (2002) argues that across a wide variety of markets, businessmen have at times found themselves incapable of managing the tangle of risks that threaten markets. These risks include moral hazards, adverse selection, limited information, as well as problems with perception, commitment and externalization. The government is uniquely positioned to manage risks, however, because it can use its power as a government to enforce participation in programs to more easily reallocate and redistribute risks as needed. So when private brains historically failed to devise independent solutions for risk management, the nation turned to the state. In his history of American risk management programs, Moss shows that risk management is one of the major, if most often overlooked, functions of the US government, evident in interventions ranging from minting money and setting limited liability law, to overseeing social security and product safety.

consider how government officials used these programs to circumvent the federal budget, and how these programs incubated the modern form of securitization.

A Critical Case Study

My aim with this project is to understand the rise of the current securitization market in America in view of its political roots, and through that, to understand better the relationship between states and markets in the U.S. For that reason I do not explore the rise of securitization after 1968, or the use of similar instruments in other nations or earlier historical periods. Sometimes the term securitization is broadly used to denote the creation of any bond backed by some kind of collateral, which is sometimes referred to as a collateralized or “covered” bond. The use of bonds that are backed by collateral have a long history. For example, the German Pfandbrief was a type of covered mortgage bond popular as early as the 18th century. However, I do not explore these forms here because I am specifically concerned with the market for securitization in the United States that developed at the close of the 1960s. With that said, an important thing to note about the use of securitization at the end of the twentieth century in the U.S. is that the process does not just entail the creation of debt instruments backed by a pool of assets like mortgages, but that *those collateralizing assets are removed from the issuers’ balance sheets*. It is this accounting treatment that distinguishes securitization from many other types of bonds backed by collateral, and understanding the causes and ramifications of that accounting treatment (and how that relates to controversies about the federal budget in the 1960s) is one of the principal points of this dissertation. Readers interested in knowing more about how these structures evolved in the 1990s will find a more complete discussion of this in Appendix C.

The existing secondary literature on our current securitization market places its origins within two mortgage finance companies – Fannie Mae and Freddie Mac – that had close ties with the federal government and that were seeking to solve problems in the 1960s mortgage market (see, for example, Sellon and VanNahmen 1988). My investigation started from there. It soon became clear that securitization emerged around the same time that one of those companies, Fannie Mae, had been spun-off from the government after thirty years of being an official government agency. This was a second line of inquiry, then. I also heard rumors and saw hints, none of them substantiated, that all of this had something to do with hiding the size of the Vietnam War debt. This further suggested that the emergence of this technology was very much politically motivated. I began my investigation armed with a set of questions. Why was the U.S. government so deeply involved with the creation of our current securitization market? Why did this originate around the same time that Fannie Mae was spun-off from the government? How did this all relate to the Vietnam War? And how did this all relate to the housing market?

I went to the archives in the summer of 2008 to follow the path of the nascent technology back through time, in order to see if I could reconstruct the events surrounding the birth of the securitization market and in doing so answer those questions. At the core of this project is archival research done at the Lyndon Baines Johnson Presidential Archives in Austin, Texas, where I went specifically to identify the reasons

why, in 1968, the Johnson administration privatized Fannie Mae and set out to create a market for MBS. This research was further developed through a series of visits to the National Archives in Washington, D.C. (to review legislative records), and the National Archives II in College Park Maryland. Additionally, through the papers of Sherman Maisel, a former Federal Reserve Board Member and Professor Emeritus of the University of California, Berkeley, I was able to review internal memos from a series of influential government task forces charged with reforming housing finance policy in the 1960s.¹⁴ This research helped me understand that federal credit programs in general and budget politics in particular were as important as housing policy for the government's securitization policy. I therefore draw extensively from the existing secondary literature on housing, budget politics, and federal credit programs to complete this analysis.

In pursuing a historical study of a single case, I have followed the lead of other sociologists who have undertaken in-depth case studies of specific markets and specific market technologies to answer questions about the state, culture, knowledge, and the economy. These case studies include MacKenzie's (2006) investigation of the derivatives market, Carruthers' (1996) study of the rise of the English stock market, and Zelizer's (1983) study of the rise of the American life insurance industry. In each of these works, a sociologist took a close look at the emergence of a new economic form or field, and pursued a fine-grained analysis of it. As with those texts, my goal here is to understand how politics and cultural forces shape the rise of a new financial practice. In that way my project might be considered a social history of a market.

In my analysis I have also followed Fourcade's critical approach to comparative historical analysis, insofar as I have tried not to take my categories of analysis for granted as somehow natural or static, but instead to recognize that those categories are themselves the outcome of complex social processes (Fourcade 2009: 12-15). Fourcade makes the case for "critical organized comparisons" that seek "to replace descriptive categories (i.e. academia, state, economy) that take structures for granted with analytical ones that focus on processes and mechanisms" (2009: 13). While I do not follow her in using comparison cases, I have tried to follow her in recognizing that what it means to be the "market" or the "state" must be taken seriously as a moving target, and not a fixed property of the world. My goal is to understand not how the state affected the market, but to understand how what it means to be classified as "state" or "market" is negotiated in the U.S.

Overview of the Dissertation

To understand why Johnson chose to privatize Fannie Mae and back the securitization market at the close of the 1960s, it is first necessary to understand a few other things. First, it is necessary to understand why Johnson felt compelled to address housing in general, and housing credit in particular. Second, it is necessary to understand why his chosen solution made sense. And to know that, it is important to understand how the government was already using indirect policy tools to manage credit throughout the U.S. economy and also to manipulate the federal budget. These concerns have driven the organization of this dissertation. Chapters two and three lay the foundation for understanding the development of the mortgage credit problem in the U.S., while

¹⁴ Additional information about the archival research is available in Appendix A.

Chapters four and five expand to include an analysis of mortgage credit programs within the broader context of the political use of federal credit programs.

Chapter two argues that the housing credit problem that Johnson was trying to solve had roots that go back much further than the postwar era. Here I suggest the American housing market has been shaped by an enduring set of economic, political and cultural contradictions that emerged in the eighteenth and nineteenth centuries. Since the Revolution, Federal Land Policy encouraged widespread homeownership, and owning a home became a political and cultural ideal in the U.S. Yet in the absence of a federal policy to support mortgage credit, the process of land buying has been marked by speculation and instability. At the close of the chapter I explain that while a private system for supporting credit emerged in the nineteenth century, that private system was often unstable, as disastrous early experiments with mortgage bonds reveal.

Chapter three discusses changes in housing policy and the housing market from 1900 to the early 1930s in view of three revealing cases. First was the creation of the Federal Farm Loan Act in 1916, which set a precedent for mortgage credit allocation as the subject of federal policy. The second case I consider is federal housing policies during World War I. Together, these two cases offer a window into the way U.S. legislators at the time attempted to use indirect tools and hybrid organizational forms to balance their interventionist activities with their laissez-faire sensibilities. This is important because this political style was reproduced in federal incursions into the field of homeownership throughout the twentieth century. The third case I consider in Chapter three is the urban housing boom of the 1920s. Here I focus on how mortgage companies experimented with increasingly complex debt instruments – including something called a participation certificate. As part of this analysis, I briefly consider the development of institutional lenders in the 1920s as both providers of mortgage finance and as an organized interest group.

Chapter four details the rise of federal credit programs in the postwar U.S. Here I trace the rise of federal credit programs in the New Deal through their proliferation in the postwar era, with a special emphasis on the development of indirect policy tools within the housing programs. Having done so, I review debates about the nature of the credit programs' influence on credit markets. I also discuss how the programs helped set the rules of the game for credit lending. This chapter argues that government programs helped organize and stabilize the field of mortgage credit in the U.S., and that these programs provided the foundation for a postwar housing boom, one that disproportionately advantaged white families and in doing so helped shape racial stratification in America.

Chapter five discusses how housing problems, credit tools, and budgetary pressures combined to transform the way the U.S. government intervened in mortgage finance during the Johnson administration. In the 1960s the relative stability of housing markets in the postwar era started to fall apart, and the nation's deeply rooted problems with federal credit reemerged. This happened just as a Vietnam-era budget crisis limited the capacities of the existing federal credit programs to respond to the housing crisis. Chapter five shows how President Johnson turned to the participation certificate as a solution for both his budget and housing problems. Here I discuss how government officials had come to realize that credit support, and specifically asset sales through participation certificates, was a tool they could use to manipulate the federal budget and hide the extent of their intervention in the economy. The chapter also explains how and

why the Johnson administration decided to transform Fannie Mae into a GSE and back a private secondary market for mortgages organized around securitization. As a whole, this chapter stresses the importance of budget politics for understanding strategies of governance in the U.S.

In the Conclusion, I briefly consider some of the ways that the Johnson administration's policies set the stage for the securitization crisis. I also consider possibilities for future research based on this analysis.

In all, I argue that the history of housing finance and credit programs offers a window into some of the murkiest aspects of federal governance in the U.S. Perhaps the greatest trick the U.S. government ever pulled was convincing the world that it did not intervene in its markets. By offering a look into the long history of housing policy, federal credit programs, and budget politics, this case suggests why the U.S. was so successful at remaining hidden. It is not simply the shallow or unmoored machinations of devious individuals that have served to hide the presence of the government, but rather deeply rooted ideological and institutional forces that have lead American politicians – over many generations and from a variety of political and ideological allegiances – to adopt a complex set of indirect policy tools.

Chapter 2: The Property Frontier, 1780s to 1900

It is a firm conviction with me that the future of the Republic depends upon the question of whether we can make this nation a nation of home-owners or not.

*Judge Seymour Dexter, 1900*¹⁵

The wilderness was a great absorber of capital, and continuous public and private efforts were pursued to make the capital available.

*Miles Colean, 1950*¹⁶

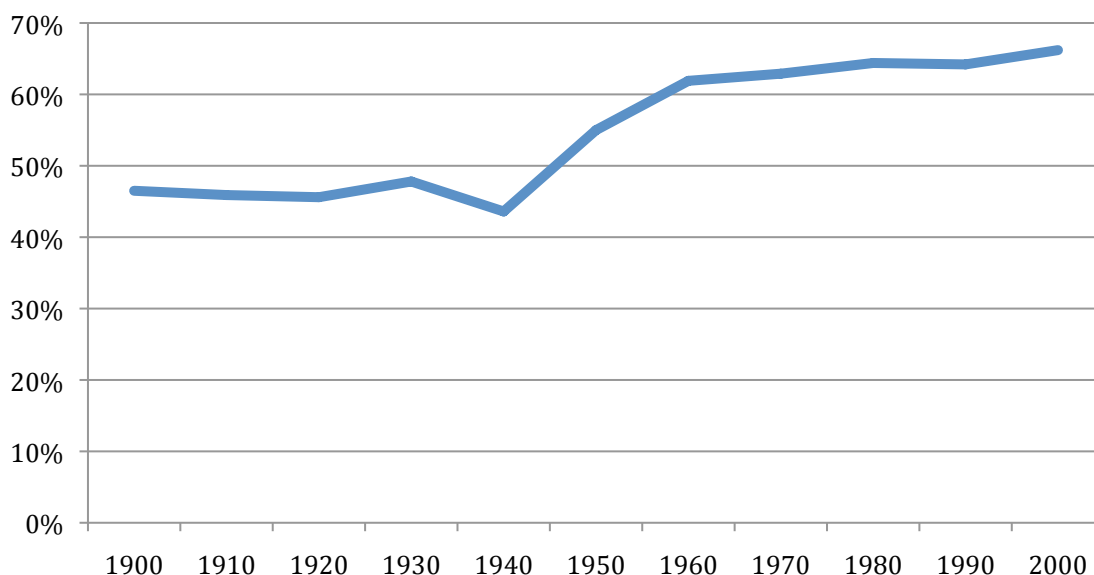
When the Johnson administration decided to back a market for Mortgage-Backed Securities (MBS), it was using a well-established strategy to resolve a set of tensions that had long plagued American politicians. On one hand, Johnson was facing a crisis with the federal budget (a crisis I discuss in detail in Chapters four and five). On the other hand, he was grappling with the endemic financial troubles that had plagued the housing market since the earliest days of the nation. The current chapter discusses the origins of that housing finance problem in eighteenth and nineteenth century America.

The United States has long had high levels of homeownership and an impressive credit problem to go along with it. Geography is one reason. In America, land has been both plentiful and habitable (Jackson 1985: 129). Historian Kenneth Jackson detailed how this expansive and habitable land combined with a variety of factors – including relatively high wages, cheap transportation and building costs, and favorable governmental policies – to make homeownership surprisingly affordable and feasible for common American citizens. Figure 2.1 illustrates that as early as 1900, over 45% of families owned their homes, a number that generally remained steady until the housing boom that followed the Second World War pushed the homeownership rate above 50% (Bureau of the Census 2004). From the close of the 1960s through most of the 1990s U.S. homeownership rates fluctuated between 63 and 66% of the population. At the height of the 2005 millennial housing bubble, rates would hover just under 70%.

¹⁵ Michael J. Brown's Eulogy, Philadelphia 1904, quoted on p. 182 of Bodfish, Henry Morton. 1931. *History of Building and Loan in the United States*. Chicago: United States Building and Loan League.

¹⁶ P. 147 in Colean, Miles Lanier. 1950. *The Impact of Government on Real Estate Finance in the United States*. New York: National Bureau of Economic Research.

Figure 2.1: U.S. Homeownership Rates in the Twentieth Century, by Decade¹⁷



Such historically high ownership rates are unusual, but not unprecedented among nations. Among similar European nations, the U.S took the lead in housing rates through most of the nineteenth and twentieth centuries; in 1985 Jackson noted, “about two-thirds of Americans own their dwellings . . . Overall, the American rate about doubles that of Germany, Switzerland, France, Great Britain, and Norway . . . Only New Zealand, Australia, and Canada, all with strong frontier traditions, small populations, and a British-induced cultural dislike of cities, share the American experience.” (Jackson 1985: 7). Since World War II, the gap narrowed or closed in many cases; some countries, including Spain, Finland, and Belgium, have even higher levels of homeownership than the U.S. (Conley and Gifford 2006; Jackson 1985: 233; Kemeny 1978). This suggests that it is not high ownership levels per se which define the American experience, but that in any country how people live combines with a specific configuration of market, cultural, and political institutions to shape experiences. In the U.S., historically high rates of homeownership came to shape social identities, political rights, and the distribution of wealth (Dreier 1982: 179; Jackson 1985).

How did Americans manage to buy up all that land, and finance the equipment and buildings necessary to develop it? According to Kenneth Jackson (1985), the answer is simply that relatively high wages and cheap land allowed even struggling workers and farmers to become property owners. But that answer elides what were significant problems in organizing the flow of capital. Not even the highest paid workers could necessarily buy their homes outright.¹⁸ That is, Americans needed loans to own and work

¹⁷ **Source:** Bureau of the Census, U.S. 2004. "Historical Census of Housing Tables: Homeownership." Housing and Household Economic Statistics Division. Published December 2, 2004. Accessed online April 30, 2010. Available online: <http://www.census.gov/hhes/www/housing/census/historic/owner.html>.

¹⁸ Even people granted frontier lands for free (or for a small fee) under the Homestead Act between the 1860s and the 1890s still needed capital to buy the tools needed to farm – a point that I will return to below.

the land. Showing that the capital existed is necessary but not sufficient to explain homeownership. We also need to know how that capital was distributed. In the nineteenth century, organizing a system of finance capable of supplying housing and farm credit to poorer people spread across a large continent was a problem. Individual loan applicants faced significant competition from commercial and industrial borrowers. Lenders and borrowers both struggled to figure out how to get capital reserves held in the East distributed on the ever-widening frontier. State and local governments were the locus of political power, but they were unable to solve a problem that needed national coordination. To explain and understand high levels of ownership, it is not enough to argue, as Jackson does (1985), that cheap land and high wages made ownership feasible. For a complete account, we also need to understand how the nation's credit markets evolved to allow people to get the mortgages they needed to buy houses.

In the following sections I discuss the early history of American housing finance through a series of contradictions. I begin with post-Revolutionary policies that sought to create a nation of small property holders. These policies were intended to distinguish the U.S. from European feudalism, but reproduced one of its core logics: the association of land ownership with political rights and social status. I next discuss the tension between the romantic ideal of the stable nineteenth century property owner and the messy reality of housing finance. In the nineteenth century, homeownership, on farms or in urban areas, came to represent the best of the American dream. It was the crowning achievement of the stable, thrifty, trustworthy man. In practice, however, the process of home buying was punctuated by intense periods of instability, mania, and irresponsibility. The frontier was settled through booms and busts.

That speculation, I argue, illuminates another paradox, one that Miles Colean posited in 1950. Colean was an architect-turned-economist who helped draft the landmark National Housing Act of 1934, and who later became the Federal Housing administration's chief economist, served as an advisor for the Mortgage Bankers Association, and coined the phrase "urban renewal" (1980a; 1980b; FHA 1959; Clark 1980; Freund 2007: 124; Jackson 1985: 203). In his book *The Impact of Government on Real Estate Finance in the United States*, Colean points out that while the early federal government set out to increase the demand for property ownership, it failed to provide a means of financing the purchase of land (Colean 1950). It was a policy fundamentally at odds with itself, and it resulted in frequent spasms of land speculation. In the absence of a coordinating mortgage policy, a patchwork mortgage market emerged. At the close of the chapter I offer an overview of this patchwork market, seeking to understand why the majority of mortgages before the twentieth century were issued by individuals, rather than banks, life insurance companies, corporations, or savings and loans. Here I suggest that some of what is most interesting about housing finance in America is not who invested in real estate, but who did not. I also discuss how problems with a local, patchwork market led to disastrous attempts to improve the flow of mortgage funds across the nation, sometimes through the use of mortgage bonds. I review all of this to show that at least one of the problems the Johnson administration was trying to solve with securitization was a very old one: the problem of having a national, but not nationalized, credit market.

Table 2.1: American Land Acquisitions¹⁹

Date	Territory	Square Miles Acquired
1783	Northwest Territories (Treaty of Paris)	895,415
1803	Louisiana Purchase	909,380
1819	Florida	58,666
1845	Texas	388,687
1846	Oregon	286,541
1848	Mexican Cession	529,189
1853	Gadsden Purchase	29,670
1867	Alaska	570,374

Federal Land Policy: The Politics and Ideology of Homeownership

The federal government acquired a tremendous amount of land in the eighteenth and nineteenth centuries. Table 2.1 shows that between 1783 and 1867, 3.7 million square miles were absorbed as the nation's boundaries came to spread across the continent. Reviewing early federal land policy, historian Gary Libecap (2007: 90, 94-95) points out that what is striking about the history of American land policy is not just this dramatic acquisition, but the government's choice about what to do with its vast holdings. Rather than hold on to most of it, or to parse it into large estates, the federal government decided to divide up the land into mostly smaller titles to make property ownership a real possibility for its citizens. Thomas Jefferson had declared that "The small landholders are the most precious part of the state." (quoted in Libecap 2007: 98) His ideas were codified, starting in 1785, in a National Survey that was "based on an infinitely expandable grid of square sections and quarter-sections, which he hoped would encourage the proliferation of small, independent homesteads as the new nation expanded." (Wright 1983: 21)

There was often great inconsistency in the policy of supporting small freeholders, and many exceptions were made. Some individuals and states benefited from large land grants, while large estates were especially common in the South (Coleman 1950: 9-10). Railways also benefited from land grants, and their mishandling eventually led to great scandal (Dobbin 1994: 48-59). But large holdings were the exception rather than the rule. Despite a variety of national debates about how to manage the distribution of land, there was nevertheless broad consensus that it should be parceled out to small landholders:

¹⁹ **Source:** Kluger, Richard. 2007. *Seizing Destiny: How America Grew from Sea to Shining Sea*. New York: A.A. Knopf.; Libecap, Gary D. 2007. "Property Rights and Federal Land Policy." Pp. 89-114 in *Government and the American Economy: A New History*, edited by Price Van Meter Fishback. Chicago: University of Chicago Press.

“Even the practice of making large grants,” writes Colean (1950: 11), “did not seriously interfere with the pursuit of this policy.” Widespread smallholdings predominated.

This diffusion of ownership, despite its inconsistencies, was so central to early conceptions of a desired political culture that it was one of the few policies the federal government was allowed to pursue. In an effort to avoid the concentration and abuse of governmental power, political authority was primarily invested in local and state governments, especially in the years after the Revolution and before the Civil War (Dobbin 1994; Scheiber 1975; Skowronek 1982). The federal government would be small, its purview limited to that which local governments could not do themselves. Land policy was one of those areas:

The main areas of positive Federal action were in the fields of tariff policy, land disposal and management of the public domain, and banking and monetary policies; in addition, the abstentionist policy of allowing virtually free immigration and the awarding of patents for invention also were influential in their effects on the economy's private sector. None of these policies, it should be noted, required extensive cash expenditures or costly administrative overhead; hence there was only limited growth of bureaucracy, and in 1850 the Federal government's civilian employees numbered less than 50,000. (Scheiber 1975: 87)

This federal policy was acceptable because the idea of the yeoman farmer who owns land and is politically invested in his local community was one of the ways that the new nation would distinguish itself from Europe. Indeed, the nation's founding fathers saw ownership of small plots of land as integral to the identity of the new nation as prosperous and democratic.²⁰ According to Libecap:

A political coalition formed to reserve federal lands for small farmers and “working men” and to oppose the perceived development of monopoly baronial estates and landlordism. Advocates maintained that every man had a right to a share of frontier lands and that this property rights allocation would not only serve as a remedy for poverty, unemployment, and the privation of the working class but would ensure the extension of democracy throughout a nation of prosperous small landholders who had a stake in the society. Such a nation would have the distributive balance to be politically conservative and free of the damning political conflicts that characterized Europe. Federal

²⁰ Indeed, Libecap (2007: 105) shows that politicians remained so dedicated to this idea of small parcels that they stuck with it even in contexts where it made little economic sense. While small parcels worked well in the Northeast Territories (where the policy was developed), it was not successful in the more arid Great Plains where livestock needed more land (small farmsteads that did well when there was a good deal of rain were devastated during periodic droughts, and in the last decade of the 19th century 37% of farms in western Kansas failed). Moreover, when it came to the Western Timberlands the U.S. government completely failed to sell off broad swaths of land because it failed to adjust its policy and instead offer larger tracts of land.

land, allocated freely and in small plots, could help mitigate any of the social pressures that might build up in Eastern cities. Immigrants would be channeled through to the frontier to reduce the supply of urban workers, maintaining acceptable manufacturing wages. (Libecap 2007: 98)

This quote reflects many themes that carry through the history of American housing. For example, over a great deal of time, and across ideological divides, the notion persists that property ownership makes better, more reliable, more dedicated citizens – and this in turn justifies the notion that the government bears some responsibility for ensuring widespread land ownership. It is an idea invoked in both Progressive Era attacks on the slums and in George W. Bush's attempts to deregulate markets. The literature on housing is full of quotes from American presidents extolling the virtues of homeownership. Together they reveal that the political promotion of homeownership in the U.S. starts early and endures:

James Madison: "The Freeholders of the country would be the safest depositories of Republican liberty." (Dreier 1982: 181)

Calvin Coolidge: "No Greater contribution could be made to the stability of the Nation, and the advancement of its ideals, than to make it a Nation of homeowning families." (Davis 2009: 209; Dreier 1982: 182)

Herbert Hoover: "[Homeownership makes] a more wholesome, healthful and happy atmosphere in which to bring up children." (Davis 2009: 209)

Franklin Roosevelt: "A nation of homeowners, of people who own a real share in their land, is unconquerable." (Davis 2009: 209; Dreier 1982: 182)

Bill Clinton: "Homeownership, home building, home sales, home mortgages, and home values will once again be the rising tide that lifts all of America's boats." (Katz 2009: 30)

George W. Bush: "To give every American a stake in the promise and future of our country, we will bring the highest standards to our schools, and build an ownership society. We will widen the ownership of homes and businesses, retirement and health insurance – preparing our people for the challenges of life in a free society. By giving every citizen an agent of his or her own destiny, we will give our fellow Americans greater freedom from want and fear, and make our society more prosperous and just and equal." (Davis 2009: 209)

Dreier (1982: 181-189) adds that as far back as the colonial era a person who owned property was seen as a better citizen and a more noble and trustworthy person. He notes that not only were homeowners lauded, but renters were in turn *stigmatized* and denied rights and privileges – including, until 1860, the right to vote in federal elections. Many scholars argue that this social stigmatization and political marginalization still persist, continuing to hurt renters and tenants (Harvey 2008; Purser 2010).²¹ Scholar Ananya Roy (2003: 464) has argued that this “paradigm of propertied citizenship” in the United States means that those who do not own property are denied core rights.

Political Pressures & Advantages of the Federal Land Policy

Yet American politicians, even from an early time, did not encourage homeownership for purely noble or ideological reasons. Even in the Revolutionary period, politicians had pointedly pragmatic and instrumental reasons for advancing it. The federal government used plots of land, starting with the Revolutionary War and through the Civil War, to pay off creditors and soldiers (Emigh, Riley, and Ahmed 2010: 37; Libecap 2007: 99). Land grants were used to encourage the development of the nation’s transportation system with private companies being given land as an incentive to build roads, canals, and railways (Dobbin 1994: 48-59). For the still small federal government, and also for the states, land sales served as an important source of revenue (Scheiber 1975: 87-89). Selling off parcels of land was an important source of income for the cash-hungry young nation that was constitutionally limited in its capacity to tax. Whereas its European counterparts undertook land surveys as a step towards taxation, in the U.S. surveys were a step away from taxation (Emigh, Riley, and Ahmed Forthcoming: 37).²²

Land policy was also shaped by various interest groups, some of which had sprung up in response to those land policies (Libecap 2007). Initially elites, especially the creditors who amassed land as repayment for backing the Revolution, placed pressure on the young federal government to formalize their property rights. Entrepreneurs who staked their wealth and wellbeing on that frontier also jockeyed to have their interests protected. Under pressure first from creditors (who held land scripts), and later from squatters, land speculators, and the railways, the federal government implemented an orderly system of land distribution. Starting in the 1780s the federal government developed clear property titles, conducted surveys, and held public auctions for land parcels (Libecap 2007: 97). As land policy developed into the middle of the 19th century, a more robust constituency emerged that placed additional pressure on the government to distribute land in an inexpensive way: “The combined political muscle of frontier land developers, or speculators (and most frontier migrants engaged in land speculation), transportation companies (canals and later, famously, railroads), and territorial boosters seeking statehood created a formidable constituency that few politicians could ignore.” (Libecap 2007: 98). How the land would be distributed, to whom, and at what price became a major political issue in the nineteenth century. The Homestead Act of 1862

²¹ For David Harvey (2008: 23) this intersection of property and citizenship is not specific to America, but is a more general tendency under capitalism: “We live in a world, after all, where the rights of private property and the profit rate trump all other notions of rights one can think of.”

²² See also Dewey (1934: 216-217) for a summary of early federal government revenues from land sales.

emerged as the centerpiece of an array of policies that converted a vast frontier into a nation of property holders, in some states allowing the distribution of lands for free or for a small fee (Libecap 2007).

Property ownership also appealed to politicians because of the more general influence it could have on the political leanings of the populace. Libecap's (2007) account suggests that the founding fathers believed that property holders may be more politically conservative, and that land policy could ease social and labor pressures in the eastern cities. Interestingly, Gerald Davis (2009: 191-234) shows that this theme made a strong resurgence in the 1990s, when Republicans like George W. Bush specifically sought to promote ownership, not just in homes but also in stocks, as a way of making people more conservative – therefore bolstering their own political constituency. Scholar David Harvey argues that widespread homeownership, and all the patterns of consumption that accompany it, serves as a means of absorbing an excess of surplus capital, and, at various points, also serves as a means of co-opting and pacifying the labor force. He believes that this is true of capitalism everywhere, but is most fully articulated in suburban, postwar America:

The suburbanization of the United States was not merely a matter of new infrastructures. As in Second Empire Paris, it entailed a radical transformation in lifestyles, bringing new products from housing to refrigerators and air conditioners, as well as two cars in the driveway and an enormous increase in the consumption of oil. It also altered the political landscape, as subsidized homeownership for the middle classes changed the focus of community action towards the defense of property values and individualized identities, turning the suburban vote towards conservative republicanism. Debt-encumbered homeowners, it was argued, were less likely to go on strike. This project successfully absorbed the surplus and assured social stability, albeit at the cost of hollowing out the inner cities and generating urban unrest amongst those, chiefly African-Americans, who were denied access to the new prosperity. (Harvey 2008: 27)

What is striking here is that conservative scholars like Libecap, who supports laissez-faire capitalism, may agree with more radical Marxist scholars, like Harvey, on the fundamental insight that one of the political appeals of homeownership is its promise to create a more docile and conservative population.

Supporting Ownership: Beyond Federal Land Policy

Above I have focused on land policy, but it is worth noting the other ways that federal and state governments promoted property ownership in the eighteenth and nineteenth centuries. First, state, local, and federal governments played a role in helping to make the mortgage a more sophisticated instrument by providing additional protections for borrowers and, later, lenders (Coleman 1962: 32). Libecap argues that the strong and clear delineation of property rights for mortgages had lasting benefits (Libecap

2007: 89). That is, clear mortgage rights not only allowed ordinary Americans to accumulate wealth, but it also provided the institutional foundation of strong property rights that would eventually allow private capital markets to flourish. “[Land] ownership institutions,” he writes, “set precedents to private ownership of other, less-tangible assets such as financial instruments and allowed for the development of private financial institutions and markets such as banks and stock exchanges.” Similarly, Douglass North (1990: 96-100) has discussed early U.S. land policy as a seminal institution in the evolution of American economic and political systems.

A second means of supporting homeownership was through the provision of public services and utilities, like irrigation and dams, roads and schools (Jackson 1985: 130-132). Governments also supported private endeavors that were attractive to potential homeowners, like railroads (Dobbin 1994: 130-132; Jackson 1985). This kind of support was valuable, and speculators aggressively lobbied for it, a point I will return to below.

A third means of supporting property ownership is through favorable tax provisions.²³ On one hand, property taxes were more common than income taxes in this era, and this tended to disadvantage owners (Clemens 1997: 180). However, Woods argues that state and local tax laws from the 1860s established important precedents when they excluded mortgage interest from taxable income, and that this ultimately served to promote homeownership in the U.S. (Woods 1979: 108).

A fourth means of supporting homeownership was by setting rules for the distribution of credit. Since this is so central to my analysis, I will return to it in greater detail below. For now it is enough to say that this includes direct government lending and guarantees, as well as rules about which kinds of organizations could invest in different kinds of property in different locations (Coleman and Committee 1944: 68-69). One important means of promoting (but not allocating) housing credit, especially on the state level, was through chartering banks. It is not clear that the government officials realized exactly how chartering lending institutions might contribute to the increased flow of credit, however, and some have argued that loose standards for charters encouraged some of the worst kinds of land speculation (Coleman 1950: 63-64).

Urbanization and the Cult of Homeownership

To this point I have focused mainly on the yeoman farmer, but of course not all Americans in the nineteenth century were farmers. The second half of the nineteenth century saw a marked rise in mining and industry, and throughout the middle of the nineteenth century cities were growing in size and population (Fligstein 1990: 37). The growth of manufacturing, starting with textile and food production, drew Americans from farms into cities (Fligstein 1990; Jackson 1985: 316-320). At the same time, technological advances brought us the first organized systems of mass transportation, including the steam ferry, rail, and cable car (Jackson 1985). This created a new trend of wealthier people moving towards the periphery and suburbs, in what Kenneth Jackson calls “the most fundamental realignment of urban structure in the 4,500-year past of cities on this planet.” (Jackson 1985: 20).

²³ See also Howard (1997) for a trenchant and in-depth discussion of how tax exemptions have served to promote homeownership throughout U.S. history.

Aided by relatively high wages, cheap transport and affordable land, Americans developed a new sense of domesticity and homeownership (Jackson 1985: 47-54). As men left home to work with the rise of manufacturing in the early 1800s, a new feminized “cult of domesticity” emerged (Jackson 1985: 49). Recounting the claims of prominent men and women, Jackson paints a vivid picture of how a cult of homeownership – centered on the ideal of a single-family home with a yard – also crystallized in the nineteenth century. Walt Whitman, for example, claimed that, “A man is not a whole and complete man unless he owns a house and the ground it stands on” (quoted in Jackson 1985: 50) In his “Acres of Diamonds” lecture on morality, given often in the 1890s and early twentieth century, Russell Conwell claimed:

My friend, you take me and drive me – if you furnish the auto – out into the suburbs of Philadelphia, and introduce me to the people who own their homes around this great city, those beautiful homes with gardens and flowers, those magnificent homes so lovely in their art, and I will introduce you to the very best people in character as well as enterprise in our city, and you know I will. A man is not really a true man until he owns his own home, and they that own their homes are economical and careful, by owning the home. (quoted in Jackson 1985: 50)

Jackson himself shows us how the issue was framed in this era in the most intimate and personal sense. “The isolated household,” he writes, “. . . even came to represent the individual himself.” (Jackson 1985: 52)

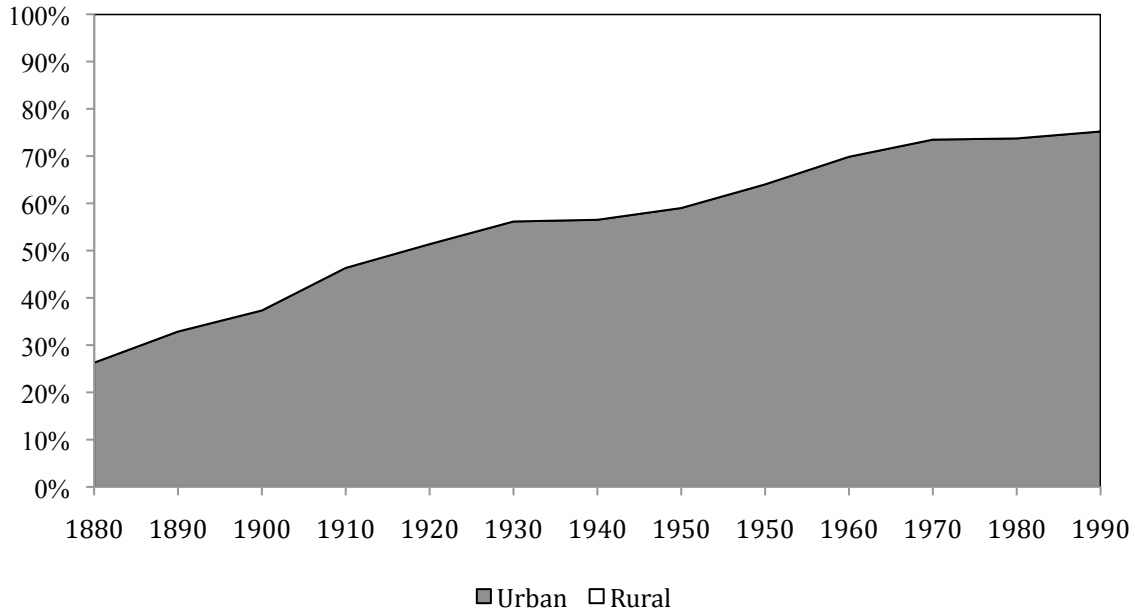
Thus the ideals Jefferson pegged to the small landholder also extended to the urban and suburban property holder. As Americans moved from farms to cities and suburbs, they took with them the notion that the property owner is a better citizen. And as immigrants arrived into cities, this trend found new expression: “The idea that land ownership was a mark of status, as well as a kind of sublime insurance against ill fortune, was brought to the New World as part of the cultural baggage of the European settlers,” writes Jackson, who goes on to later add, “Whether well-born or an indentured servant, practically everyone set himself quickly to the task of organizing the landscape into private parcels and somehow procuring a share of the division. The American dream was in large part land.” (Jackson 1985: 54)

American immigrants and workers bought land at levels unheard of in Europe. Jackson notes that one study in Bristol, England in 1838 reported that a miniscule number of manual laborers – a third of a percent – were homeowners (Jackson 1985: 117). Compared to that, reports of ownership in American cities of the era are striking: 63-78% of working class men who had been in Newberry for 20 years owned homes, and in 1900 in Detroit over half of the Germans (55%) and slightly under half of Irish (46%) and Poles (44%) owned homes, as did 58% of immigrants in Toledo (Jackson 1985: 118). Unlike European immigrants to the U.S., however, African Americans families were often excluded from this rising tide of homeownership. By the start of the twentieth century, 48% of white families owned their homes, and only half that many black families did (Carter et al. 2006c). That 24% of black families owned their own homes in 1900 is testament both to the relatively high rates of homeownership in the U.S. even

among the most disadvantaged, and to the degree of discrimination faced by African American families (Oliver and Shapiro 2006: 15).

The decade between 1880 and 1890 was a watershed in the ways American lived. In 1890 the government took its first census of housing, and announced that the Western frontier was settled (see also Frederiksen 1894: 203; Jackson 1985: 46; Snowden 2006: 4-398). As industry and manufacturing increased in urban centers near the end of the nineteenth century, an agricultural depression drove down the value of farm land (Jackson 1985: 129). For farmers adjacent to growing cities, selling land was far more profitable than tilling it. Speculators were happy to buy, and they set to work converting the farms into suburbs (Jackson 1985: 129). This period marked the largest increase in the portion of Americans living in urban areas and towns in the nation's history: by 1890 over a third of the nation would be city dwellers, up from about a quarter of the nation's population in 1880 (Carter et al. 2006a; Snowden 1988: 274). As Figure 2.2 illustrates, this trend towards urbanization would continue through the rest of American history: whereas 26% of Americans were urban dwellers in 1880, by 1920 that number had doubled. It continued to rise in the twentieth century, so that by 1990 75% of Americans lived in urban areas. Homeownership levels on farms were higher than levels in cities at the turn of the twentieth century, but a nation of agricultural homesteaders was nevertheless on the path toward becoming a nation of urban homeowners.

Figure 2.2: Proportion of Americans Living in Urban Areas²⁴



²⁴ **Source:** Table Aa716-775: Population, by race, sex, and urban-rural residence: 1880-1990 in Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, Gavin Wright, and Kenneth A. Snowden. 2006a. "Historical Statistics of the United States." New York: Cambridge University Press. **Note** that the 1950s definition of urban (versus the 1940s definition) is used for the 1950 calculations.

Speculation & Instability: How Credit Markets Shaped Land Development

In the nineteenth century the nation expanded westward, cities grew, and homeownership reached new heights. But the country's credit markets were often ill equipped to manage the demands of this extensive growth. The federal government, which was actively promoting property ownership, had for the most part refrained from directly intervening in credit allocation for homes. The resulting mismatch between a near insatiable demand for housing credit driven by government policy, and the inability of credit markets to responsibly manage that need, encouraged rampant speculation, financial experimentation, easy money, and periodic disasters (Coleman 1950: 15-17; Reps 1965: Chapter 13).

In the U.S., private speculators, developers, and real estate specialists led the way in land development.²⁵ States and railroads would sometimes receive large land grants to parcel and sell for profit, and sometimes schools (e.g. Cornell), religious groups (think Salt Lake City), and in the early twentieth century, companies (notably Hershey) would take the lead in developing a town (Bogue 1955: 2; Jackson 1985; Reps 1965). Overall, though, it was more typical for smaller developers and speculators to lead the way (Hayden 1984: 19; Jackson 1985). On the frontier, speculators often would identify an area with some kind of geographical advantage (like a waterway), lay out a town, and then head east to encourage families to settle there, often wooing them with overblown claims: "Land speculation produced unnumbered tragedies. Families lured from the comparative comfort of some seaboard community by the siren song of the town promoted frequently found themselves suddenly stripped of their savings and faced with the crude life of the frontier" (Reps 1965: 360). Private developers similarly took the lead in luring city-dwellers into the suburbs. Jackson (1985: 134-135) explains that with the exception of a few real estate syndicates in urban areas, it was a small developer who would buy land, commission a civil engineer to lay out streets and lots, and then construct roads or lobby the local municipality to do so. The developer would often keep a lot for his own use, and then sell the rest of the land (in the 1800s, usually via auction). It was the land buyers who would then build houses for their use or resale.

To say that private interests led development does not mean that government officials were uninvolved. Entrepreneurs extensively lobbied government officials to pursue programs that would help them along, usually in the form of desired public work projects (Jackson 1985; Reps 1965). In the frontier towns this might take the form of encouraging official land surveys. In the development of suburbs it was more likely to involve the provision of railways and the use of public roads. Addressing speculators who sought to profit from the development of streetcar suburbs, Jackson writes:

All pretended to be operating as independent entrepreneurs in the best tradition of a democratic society. All in fact manipulated government agencies and employed political favoritism in order to use public streets and gain public franchises for their private ends.

Although few eyebrows were raised over the way politics and business were mixed in the development of the American

²⁵ Jackson (1985: 134) notes that this is in sharp contrast with Europe where governments were often extensively involved in land development.

suburbs, such tactics were unique to the United States. In Great Britain and in the European Continents, transit owners were not allowed to speculate in real estate served by their lines, and landowners were not given streetcar franchises. (Jackson 1985: 124)²⁶

The point is that it was not just that land speculators targeted the railroads, but that railway developers often doubled as land speculators. Where the railways went, land speculation followed. The federal government, starting with the Pacific Railroad Bill in 1862, granted two railways land near to their tracks to sell in order to offset building costs; the government also made special provisions to help mortgage that land (Dobbin 1994: 53). A later, twentieth century example of land and rail speculation was found in Ohio, where the Van Sweringen brothers combined rail and land speculation to create not just a large rail empire, but also to make strides in land development with the trend-setting planned community of Shaker Heights, a new skyscraper called terminal tower in Cleveland, and the Shaker Square shopping area (Wolner 1989: 10-13).

This rampant land speculation meant that housing finance in the 1800s suffered from dramatic swings (Dewey 1934: 224-227; Reps 1965: 224-227). “To some extent,” writes John Reps, “an element of speculation was present in almost every American town planning.” (Reps 1965: 349) It was common for people to borrow money and buy land in hopes of receiving a financial windfall for selling it later (Dewey 1934: 226). The belief in rising land values, often shared by brokers and settlers, began early in the U.S., where “the availability of cheap land on an ever broadening frontier was, at least in theory, a hedge against disaster not present in England” (Colean 1950: 16, 38). And that belief was not limited to Americans. It was not uncommon for European investors to invest in U.S. land and commodities (notably, cotton), the latter also being the target of speculative bubbles (Sparks 1932: 239). A nineteenth century commentator quipped that American “good fortunes fired the imaginations of even the dull Europeans” (Dewey 1934: 226).²⁷

The frontier was an incentive for exuberant lending and land speculation, and a powerful draw on credit: “These facts are, first, that a strong movement in favor of cheap money has existed continuously in this country from the earliest period of colonization; and, second, that the persistence of such an agitation has been due, more than to any other single cause, to the constant spread of settlements westward over large areas that have long remained thinly populated” (Bullock 1900: 1, and cited in Colean 1950). Americans borrowed money to buy land, and when they were given the land for free or already owned it, they would often mortgage it for improvements (Bogue 1955; Colean 1950: 15-16). Data from 1894 suggests that half of the nations’ property at the time was mortgaged up to 35 to 40% of its value (Frederiksen 1894: 207; Sparks 1932: 178).

Local markets were subject to smaller-scale booms and busts. On top of this, there were significant regional and national crashes in 1815, 1837, 1857, and 1893 (Callender 1902; Sparks 1932: 130-131). The last one was immediately preceded by a “farm

²⁶ See Dobbin (1994) for a more extensive comparison of railroad development in the U.S., Britain and France.

²⁷ This is not to say that speculation was necessarily higher in the U.S. than in Europe, which had already weathered a set of impressive speculative manias, including the 1637 Dutch tulip bubble, the 1720 South Sea bubble, and the 1720 Mississippi land bubble (see Kindleberger, Poor and Aliber 2005).

mortgage craze” in which mortgage brokers and nationally organized thrifts promised investors on the East coast, and even abroad, high returns on the western frontier. The market came to a crashing halt when drought and deflation caused a general depression in the 1890s and the investment vehicles were revealed to be tenuous and speculative (Davis 1965: 386; Frederiksen 1894; Sparks 1932: 177-188). Even under the best of circumstances, high levels of homeownership required the flow of credit to people who were ill equipped to repay their debts. Add a speculative bubble, and you have a situation in which lenders are doling out excessive amounts to people who represent significant credit risks. “Between unlimited entry on the one hand and extensive borrowing on the other,” wrote Colean, “the land structure from the start was economically unstable. Investment in a true sense was extremely hazardous, and, in the speculative sense, losses ran a close race with profits.” (Colean 1950: 16) By encouraging land ownership the government unleashed a demand for long-term credit, but the nation lacked a sophisticated financial system capable of providing long-term credit to the masses, and housing finance was therefore plagued with problems. The government had left the credit markets to private companies that did not have the technology, experience, skill or means to manage the dangers and temptations that came with it. Deeming it a policy of “intervention in reverse,” Colean concludes that, “instability was thus built into the urban as well as the rural land structure, producing a constant hazard to investment and a constant threat to the security of real estate loans” (Colean 1950: 16-17).

After over a century of devastating housing crashes, the trauma of the Great Depression spurred the U.S. government to comprehensively and systematically stabilize housing finance, and even then the problem would continue to ebb and flow. Before the New Deal, however, private companies and entrepreneurs generally struggled alone, with varying levels of success, to find a viable means of funding the nation’s widespread homeownership.

The Structure of a Patchwork Market

How, then, did Americans buy up all that land? How did they afford the property, structures, and farm equipment needed to settle the frontier? Above I mentioned that many Americans used mortgages, both to purchase the land and the tools needed to cultivate or improve it, so that by 1894 an estimated half of the property in the U.S. was mortgaged up to 35 to 45% of the value (Bogue 1955: 1-6, 268-9; Colean 1950; Frederiksen 1894: 207; Sparks 1932: 178).²⁸ A mortgage is a loan contract in which the borrower uses a piece of property as collateral for the debt. The kinds of terms included in mortgages change over time and place. Today a mortgage in America is likely to be 20 to 30 years long, and it is likely to be amortized, meaning that the borrower repays both the principle and the interest of the loan slowly over time. It is also likely that the borrower commits a relatively low down payment of 5% to 20% of the property value. But, as we will see in Chapter four, those kinds of terms were widely popularized in the U.S. only after the Depression; before that, such terms were not unheard of (notably, building and loans and land banks in the late 1800s and early 1900s used these kinds of

²⁸ See Bogue (1955: 1-6, 268-9) for a discussion of how farmers used mortgages to raise funds for farm equipment.

terms), but they were relatively rare (Carliner 1998; Freund 2007: 104; Green and Wachter 2005; Jackson 1985: 204; Rabinowitz 1980: 65; Snowden 2009; Weiss 1989).

Before the 1930s, a typical mortgage would be somewhere between three to ten years in length, and would require a high down payment that covered 40% to 60% of the property value (Carliner 1998; Freund 2007: 104; Green and Wachter 2005; Jackson 1985: 204; Rabinowitz 1980: 65; Snowden 2009; Weiss 1989). Families would often take out smaller second and third mortgages to help cover the cost of the land. These loans were not usually amortized, so payments went towards the accrued interest, and the principle was due in one large “balloon” or “bullet” payment at the end. Interest rates varied a great deal by region, especially before the twentieth century. In the East, a typical mortgage matured in 6 years and had a 5.5% interest rate, while in the South and West a typical mortgage would mature in 3 or 4 years but carried an 8-10% interest rate, and on the West Coast the rate would be closer to 10%, nearly twice what someone in the East would have to pay (Frederiksen 1894: 206; Sparks 1932: 178).

Who lent this money? Most often that individuals lent to each other (Coleman 1950: 58; Frederiksen 1894; Grebler, Winnick, and Blank 1956; Weiss 1987). But while individuals remained the primary source of credit, the nation experimented with creating organizations that were capable of more systematically managing the persistent credit risks that were associated with creating a nation of property holders. As farms, villages, and cities developed in the 1700s and 1800s, the structure of mortgage lending began to take shape, and commercial banks, life insurance companies, and later, mortgage bond houses emerged. Below I discuss each type of lender in more detail. I start with governments, corporations, life insurance companies, and commercial banks, because their exclusion from the market is key to understanding the predominance of non-institutional lenders and eventual rise of the mutuals, building societies, and savings and loans (S&Ls). Even this general overview reveals that much of what is remarkable about the U.S. is not just who invests in mortgages, but which kinds of organizations, through the constraints of law and markets, refrained from doing so.

Before continuing, however, it is important to provide some caveats about the data I use in this section. The U.S. census started looking at housing and mortgage debt in 1890 (Frederiksen 1894: 203; Snowden 2006: 4-398). We do not have clear data on the market earlier in the century, but some studies done using the census data provide clues to how it looked at the close of the century, and I draw on those studies below.²⁹ We have the most detailed information about who held the debt for dwellings owned in and around towns and urban areas (residential debt) in 1896, as illustrated in figure 2.3 (which I discuss in detail throughout this section).³⁰ By 1896, commercial banks held about 5% of residential nonfarm mortgage debt, and life insurance companies 6%. Mortgage companies and other kinds of insurance companies (listed on the chart as “other institutional lenders”) held about 2%. In the middle of the nineteenth century Americans formed their first cooperative savings institutions; by the 1890s the mutual banks had

²⁹ The data reported in this section are derived from the Historical Statistics of the United States (HSUS), except where otherwise noted. For more on this data, see Appendix B.

³⁰ Following the HSUS, I exclude bonds from the nonfarm numbers because they are unable to disaggregate, for reasons of data collection, the portion of those bonds that represent residential and commercial debt, and residential debt is where we have a window into the breakdown of market share.

become significant market participants, holding about a fifth of the nation's nonfarm residential debt, with the S&Ls close behind, holding 16%.³¹

It is important to note the limits of looking at residential non-farm debt. To begin, this segment makes up only about 60% of the urban mortgage market between 1896 and 1900, as table 2.2 shows (please note that I will return to this table when discussing mortgage bonds, below). The other 40% of non-farm mortgage debt is mostly made up of commercial mortgages, that is, mortgages to businesses and industry. More importantly, these amounts do not include any of the nation's mortgages for farms, a substantial portion of the total mortgage market.

I note those differences because it is likely that different kinds of firms specialized in commercial and agricultural mortgage lending. Raising money for a farm is very different than for a small house, which is very different still from the kinds of funds needed to build a factory, apartment building, or skyscraper. The issue is not just cost (i.e. the sheer amount of the money you need to build a larger building), but the different ways a lender evaluates risks. With a larger building, the primary question is not whether the borrower is trustworthy (i.e. has good credit), but whether the property will succeed in generating enough income or rents to pay back the loan (Jones and Grebler 1961: 6-7). A problem with farm lending is that borrowers are more likely to be isolated and income seasonal. In contrast, it is much easier to lend money through collectives in cities and towns, where increased population density makes it easier to organize collectives and evaluate creditworthiness, and where income is more likely to be regular. For these reasons, historians believe that cooperative groups like mutuals and S&Ls were not very active in providing mortgages to farms, but focused on smaller houses in towns and cities instead. Although we do not have comprehensive national market data about this, what we know suggests that agricultural and commercial lending was usually funded by insurance companies, commercial banks, and mortgage brokers (Klaman 1959; Saulnier 1950; Sparks 1932).

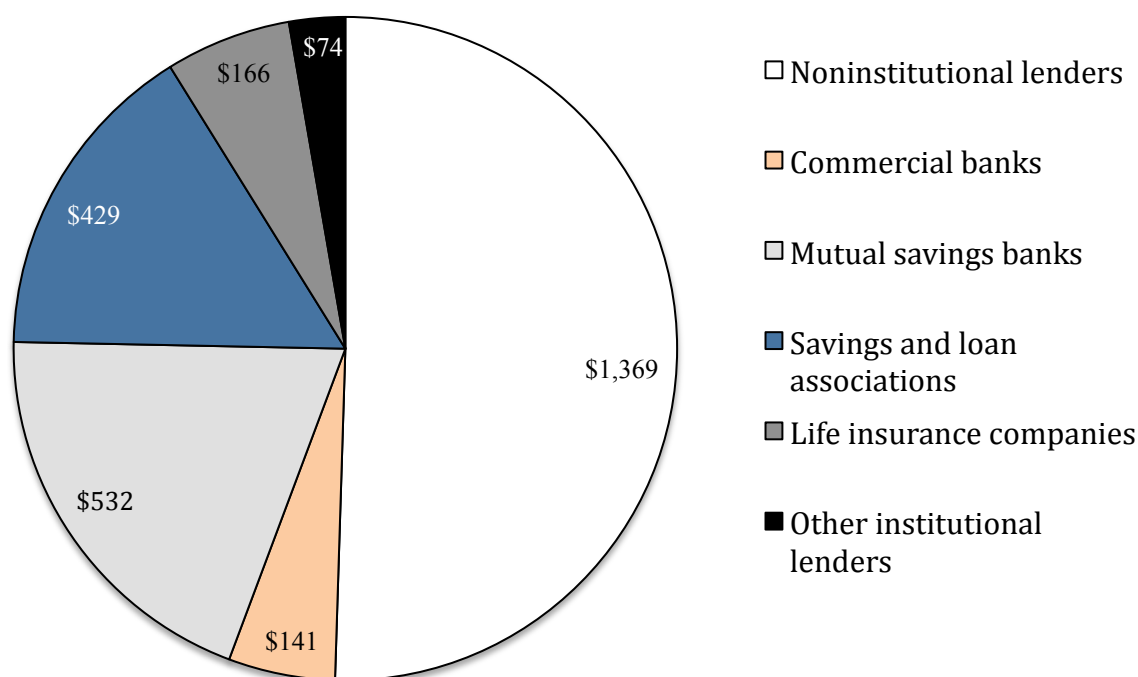
Table 2.2: U.S. Non-Farm Mortgage Debt, 1896-1900 (millions)³²

Year	Residential and Commercial Nonfarm Debt	Held in Bonds	%	Residential	%
1896	\$4,415	\$15	0.3%	\$2,711	61.4%
1897	\$4,459	\$20	0.4%	\$2,746	61.6%
1898	\$4,508	\$25	0.6%	\$2,783	61.7%
1899	\$4,577	\$30	0.7%	\$2,835	61.9%
1900	\$4,696	\$35	0.7%	\$2,917	62.1%

³¹ Note that this data does not distinguish between what portion of this debt is used to finance smaller homes (one-to-four family units, in real estate parlance) or larger apartment buildings.

³² **Source:** "Series Dc903-928: Debt on nonfarm structures, by type of debt, property, and holder: 1896-1952." In Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, Gavin Wright, and Kenneth A. Snowden. 2006a. "Historical Statistics of the United States." New York: Cambridge University Press.

Figure 2.3: Residential (Non-Farm) Mortgage Debt by Holders in 1896 (millions)³³



Across the nation's markets, non-institutional lenders predominated. This is a residual category that economic historians have traditionally used to lump together individuals, small trusts, nonprofits and other kinds of companies. Still, scholars believe that individual lenders overwhelmingly constituted this category (Grebler, Winnick, and Blank 1956: 191; Weiss 1987).

The Government

While the federal government mostly stayed out of direct intervention into housing credit markets during this period, there was a significant exception from 1800 to 1820. Recall that one of the reasons the post-revolutionary government sold off land parcels was to raise funds in lieu of taxation (Dewey 1934: 216-217; Emigh, Riley, and Ahmed Forthcoming; Libecap 2007: 99). Having not raised as much money as expected through selling off lands after the Revolution, the federal government in 1800 set up land-offices that provided credit with favorable terms for land purchases (Dewey 1934: 216-217). Earl Sparks explains: "the public lands were to be sold at \$2 an acre on the installment plan, a credit of four years being allowed with interest at 6 per cent from date of sale on the last three payments." (Sparks 1932: 320) A financial panic in 1819 and

³³ **Source:** "Series Dc903-928: Debt on nonfarm structures, by type of debt, property, and holder: 1896-1952." In *Ibid.* **Note:** Excludes mortgage bonds.

widespread defaults – to the tune of \$21,000,000 by 1820 – led Congress to forgive many of these debts (Dewey 1934: 216-217).

In addition to the financial loss, the speculative land bubble that preceded the 1819 market crash reflected negatively on the U.S. government. One critic at the time wrote: “Capitalists, both real and fictitious, have engaged extensively in this business [of land speculation]. The banks have conspired with the government to promote it; the former by lending money to the speculator, the latter by its wretched system of selling land on credit.” (quoted in Sparks 1932: 231). In 1820, the government responded to this crisis by switching to “cash sales at \$1.25 per acre” the low price being a kind of consolation prize for cutting off credit (Dewey 1934: 216-217; Sparks 1932: 230-231). The federal government at this point withdrew from facilitating housing finance until the Great Depression.

This is not to say that the federal government did not participate in credit support in other sectors of the economy. Industry, especially the transportation sector, was more likely to receive some kind of credit support. Though at times this involved support for mortgages, it was primarily a means of supporting commerce, rather than a means of supporting the mortgage market or property ownership *per se*. For example, in 1862 the federal government agreed to guarantee up to \$50 million for mortgages of land granted to the Union Pacific and Central Pacific railroads so that they could borrow funds to cover the considerable expenses they incurred creating the transcontinental railroads (Dobbin 1994: 53-59). Within a decade this program was embroiled in a massive scandal, as the railways siphoned funds and defrauded investors through bribes and manipulation. The federal government once again retracted from credit markets under a barrage of criticism. According to Dobbin (1994: 93), this scandal helped reinforce the notion that the federal government had no place in directing private markets, and was one of the reasons why, when the federal government did get involved in managing markets, it took the form of being “an umpire enforcing the ground rules of competition” and so pursued price and competition controls rather than direct involvement.

State and local governments seem to have been more involved with mortgage credit than the federal government. Each of the thirteen colonies experimented with land banks and public loan offices, sometimes as part of an effort to issue their own currency (Sparks 1932: 62-81). These attempts were varied and inconsistent, and frequently failed. There was a great deal of experimentation in the 1800s in the South and Southwest, as state governments set up and invested in property banks that used state bonds to fund real estate lending (Callender 1902: 160-161; Lively 1955: 88-89; Sparks 1932: 83-113). Partly commercial banks, partly relief agencies, partly means of generating revenue, Sparks considers the southern property banks to be an important step in the evolution of mortgage banking in the U.S. Most struggled with “poor and dishonest management” and ended up lending excessively and unable to meet the needs of depositors (Sparks 1932: 83, 96-97). At the same time, Sparks explains, a half dozen Southern states also set up hybrid public-private commercial banks that were effectively loan offices used to buy votes. These loans, sometimes backed by slaves, helped finance the cotton industry (Sparks 1932: 109-111). These experiments with property banks and state banks were at the cutting edge of creating mortgage bonds.

According to surveys of the residential mortgage industry in the 1890s, by the late nineteenth century state governments seem to have refrained from lending to individuals

to buy land (see figure 2.2; see also Frederiksen 1894). It seems that, to the extent governments got involved in risk management at this time (before 1900), they were mostly focused on encouraging businesses and industry rather than small landowners.³⁴ Land policy may have promoted homeownership, but state credit concerns were directed toward banks, currency development, and industry.

Often when states provided guarantees or credit for mortgages, however, they were driven primarily by industrial policy.³⁵ In an era when states competed with each other for investment and economic growth, local governments provided financing to the kinds of industry they wanted to attract, like railways. Grants, loans, helping to issue bonds on behalf of companies, or providing guarantees were not unusual (Dobbin 1994: 33). Dobbin, for example, found that at least half of the funds for the early railways came from state and local governments (Dobbin 1994: 41). State and local government involvement generally seems to have fueled, rather than offset, speculative bubbles. In addition to Spark's sobering account of property bank failures, we know from Dobbin that the states sometimes defaulted on their obligations (Dobbin 1994: 31; Sparks 1932: 62-113, 238-243).

Corporations

When the founding fathers set out to create a nation of small freeholders, they were aware that corporations had great potential to amass land, wealth and power. Laws that emerged in England to prevent the Catholic Church from accumulating land were adopted in the colonies to prevent corporations from doing the same. Colean (1950: 12-13) writes that corporate landowning was widely distrusted in the colonies, and states like Massachusetts, Illinois, and the District of Columbia went so far as to forbid the creation of a corporation for the purposes of profiting from trading in real estate. Many other states did not ban the creation of such corporations, but nevertheless imposed a variety of restrictions on where and how corporations could hold property. These laws were gradually repealed in the twentieth century, but when companies did acquire land in the 1800s there were rules that often prevented them from retaining it, and that property was usually sold off for profit (Colean 1950: 13-14). To the extent that U.S. companies held mortgages by the 1890s, the amount would have been small and likely captured in the residual "non institutional lender" category (figure 2.2).

Life Insurance Companies

Life insurance companies were first founded in the U.S. at the end of the eighteenth century. After a halting start, they grew rapidly until the 1840s and were well-established by the 1870s (Zelizer 1978: 596). As financial institutions that held savings for long periods of time, life insurance companies invested in mortgages early on in their history (Colean 1950: 60). Reviewing the role of life insurance companies in mortgage

³⁴ Whether or not guarantees were used to back land purchases for small purchasers is unclear to me at this time. It is possible that extensive use of guarantees could have been used to stimulate lending, but that would not show up in surveys as government-held debt.

³⁵ This would fit with what we know from Moss (2002) about government risk management efforts of the era: they focused on business growth more than workers or individuals before 1900.

markets, Richard Saulnier (1950: 9) found that mortgages, both rural and urban, were the most common investments for life insurance companies, especially before the 1860s.

The first life insurance companies were organized locally and not very diversified, but after the Civil War, the industry spread (Saulnier 1950: 9-11). Free of the geographical limitations faced by banks and S&Ls, they invested in mortgages around the country, though at the same time they also increased their holdings of stocks, bonds, and government debt. By 1900 mortgages represented about 30% of insurance companies' total holdings. While mortgages were a popular place for life insurance companies to invest in the second half of the nineteenth century,³⁶ the relative small size of the industry and their decreasing rate of investment made it so they never held a great deal of the nation's housing debt. They held five to six percent of non-farm real estate debt at the close of the nineteenth century, and only reached ten percent of the market in the 1930s (Grebler, Winnick, and Blank 1956: 199).

Commercial Banks

The early involvement of commercial banks can be divided into two periods: before 1864, when banks made frequently disastrous forays into mortgage investment, and after 1864, when the regulation of nationally chartered banks discouraged their extensive involvement in the market. Early colonial banks in the Northeast experimented with mortgage lending, and had some moderate success before "inept or unscrupulous management resulted in widespread failures, bringing the whole theory of land bank finance into bad odor" in the 1780s (Coleman 1950: 68). Sparks (1932: 77) reminds us that land, being "plentiful and cheap," had a great draw for early Americans interested in finance. Banks experimented with using mortgages to back currency and even Alexander Hamilton supported a plan that used real estate debt to back banknotes before realizing that the mismatch between short-term obligations and long-term investments could prove problematic (Sparks 1932: 57-58, 62-77). As early as the 1730s, a private group in Connecticut issued long-term (12 year) bills of credit that were intended to serve as currency. "The people hailed the bills with delight." According to Earl Sparks. "A scheme which could start without capital, and yet furnish the means of obtaining capital on easy terms to its many members was naturally regarded as a great boon by those who wished for more capital" (Sparks 1932: 53-54). This, like many other endeavors, ended up in financial loss and scandal. In fact, the series of speculative and frequently disastrous attempts to integrate banking and real estate stretched into the first half of the nineteenth century (Sparks 1932). All together, they served as a hard-earned lesson: using redeemable debt to fund real estate was a tricky, potentially destabilizing endeavor (Sparks 1932: 304). It was painfully clear that the relatively long term commitment implied by a mortgage (3 to 10 years, at the time) made it difficult for banks to responsibly serve customers who could withdraw funds at any time (see, for example, Behrens 1952: 19-20). These concerns were reflected in the National Banking Act of 1864, which instated capital requirements and lending restrictions that limited the conditions under which nationally chartered banks could acquire and hold mortgages

³⁶ See Saulnier (1950: 9-14) for a more detailed description of life insurance investment strategies in mortgages from 1890-1940. See Grebler, Winnick and Blank (1956: 99-201) for a more extensive discussion of the role of life insurance in the late nineteenth and early twentieth century.

(Coleman 1950; Keehn and Smiley 1977; Sylla 1969: 659). Sparks argues that these specific restrictions were, in fact, a direct response to calamitous experiments with bank lending on the frontier (Sparks 1932: 305-307).³⁷

This is not to say that commercial banks were entirely out of the business of mortgage holding. National banks were largely precluded from issuing or investing in mortgages from 1864 until the laws were reformed in 1913, but they had a wide variety of ways of getting around these rules. And especially in the later years of this ban, regulators were often generous in their interpretation of the restrictions (Behrens 1952; Keehn and Smiley 1977: 15-16).³⁸ Additionally, state-chartered banks were often allowed a good deal of leeway when it came to mortgage investment. A survey from 1910 found only 11 of the 46 states had restrictions on mortgage holdings (Behrens 1952: 16).

Reliable and comprehensive statistics from the 19th century are scarce, but we know that in 1896, commercial banks held only about 5% of home mortgages in cities (figure 2.2). Keehn and Smiley (1977) argue that banks were especially active in agricultural regions and that their participation in the market may be significantly underreported, so there is reason to believe that better data on agricultural mortgages would show a more significant role for commercial banks in the housing market.

The laws designed to curtail commercial bank investment in mortgages had interesting unintended consequences, according to historian Richard Sylla (1969). Because national banks were shut out of the real estate market, the flow of capital across state lines dwindled. These laws, then, played a significant role in making the U.S. mortgage market a patchwork of local markets rather than one coherent market. That is, while the laws may well have helped banks behave more responsibly and protected those who kept their savings in them, they also reinforced a localized system of mortgage finance that caused endemic problems with the supply of mortgage credit. When the U.S. government created a system of housing credit support through federal insurance and mortgage-buying programs in the New Deal it was in part a response to this problem of localism, and when the Johnson administration took steps to support the securitization market, it was, again, to solve this problem. Sylla (1969: 686) suggests that more extensive and rapid industrialization may have been another consequence of these laws. He argues that since banks were largely unable to invest in mortgages, they redirected their capital towards urban manufacturing, slowing agricultural development but promoting industrialization.

Mutual Savings Banks, Building and Loans, and Savings and Loans

A mutual savings bank is a cooperative savings institution, a financial form that started in the U.S. around 1816 to support smaller, poorer savers (Bodfish 1931: 14; Steiner 1952). These first cooperative saving groups were unconcerned with housing; their main focus was encouraging common workers to save in order to protect against

³⁷ Overall, the impetus for the law was largely related to providing wartime funding and creating a national currency during the Civil War (Sylla 1969). For more on how restrictions on real estate investment as a response to the illiquid nature of mortgages, see Keehn and Smiley (1977: 475): “Real estate loans were invariably denounced by those who mentioned them. They ‘lock up’ funds, it was asserted, and are not salable.”

³⁸ See especially Keehn and Smiley (1977), who explain these strategies with great clarity and detail.

injury and loss (Bodfish 1931: 5-14; Kendall 1962: 4). At the time of their emergence, urban centers were growing quickly due to population growth and industrialization. Urban workers who had regular income and were starting to accumulate enough for savings were largely ignored by the commercial banks, which mainly served corporations (Bodfish 1931: 14, 25, 29; Haveman and Rao 1997: 1608). The cooperative forms of saving filled this gap. As a group, the mutuals did not see investing in mortgages as a primary goal. They were more likely to emphasize thrift and invest in other types of assets, like government bonds (Coleman 1950: 60-61; Haveman and Rao 1997: 1609). Yet while mortgages were not the mutuals' primary source of investment, by the end of the nineteenth century they did come to represent about a third of their holdings. By 1893 the mutuals held about a fifth of the nation's urban mortgage debt.

The same conditions that led to the rise of the mutual banks also helped spur the creation of their close cousin, the building and loan societies (Bodfish 1931: 14, 25, 29; Haveman and Rao 1997: 1608). The latter invested primarily in mortgages and came to dominate American mortgage lending in the next century as they evolved into S&Ls. "Thriffs" is an umbrella term used to discuss an array of cooperatives that organized savings and mortgage lending in the U.S., including S&Ls, building and loans, and some cooperative banks (Bodfish 1931: 32, 66-72; Haveman and Rao 1997: 1608).

It was in 1831 that the first cooperative society specifically organized around investing in housing was formed in the U.S. (Bodfish 1931: 32; Haveman and Rao 1997; Kendall 1962).³⁹ Modeled after the English Building societies, the Oxford Provident Building Association lent \$375 to Comly Rich to buy a small two story home, one that still stands today at 4276 Orchard Street in Philadelphia (Bodfish 1931; Kendall 1962: 32-72). A second building society was founded in 1836 in Brooklyn, and from there, the form spread through the nation (Bodfish 1931: 79). From the 1830s to the 1880s the thriffs spread mainly throughout larger cities in the Northeast and Midwest, growing and spreading rapidly as urbanization accelerated in the 1880s (Snowden 1997: 228). Their rise was impressive. There were over 3,000 thriffs by 1888, and within five years there were over 5,000. By 1900, building societies had somewhere between 1.4 and 1.75 million members, held over half a billion in assets, and represented a third of the nation's mortgage debt (Bodfish 1931: 136; Haveman and Rao 1997: 1609). And they continued to grow. By 1925 the number of building societies doubled, there was nearly a sevenfold increase in membership, and they held \$5.5 billion in mortgages (Bodfish 1931: 136; Kendall 1962: 9).

Sociologists Heather Haveman and Hayagreeva Rao (1997) trace the rise and transformation of the thriffs in the nineteenth and early twentieth centuries. They explain that initially thriffs were non-profit groups, based on personal ties among members, which sought to encourage saving more than make a profit. Participants knew each other and held shares in the institution. In exchange for buying shares, they received the right to borrow from the group. Especially in the earliest building and loans, close social ties were used to manage the risks that came with lending. These were deeply moral institutions. Their financial and organizational arrangements reflected specific notions about how a man should ethically manage his funds and relate to his community

³⁹ Note the National Banking Act of 1864 would not restrict nationally chartered banks from holding mortgage debt for another 30 years. This means that the thriffs were responding to banking problems independent of national regulation, though the 1864 regulation exacerbated these trends.

(Haveman and Rao 1997).⁴⁰ In the next century they would transform into more bureaucratic, less communal organizations.

The thrifts were important not just as lenders, but also as purveyors of the cult of homeownership, promoting the ideal as they developed: “Everywhere they fostered the view that proper households could and should purchase their own dwelling and that people of moderate means could benefit from the institution of private property.” (Jackson 1985: 130) This is well illustrated by Haveman and Rao (1997: 1612), who offer a litany of quotes that show how in this era the morality of saving was joined with ideas about the moral supremacy of homeownership in particular. I quote them at length [emphasis added]:

A man who has earned, saved, and *paid for a home* will be a better man, a better artisan or clerk, a better husband and father, *and a better citizen of the republic*. (Dexter 1889, p. 11)

The impetus of association in a common purpose, the desire to maintain his standing among his associates, *the pride and satisfaction of acquiring a home*, will nerve [a thrift member] to his best efforts; will make him more frugal, more industrious, more painstaking in his daily life, and cause him to get ahead in the world, when under different circumstances his earnings might have been entirely frittered away. In this manner the Building and Loan system helps to make good citizens. (California 1896, pp. 4–5)

. . .

⁴⁰ The history of the thrifts was primarily written by men with close ties to the industry (Weiss 1989: 244). For example, author Morton Bodfish was an economist at Northwestern who was President of the Savings and Loan League and involved in the creation of the Federal Home Loan Bank system (1966a, 1966f). His history is a detailed and largely uncritical look at the industry. The dedication of his review of early Building and Loans (1931) is testimony to this: “to the leaders of the past whose practical idealism, unselfish motives, and business ability laid the foundations of the American building and loan movement, as well as to the leaders of the future, pledged to sound principles and policies for advancing systematic thrift and homeownership among the American people, this book is dedicated.” For a late 19th century critique of Building and Loans, however, see Frederickson (1894: 266-267), who views them as speculative and poorly organized: “Their means are not great, the average assets of a Massachusetts cooperative bank being, in 1891, \$100,000, and of a New York building and loan association, \$55,000, the average for the entire country being, in 1893, only \$83,093, and a few bad investments would, therefore, seriously affect any one of them. Add the fact that they are not always managed by business men, their limited means preventing them from paying good salaries, or any salaries at all, and also the further fact that the persons who invest in them are usually not business men themselves, are rather unfavorable considerations, when the safety of such an investment is to be considered. Furthermore, it is an undeniable fact that many such associations have been formed and are managed by persons who are themselves borrowing practically all the funds, and it is certain that some of the associations of this description are being mismanaged, and must be regarded as unsafe. As a rule the building and loan associations have been profitable, charging the borrowing member a high rate of interest, and in many cases they allow members to withdraw funds after a certain time, with 6 per cent. [sic] interest from the date of deposit. That they would in cases of emergency be far less able to pay out on demand the money invested in shares, than the savings banks their deposits, can not be doubted, and a share in a building and loan association is, therefore, for many reasons a more profitable, but a far less safe and available investment, than a listed debenture bond of a strong mortgage bank.”

The building and loan association is more than a business concern; it is a great social institution conducive to the cultivation of those habits of thought and life which make for national progress and prosperity and for the advancement of civilization in general . . . The greatest achievement[s] of this movement . . . are those large personal and social values which I designate as the spiritual accomplishments of this great movement, namely: . . . its development of the spirit of self-respect and confidence in one's own personality; . . . *the immeasurable personal satisfaction which comes from the sense of home ownership; the contribution it makes to the stabilization of population and the consequent stabilization of those other great institutions—industry, the home, the state, the school, and the church.* . . . In encouraging thrift and home ownership, the building and loan movement is making more solid the foundations of the greatest civilization the world has yet known. Yours is not merely a business function; it is a mission which seeks to achieve social justice in an evolutionary manner. Yours is not just a job, but a profession of the highest order. (Address by Professor Gordon Watkins to the California Building-Loan League, quoted in California 1926, p. 314)

Homeownership in these accounts has two main benefits. The first is personal: ownership makes you a better man. The second is political: ownership makes you a better citizen. Here again we see that home ownership is a place where Americans conflate economic interest, identity, and political rights. In April of 1893 leaders from the nation's local building and loans met in Chicago to form a trade association that they named the *United States League*. Two months later they held their first annual convention (Bodfish 1931: 140-144), where they formerly adopted the slogan: "The American Home, The Safeguard of American Liberties." The thrifts seem to have been a locus of discourse about identity, politics, and housing in the nineteenth century, and took the lead in doing so in the twentieth.

National Thrifts

Overwhelmingly the thrifts were organized locally, but there was one significant exception. A group of thrifts, known as the Nationals, spread beyond local regions in the 1880s and the 1890s (Bodfish 1931; Haveman and Rao 1997; Snowden 1997: 1636-1645). These groups often amounted to speculative "get rich quick" schemes, and were known to use controversial practices (such as strict penalties for participants), have poor credit checks, and even rely on Ponzi-type structures (Haveman and Rao 1997: 1639). The first National was founded in the middle of the 1880s.⁴¹ The form rose in popularity during the land bubble of the decade, with at least 240 organized by 1893 (Haveman and Rao 1997: 100-104). As a group they did extremely poorly in the depression of the 1890s

⁴¹ Note that because national thrifts are mutual cooperatives and not chartered commercial banks, they were not subject to the 1864 ban on commercial bank investment in real estate.

that followed and none of the major nationals survived into the twentieth century (Bodfish 1931: 115). The more conservative locally organized thrifts, which struggled to distance themselves from the fast-and-loose nationals, emerged victorious. Thereafter, the thrifts would remain locally organized. In large part this was because the failure of the nationals highlighted the perils of lending to unknown people (Haveman and Rao 1997).

Snowden (1997) offers an interesting perspective on this. He argues that local businessmen who had some connection to real estate (either in construction or as speculators) largely ran the thrifts. They volunteered to run the organization because they ultimately gained when more people in their region could own homes. These leaders were often able to keep their own potential conflicts of interest in balance because they were closely connected. The problem with having a national market was not simply that people could not find a way to manage the risks, but that local leaders of the thrifts were *unwilling* to do so outside of the local market from which they more directly profited, and which they had a vested interest in keeping healthy.

Mortgage Trusts, Companies and Bonds

Mortgage companies are companies and trusts that issue, buy, sell, broker, and sometimes guarantee mortgages (Jones and Grebler 1961; Klamman 1959: 5; Klamman 1961). While these companies specialize in mortgages, at times the distinction between them and commercial banks blur, with commercial banks dealing in mortgages, and mortgage companies sometimes acting like banks (Frederiksen 1894: 215). In the nineteenth century, mortgage companies predominately brokered or sold mortgages to individuals, but sometimes also worked closely with insurance companies and commercial banks investing in real estate (Klamman 1959: 5-7). The mortgage companies' lending activity in the West and in agricultural areas increased in the 1860s when the homestead laws further promoted the settlement of the frontier (Frederiksen 1894: 213). For the purposes of this study, mortgage companies are especially interesting because they are the companies that most often buy and sell mortgages and bonds secured by mortgages.⁴² However, it is important to note that not all mortgage companies issued bonds or sold mortgages, and not all companies that issued mortgages and sold bonds were mortgage companies (notably, commercial banks did so as well).

A *bond* is a contract that gives the holder the right to regular payments of the principle and interest of a loan. A *mortgage* is a specific kind of loan where a piece of property is pledged as collateral against the debt, meaning that if the borrower fails to repay her debt as agreed, the lender has the right to take the property in response. A *mortgage bond* is a bond in which a mortgage, or group of mortgages, serves as collateral. In other words, it is a debt that is backed by a loan, which is in turn backed by a piece of property. Why go through all the trouble of making mortgage bonds? The reason is that bonds are simpler to understand and so easier to trade than mortgages. As a result, they are much easier to buy and sell. Attempts to use bonds to attract investors to the field of housing finance have a long history. As noted in the discussion of commercial

⁴² The most extensive review of the history of mortgage companies that I know of was written in 1959 by Saul Klamman who pieced together a history of the industry using the historical reviews available to him, supplemented with interviews with notable persons in the mortgage industry. At the time he noted that the comprehensive history of these companies is still to be written. From what I can tell, that holds true today.

banks, in the colonies, government and private actors experimented with using bonds to back currency. Colean (1950: 58) reports that in the late 1700s Southern “property banks” specialized in holding property and issuing bonds, and that the practice was also common in the Midwest in the 1840s and 1850s, both of which burned out because, like today, financiers tended to price the bonds based on inflated expectations of rising land values. According to Sparks (1932: 177), mortgage companies since the 1840s in the Midwestern states had worked to overcome localism and bridge the eastern and western capital markets, loaning money to farmers and then selling the loans to East Coast investors. Soon, in the eastern cities, specialized companies emerged around this, and in the 1860s this practice grew quickly, so that there were 167 such companies by 1893, most of which had sprung up within the previous 20 years (Sparks 1932: 178-179). The National Banking Act of 1864 likely contributed to this rise, as some of the nationally chartered commercial banks constrained from investing in mortgages seemed to have simply set up mortgage company offices instead, at times in their same office space (Sylla 1969: 661).

In the midst of the rapid economic expansion of the Gilded Age there was a small burst, in the 1870s and 1880s, in the use of companies that sold mortgages in the West and used bonds to raise funds from eastern capital markets (Davis 1965: 385). Many mortgage brokers acted as straightforward middlemen who worked on behalf of a small group of wealthy families back east, or else were direct agents of corporate entities like the railroads (Bogue 1955; Miller 1958; Weiss 1987). The mortgage companies and brokers used a mix of financing mechanisms, and as they grew in size and sophistication they experimented with bonds, sometimes offering guarantees for individual bonds or groups of bonds (Davis 1965: 385) Sparks writes that the Iowa Loan and Trust Company (founded 1871) led the way in creating a new kind of mortgage bond: “Although companies and brokers had long been negotiating individual mortgages, guaranteed and unguaranteed, they now [between 1872-1893] began for the first time to issue debenture bonds secure by the mortgages deposited in trust.” (Sparks 1932: 178-179) Held in a trust, these bonds were long term. Usually they matured in 5 to 10 years, but ranged from as short as 1 to as long as 20 years (Frederiksen 1894: 218; Sparks 1932: 180). They often proffered a windfall for the brokers, not because the bonds sold particularly widely, but because brokers charged hefty commissions and took advantage of the large difference between how little it cost them to borrow money in the East, and the high rates they could charge when lending in the West: “The average rate of interest was nearly 6 per cent. At this interest many companies made loans with a spread of 3 or 4 per cent above the price paid for funds. For a few years, some of the companies showed huge paper profits.” (Frederiksen 1894: 218-221; Sparks 1932: 180) Bonds were sold primarily on the East coast, and, by some accounts, were also popular with English and Scottish investors (Davis 1965: 368; Sparks 1932: 179).

We do not have extensive aggregate data for this line of business. Frederickson estimated that mortgage companies held less than 2% of the total mortgage market in the 1880s and 1890s, and the Historical Statistics of the U.S. estimated that between 1896 and 1900, bonds never made up to even 1% of the nation’s residential nonfarm mortgages, as table 2.2 shows (Carter et al. 2006b; Frederiksen 1894: 209). The mortgage companies do not seem to have ever held a particularly large share of the market, and overwhelmingly it seems they sold single mortgages to individuals, rather than packing them into bonds held in trusts (Frederiksen 1894: 216). Even in the boom years leading

up to the 1893 panic, it seems that these were considered to be questionable new instruments marketed by unknown companies, and in the absence of a central exchange, the bonds were approached by investors with great care (Frederiksen 1894: 216-217).⁴³ In 1894 Frederickson (1894: 211) estimated that there were 165 companies nationally.⁴⁴ One study of the over 800 mortgage companies that were approved to issue FHA loans in 1954 found that only six of them were founded in the nineteenth century (Frederiksen 1894: 211; Klamann 1959: 17). It seems that the few mortgage companies survived the depression of the 1890s (Davis 1965).

Sparks provides some illuminating case studies of this market that show striking resemblances to later mortgage bond fiascos in the U.S. in the 1920s and at the turn of the millennium. In the 1880s, western Kansas was home to a speculative bubble that, he argues, was in part driven by speculation in mortgage securities:

Money was loaned on farm and town property in amounts far in excess of the actual value. The agents of loan companies, anxious to secure commissions, were principle factors in the land boom. In his report for 1894, the Kansas State Bank Commissioner stated that during the fifteen years preceding 1894 hundreds of companies had been organized in the State for the purpose of loaning money or negotiating loans in real estate security. This business proved very profitable when conducted on sound principles, but unfortunately the profits attracted the attention of financial adventurers, and many companies were organized apparently "for the sole purpose of robbing their customers at both ends of the line." Companies with large capitalizations, but very little paid in-capital, did not hesitate to guarantee the payment of both principle and interest on loans guaranteeing millions of dollars. Thousands of dollars were collected and never remitted to eastern investors. Much of the mortgage real estate was unproductive and greatly over valued. (Sparks 1932: 180-181)

Many of the facets of the events discussed by Sparks in different contexts may seem familiar in view of the most recent housing bubble. A well-meaning attempt to improve the flow of mortgage credit yielded great profits, attracting imitators and fraudsters who conspired with corrupt appraisers to drive up land values. Companies became increasingly leveraged and provided guarantees to investors at home and abroad that their reserves could not cover. Regulators did too little too late, and the situation escalated until a panic and crash resulted in a protracted depression. Then the whole sordid event was largely forgotten.

⁴³ Sparks (1932: 178), however, at points suggests that the mortgage companies helped cause the bubble: "In the decade before the crisis of 1893, mortgage indebtedness increased very rapidly in the west. This was due largely to real estate speculation and the excessive activities of newly organized western loan companies." Most of this money (67%) was used to buy land, but farm mortgages were also used to raise funds for equipment and improvements.

⁴⁴ Frederiksen found that there were 65 separate mortgage companies licensed in Massachusetts, Connecticut, and New York, and extrapolated from there, based on the understanding that these companies were concentrated in the East, especially New York.

In the nineteenth century, then, mortgage finance was for the most part “rigid and local” (Frederiksen 1894: 210). Lending was primarily offered through nearby individuals or companies, and the market was segmented by region. One consequence of this was that borrowers in the West frequently paid twice as much in interest as those in the East (Frederiksen 1894: 206; Sparks 1932: 178). Lance Davis looked at this market systematically and found that this piecemeal market veered towards national integration in the years from 1870 - 1885, a trend he attributed to a rise in insurance companies, national securities markets, and mortgage companies (Davis 1965: 380). The effort to overcome localism, or the geographically fractured nature of the U.S. housing market, started early in the U.S. Throughout this dissertation, I will discuss a series of efforts to achieve a more fully integrated national market that continued up through the postwar era, and how one of the legacies of this effort were the policies that supported securitization in the late 1960s.

Homes & Contradictions

This chapter has shown that the federal government worked alongside state and local governments to encourage a nation of small property holders and homesteaders. Federal land policy made it possible for Americans to own homes, and generations of politicians extolled the virtues of property ownership. As Americans moved from farms into cities, they took this idea of the value of property ownership with them, and a kind of cult of homeownership emerged. Land was abundant, habitable, accessible, and cheap. Homeownership became a core part of what it was to be a citizen and a moral person in the U.S. By 1900, when nearly half of Americans owned their homes, the nation had succeeded in differentiating itself from European feudalism that took the form of large estates and concentrated political power. Yet despite this distinction, the U.S. retained and reinforced a core logic that animated feudalism: that land ownership confers both moral superiority and citizenship. In providing land to more people and valorizing it, America had overturned the feudal concentration of power, but not the association of land with social status and political rights.

Colean (1950) points to another contradiction at the heart of American land policy: the federal government systematically encouraged homeownership, but at the same time refused to enter the credit market on a major scale. Outside the government, there was no national institution poised to provide the credit that a nation of homeowners would require. Easy credit, speculation, innovation and instability resulted. America’s frontier was settled and its cities built in fits of speculation.

By the second half of the nineteenth century a system of local markets had developed, and the system of organization that would structure housing markets in the next century was taking shape. By that time it was also clear that a locally organized market, while well suited to managing the credit risks that nationally organized companies ran aground upon, was a far from adequate solution. The problem remained that borrowers in the West were paying twice as much for their mortgages as those in the East, and mortgage finance regularly spiraled into speculative frenzies. For all that the American home represented the ideals of thrift and stability, that ideal was belied by turbulence and excess in the field of housing finance.

In conclusion, housing in nineteenth century America evinced a set of contradictions that were at once political, economic, and cultural. The founding fathers rejected large feudal estates but continually reinforced the feudal logic that citizenship and political rights inhere in land ownership. The federal government supported widespread property ownership but not housing credit markets. The nation had high levels of homeownership but lacked sophisticated, long-term credit facilities. The idea of owning a home came to stand for trustworthiness, stability, and moral restraint, but the process of financing homeownership was frequently marked by instability, speculation, fraud, and mania.

Chapter 3: Three Examples of Transition, 1900s to the 1930s

The national land policy created a credit problem that strained the capacity of traditional devices and methods. In the end, the federal government, which had laid down the policy, was called upon to salvage and restore what it had created.

*Miles Colean, 1950*⁴⁵

We must not forget that this calamity occurred in the real estate field.

*George Alger, 1934*⁴⁶

In Chapter two I discussed the expansion of the U.S. in the eighteenth and nineteenth centuries as the nation spread across the continent and its population grew, manufacturing rose to prominence, and cities swelled and then began to seep into the suburbs. In 1900, 45% of Americans owned their home. Although the United States was a relatively wealthy nation, with workers who had relatively high wages, its credit markets struggled to keep up with the demands for capital this massive expansion across the frontier required. American homes may have already come to symbolize stability, but housing finance was frequently manic and turbulent. At regular intervals mortgage markets suffered from terrible seizures.

In this chapter I discuss the early twentieth century as a time of transition. I focus mainly on three cases, each of which represents an important change that helped bring the period of credit turbulence to a close and set the stage for the next, more stable era of mortgage finance. The first case I consider is the creation of the Federal Farm Loan Act of 1916, showing how as the nation's farmers experienced unmatched success and then great loss in quick succession, the federal government established a new system of cooperatives and federal banks for farmers. The second case is how collaboration between the real estate lobby and the federal government developed during World War I. The third case I consider is the 1920s real estate boom and bust that was concentrated in the nation's largest cities. Brokers in this market used mortgage bonds to help fund some

⁴⁵ Page 56 in Colean, Miles Lanier. 1950. *The Impact of Government on Real Estate Finance in the United States*. New York: National Bureau of Economic Research.

⁴⁶ Page 3 in Alger, George William. 1934. *Report to His Excellency Herbert H. Lehman, Governor of the State of New York*. New York.

of the nation's great skyscrapers. The subsequent bust would exacerbate the Great Depression.

I review these cases in detail because they set important precedents for the changes in housing finance and federal credit, and in this way, they are significant for the eventual emergence of securitization. Additionally, together they provide an interesting window into the development of market intervention in U.S. history. The first case and second cases matter because it was at this point that the federal government turned to the systematic use of indirect policy tools and public-private collaborations to manage the problems with mortgage credit detailed in the last chapter. Doing so, they set precedents that would matter a great deal in the New Deal and postwar era. As such, they offer a window into the various strategies that government officials used to balance the need for market intervention and the desire to curtail federal power. In contrast, the mortgage bond market of the 1920s is useful as an example of the federal government's more typical hands-off approach to markets at the time. More than that, however, it is useful because of what it tells us about the evolution of mortgage bond markets in America. One of the mysteries of the current securitization market is why it started from within the government, rather than within the private market. The disastrous bond craze of the 1920s provides important clues to as to why: because it effectively washed out the private real estate bond market for the entirety of the postwar era. Additionally, it was during this period that the *participation certificate*, an instrument that would eventually spark the bond market's resurgence, was first used in the mortgage industry.

Changing Market and State Relations in the U.S.

Before proceeding with the case studies, it is useful to note that these events happened a time when the U.S. government was undergoing significant changes. The years between the Civil War and the New Deal were, in a sense, the federal government's awkward adolescence. It was a period of transition in which the federal apparatus was developing entirely new capacities. Yet the nation was still at the early stages of figuring out what that meant in practice. The point here is not that the federal government before this time was completely powerless, or that the further development of the federal government was somehow a natural and inevitable progression. Rather, the point is that in the years between the 1860s and The Great Depression, a new system was developing, and the shape of what was to come was still indeterminate. Below I outline some major trends in that transition, paying special attention to the changing federal budgeting practices during that time.

The Federal Government from the Revolution to the Civil War

Before the Civil War, state and local governments were an especially strong locus of political power in the U.S., and they extensively regulated economic and social life (Dobbin 1994; Fligstein 1990; Novak 1996; Scheiber 1975; Skowronek 1982). Scholars have tended to see the federal government's role in this period as residual, in that its job was to coordinate what the state governments could not. The domains included settling the frontier, tariff policy, banking and currency, immigration, and stabilizing interstate

exchange (Scheiber 1975). A recent wave of scholars have warned against overstating the weakness of the federal government before the Civil War, noting that the federal government played an important role in developing the economy (especially capital intensive projects like the railroads), settling the frontier, and building communications technology (see the review of the literature in Novak 2008: 758-759). Still, even if we revise our notion of the early federal government as being stronger than we once thought, its role was nevertheless less extensive than it would be following the 1860s.

Starting in the Revolution, one of the ways that the nation's founders had curtailed the power of the executive was through the organization of the federal budget (Ippolito 2003: 21-60). Control of the budget was squarely in the hands of the legislature, with the House given the responsibility of originating appropriations bills. Beyond individual appropriations bills the budget process was informal, and spending and revenue uncoordinated (Ippolito 2003: 60). When the administrative offices prepared their budgets they reported them directly to the Treasury, and the Treasury was required to send those estimates unrevised directly to Congress. When Hamilton tried to assert the power of the Treasury, Congress responded with line-item appropriations and setting up the Ways and Means committee.

The notion of a small and balanced federal budget became a strong norm in the Revolutionary period (Ippolito 2003: 21-60; Webber and Wildavsky 1986: 385). Jefferson saw large and unbalanced budgets on the federal level – and only on the federal level – as a sign of political corruption and moral depravity. Ippolito (2003: 60) points out that budgetary balance was not driven by economic principles as much as political ones. The intention was to keep the federal government small. This norm of balance grew in importance over time, and became a powerful unwritten rule by the Civil War (Ippolito 2003: 49). Exceptions were made for wartime borrowing, but balance would be quickly restored in times of peace.

Expansion, Corruption, and Reform: From the 1860s to the 1920s

Things started to shift during the Civil War. As part of the war effort and Reconstruction, the federal government had grown, in the words of Aaron Wildavsky and Carolyn Webber, “from tiny to small” (Webber and Wildavsky: 383). In the wake of the Civil War, the federal government conferred new rights to individuals and took steps to regulate railroads, create schools, help farmers, and provide support to veterans (the latter being the foundations of the U.S. welfare state) (Dobbin 1994; Novak 1996-248; Skocpol 1992; Webber and Wildavsky 1986: 383-384). Novak has therefore argued that the “Civil War played midwife to the liberal American State. It delivered new definitions of individual freedom, state-power, nationalism, and constitutionalism” (Novak 1996: 241).

The federal government also took new steps to manage the massive expansion in national industry in the decades following the Civil War. During the Reconstruction Era and throughout the Gilded Age, industries accumulated power and wealth as they grew rapidly. It was a time of great economic turbulence, and in an attempt to gain some control of volatile markets, the industrialists created cartels, fixed prices, and then integrated to form monopolies (Fligstein 1990). The longstanding American suspicion of concentrated power now found a new adversary in the cartels (Dobbin 1994; Fligstein 1990: 35; Fourcade 2009: 36). The federal government moved to reign in some of the

worst corporate excesses, but it did so haltingly (Fligstein 1990: 53). While Americans needed a national apparatus to reign in the national corporations, earlier governmental scandals (including problems with railroad credit aid) had reinforced the idea that a centralized government power was also a danger (Dobbin 1994: 66-81).

The growing federal government had to walk a tight line, and that line was drawn around the competitive free market. When it came to industry, it would protect the market, but not otherwise interfere with it (Fligstein 1990: 53, 98). Dobbin explains that by the end of the 1800s, “the idea that economic life should be organized by subnational governments seeking to promote regional economic development in collaboration with business interests gave way to the idea that the economy should operate as a free market under a state that established ground rules for competition.” (Dobbin 1994: 92) The emergent federal government would make sure everyone played fair but would not enter the game itself. Economic sociologists, building on the work of Andrew Shonfield, characterize the federal government of the time as the market’s “referee” (Dobbin 1994; Fligstein 1990; Fourcade 2009: 37). Thus as the nation approached the twentieth century a new balance had been struck: the federal government would grow, but it would do so only at the sidelines of industry. Economic sociologists consider the creation of the Interstate Commerce Commission of 1887 and the enforcement of the Sherman Antitrust Act of 1891 legislative emblems of the era, representing the federal government’s attempt to protect market competition, but only at arm’s length (Dobbin 1994: 93; Fligstein 1990; Fourcade 2009: 37; Gotham 2000).

It is useful to note here that while the federal government took halting steps towards regulating market competition following the 1880s, state and local governments held on as the locus of political authority. According to Skowronek (1982), it was the courts and political parties that took the lead in coordinating the various strands of the fragmented government. Patronage politics, wherein politicians and parties doled out favors, appointments, and privileges to their allies, reigned in the Gilded Age. Much of the Progressive Era political reforms of the 1890s through the 1920s were a backlash against this system.

Again, we find the general political models reflected in and reinforced by the structure of the U.S. budget politics. During the Civil War and Reconstruction the federal government significantly expanded its purview and spending, providing more funds to the new social welfare policies and internal developments (like harbors and railroads). The expansion of spending soon overloaded the House Ways and Means committee, and so the Appropriations committee was spun off from it in 1865. A year later the Senate created its own Appropriations committee (Ippolito 2003: 71; Webber and Wildavsky 1986: 385-386, 398). There was now in each chamber a specialized committee “with exclusive jurisdiction over annual spending bills” (Ippolito 2003: 71). At the same time, norms about the balanced budget shifted. While the government was still expected to balance the budget, it tended to do so at higher levels. That is, instead of reaching balance by keeping the budget small, after the Civil War relatively high revenues generated by protective tariffs meant that Congress sometimes reached balance by increasing its expenditures (Ippolito 2003: 97).

I noted above that patronage politics flourished during the Gilded Age, as the political parties took a strong lead in coordinating the parts of the fragmented government. A decentralized budget process facilitated this system. The trend toward

decentralized budgeting began in the 1880s, and by 1890 appropriations was dispersed across a set of committees: five in the Senate and fifteen in the House. This fractured system meant that decisions about expenditure were institutionally separated from decisions about taxation, which effectively created small fiefdoms. Webber and Wildavsky argue that this structure reinforced the emergence of “iron triangles” that knit together the fates of congressional committees, interest groups, and administrative offices (Webber and Wildavsky 1986: 385-386, 398, 414). It also was amenable to the exchange of favors (such as votes for grants) between representatives, a practice called logrolling.

The Progressive Era reformers fought against the corrupt patronage system at the turn of the twentieth century. As part of this effort, they sought to modernize the budgeting and expenditure process. In 1894 the Dockery Act standardized the Treasury’s auditing and accounting systems (Ippolito 2003: 91). While there was increasing talk about budgetary reform between 1900 and 1920, not much came of it. A telling example is when President Taft prepared a model executive budget for Congress in 1912, and Congress responded by refusing to even print it, much less consider it (Ippolito 2003: 95).

Still, the halting accumulation of executive authority continued during the first two decades of the twentieth century, and in 1921 found expression in the Budget and Accounting Act. This was a major piece of legislation that overhauled budgeting in the U.S. and was of lasting importance (the next big overhaul would not happen until 1968, when accounting controversies in the Johnson administration led to calls to modernize the system). The Budget and Accounting Act of 1921 centralized budgeting and gave the President a much more prominent role (Ippolito 2003). Spending requests would now go through the executive. The Act created the Bureau of the Budget to coordinate spending across the administration. It was located within the Treasury and its director reported to the President. Congress retained a strong say, as the General Accounting Office was formed under the authority of the Congress to audit spending. By 1922, both the House and Senate amended their rules to centralize appropriations. Each chamber would once again rely on a single committee to oversee all appropriations (Ippolito 2003: 108-114).

According to Webber and Wildavsky, the “inauguration of the executive budget ushered out the era of small government in the United States.” (Webber and Wildavsky 1986: 416) In many ways, then, the creation of the executive budget capped off the period of transition towards a larger and more assertive federal government. However, for our purposes it is important to emphasize that this federal assertiveness was still especially reserved when it came to intervening in industry, where the federal government was generally expected to protect competition but not overtly interfere with or direct industry. When we look at the urban mortgage bond market in the years before the Depression, we see virtually no federal government presence, which reflects this hands-off approach. The market grew at a rapid pace in the 1920s amidst a flurry of real estate speculation, and the federal government refrained from regulating the industry. The federal regulatory apparatus only got involved after the market crashed at the start of the Great Depression.

The Agricultural Sector: Exception to the Rule?

Agricultural credit lending in the early twentieth century provides another interesting perspective into the changing and tenuous role of the federal government.

While the government was generally a referee for industry in the Gilded Age and Progressive Era, it was more willing to be an active booster for farming, where it directly supported education, research, and development. The U.S. Department of Agriculture (USDA), founded during the Civil War, had emerged in the twentieth century as “an island of state strength in an ocean of weakness” (Skocpol and Finegold 1982: 271). In fact, Skocpol and Finegold note that the USDA was just one of many programs at the time designed to encourage agriculture. The Morrill Act, which authorized land grants for agricultural colleges, joined the USDA as one of many institutions that used professional experts to help direct policymaking in a way that was very unusual at the time (Skocpol and Finegold 1982: 273).

The Federal Farm Loan Act (FFLA) of 1916 is part of this nexus of institutions that intervened in the agricultural sector. It overhauled the distribution of farm credit, and created a national network of national cooperatives and Land Banks. On a basic level, understanding the FFLA’s development is useful because agricultural credit aid would become a major focus of the federal credit programs beginning in the 1930s (Bosworth, Carron, and Rhyne 1987; Ippolito 1984). In retrospect, the FFLA seems to be an important halfway point between the ad-hoc credit programs of the nineteenth century and the government’s systematic extensive use of direct loans and guarantees following the New Deal. We may look to it, then, to understand the development of a set of policy tools that would come to proliferate in the U.S. Moreover, because this was an arena where the federal government was extremely active, it is a particularly good case for considering the tensions and limits of federal power in the Progressive Era. That is, it provides an opportunity to see that even when the government surpassed the role of referee, it nevertheless tried to act as much like one as possible. In order to do so, the federal government in the Progressive Era sought to meld tentative market interventionism with laissez-faire ideals. Indirect policy tools were central to this effort.

Farms and Federal Aid

American farmers experienced a tumultuous economy at the turn of the twentieth century. The depression of the 1890s fueled an agrarian populist movement that fought passionately for economic support and debt relief. The Populists supported Bimetallism, or “Free Silver” – that is, they called on the government to mint silver coins. It was an inflationary policy that would have very effectively lessened the debt of farmers. Bankers opposed this, since they benefited from the non-inflationary policy of keeping to the gold standard. The battle over the currency pitted, as Milton Friedman (1990: 1172) has noted “Wall Street versus Main Street,” with eastern elites (bankers, industrialists, and foreign investors) pitted against the farmers of the South and West.⁴⁷ This was followed in the

⁴⁷ Debates about currency of that day were not abstract or dispassionate. The call for bimetallism found passionate expression in William Jennings Bryan’s 1896 famous Democratic Convention Speech that culminated with him declaring that the nation would not be “crucified on a cross of gold.” Rockoff (1990) ingeniously offers up the *Wizard of Oz* as an allegory for the political debates of this era, with Dorothy standing in for the common American, the yellow brick road representing the gold standard, the silver slippers representing free silver, the scarecrow representing the farmers, tin man representing eastern factory workers, the lion standing in for Bryan (because he later compromised on bimetallism), munchkins as the East coasters, Toto as the Prohibitionists (teetotalers), Emerald City as Washington, D.C, McKinley

early 1900s by a “golden age” when farmers thrived by exporting goods to Europe, whose own crops had been devastated by drought and World War I (Benedict 1953: 116; Fishback 2007: 401; Saloutos 1982: 3). In 1916, at a relatively high point in the midst of this turmoil, the federal government established the first systematic federal credit program in the field of agricultural finance.

By the early 1900s the nation’s farms had largely recovered from the agricultural depression of the 1890s, but concerns about the distribution of credit had not waned. Even when markets were better, the patchwork credit market meant farmers often paid higher interest rates than other groups, and farmers came out of this earlier depression organized and radicalized (Putnam 1916: 771). At the same time, an uptick in studies of American life also called attention to the problem of farm credit to politicians and bankers on the East Coast.

A National Monetary Commission in 1907 issued an extended report on German mortgage finance that stoked interest in alternate ways of organizing farm mortgage credit (Putnam 1916). More important, however, was the 1908 report from President Theodore Roosevelt’s Country Life Commission (Ellsworth 1960; Sparks 1932: 114-115). Credit distribution had been only a secondary concern of the Country Life Commission, which had set out to understand how to better bureaucratize and rationalize farms, conserve land, protect the soil, and keep a low cost of living through low commodity prices. It was a popular endeavor that appealed to different groups for different reasons. For Progressives, the Commission was a chance to study and assist the “backwards” American farmers. Eastern business interests saw it as a way to support their own enterprise and possibly co-opt agricultural interests. For railroad builders, the Commission was free propaganda for their land and rail speculation (Shulman 1999).

As part of its findings, the Commission recommended that the government encourage the creation of cooperatives as a solution to a host of problems, like social isolation and low commodity prices, which included but were not limited to credit (Ellsworth 1960: 168). There were many controversial provisions of this report, and disagreements within the Commission, but it turned out that across party lines, many otherwise contentious groups could again agree with the Commission’s findings that farm credit was a problem that needed study and repair (Bailey 1971; Ellsworth 1960; Shulman 1999: 69-75).⁴⁸ When it came to farm credit, the 1908 report’s major influence was in further highlighting the importance of the issue.

In 1913 some interim agricultural credit relief came by way of the Federal Reserve Act, which authorized national banks to issue mortgages to farmers; within three years \$45.7 million in loans had been issued to farmers from commercial banks (Studenski and Krooss [1952] 2003: 262). Nationally chartered banks, however, were

as the witch of the East, and drought and/or railroads as the witch of the West. But see also Hansen (1992), who warns that the allegory, while pedagogically useful, was not necessarily Baum’s intended meaning of the famous children’s book.

⁴⁸ The reasons why many groups agreed with the Commission Report were similar to the reasons why those groups had agreed that the Commission should be organized in the first place. For the Populist farmers, credit reform promised cheaper money. Republicans saw credit reform – as long as it did not involve giveaways or direct federal lending – as a way to neutralize the more radical farmers by helping them learn to help themselves. For the Progressives, the notion of surveying Europe to find a viable solution to a public problem was eminently attractive. Thus a plan to study Europe’s farm credit system was endorsed by all party platforms in the 1912 elections (Buckley 1917: 132).

limited to investing a quarter of their capital and to mortgages of five years or less, and they were also leery of tying up funds in long term debts (Palmer 1916: 292-293). Something else would have to be done to make it easier to get stores of capital on the East Coast distributed, more cheaply, to farmers spread out across the frontier who wanted mortgages to buy land and equipment.

The U.S. again looked to Europe for a more lasting solution. Stuart Shulman's (1999: 73-85) dissertation on the origins of the Federal Farm Loan Act (FFLA) provides a useful insight into this period. From 1912 to 1914 there was a flurry of public discourse about farm credit, as various farm and banking groups made competing claims about how the credit problem might best be solved. Two commissions, one privately sponsored and one sent by Congress, set off to study European systems of farm credit.⁴⁹ Both found much to recommend about European systems that made good use of cooperatives and mortgage banks, and the question now became how to construct a similarly successful system in the U.S. without direct government support, since some constituents saw the European model as a violation of American commitment to free markets. By 1914 the first of many competing agricultural credit bills was introduced to Congress, and groups vied for their preferred solution. Bankers wanted a system of private mortgage banks, and so supported a law that simply allowed the federal government to issue charters for private mortgage banks. Farmers, on the other hand, wanted direct federal loans at low rates (Putnam 1916: 772-773). The law that was eventually passed in 1916 was a kind of Frankenstein policy that patched together elements of both, as I will explain below (Putnam 1916: 780).

The Farm Loan Act of 1916

The Federal Farm Loan Act of 1916 (FFLA) was a significant piece of legislation. The FFLA set up a dual system: first, a government-backed set of Land Banks that would lend to newly organized National Farm Loan Associations, and second, a private set of Joint Stock banks. Below I explain this system in more detail. I first discuss the Land Banks, and then the Joint Stock Banks.

The basic idea with the Land Bank system was for the federal government to indirectly bolster farmers, not by lending them money or giving them grants, but by helping them pool their risks (Jones and Grebler 1961; Putnam 1916; Shulman 1999). At the core of the system was the Farm Loan Bureau, which regulated twelve Land Banks, each covering a distinct region of the nation. Each Land Bank lent money to farmers in its region, but only through a set of cooperatives, called the national Farm Loan Associations. Every time a national Farm Loan Association secured a loan for one of its farmers, the farmer would have to invest a small amount (5% of the loan) in his local

⁴⁹ The private Southern Continental Congress sent a group that was named the American Commission. By the summer of 1913 its members had returned from their tour and were at work producing a 900-page report on European farm credit (Shulman 1999: 83). The majority position of the group was that cooperative farm credit in Europe, which benefited from government financial support, had been very successful. A minority objected on two grounds: (i) that the European system was deeply flawed, and (ii) that individualistic Americans would not be amenable to cooperatives like the much more homogenous and communitarian Europeans in any case (Shulman 1999: 87). The second commission was backed by the federal government, and was named the United States Commission (Shulman 1999: 73-78). This group's report touted the benefits of mortgage banks that issued bonds.

Association, and then that Association was required to in turn invest a small amount (again, 5% of the loan) in its regional Land Bank. The more a member of a given Association borrowed, the larger stake that member had invested back into their Association, and through that, its regional Land Bank.

The most radical element of the plan was the creation of the new borrowing cooperatives, the Farm Loan Associations, because they “were created *de novo* as integral parts of the Federal Land Bank System” (Jones and Grebler 1961: 108-109).⁵⁰ To ensure their formation, the federal government, acting through the Farm Loan Bureau and the USDA, organized a campaign through pamphlets, journals, newspapers, and magazines to promote the benefits of the National Associations and the longer-term, amortized, lower interest rate loans they offered (Putnam 1919: 61). This campaign succeeded in promoting the program, and there were 4,662 Farm Loan Associations by the end of 1929 (Sparks 1932: 119).

The system was set up to support small borrowers. Loans ranged from \$100 to \$10,000 in value, and capped interest rates at 6%. The loan would be amortized and range from five to forty years. This was the first federal program to take the lead in promoting the low interest rate, amortized, long-term mortgage. In doing this, the Land Bank system set a precedent that would be adopted by later government agencies, and that would help change mortgage lending across the nation in the postwar era.

The Federal Land Banks were very different from the property banks of the previous century discussed in the previous chapter (Sparks 1932: 115). Since the Land Banks were investment banks, no one needed to withdraw deposits, and so the thorny issue of short term and long-term credit mismatch would no longer be a problem. The federal government would supply the funds to establish the Land Banks, but would withdraw its backing as the Farm Loan Associations invested in them, a process that was finally completed in 1947. The Treasury retained the right to inject funds into the banks after that in times of need, however (Jones and Grebler 1961: 110).⁵¹ In 1932, when the Federal Land Banks found that they could not find buyers for their bonds due to the Depression, the Treasury stepped in and dispersed \$125 million of its stock to the Land Banks to help keep them financed (Jones and Grebler 1961: 109).

Studenski and Krooss ([1952] 2003) note that the system had an early dramatic impact: “The Federal Land Banks changed farm credit drastically. First of all, they increased the amount of capital funds flowing into agricultural regions, thereby reducing interest rates in farm mortgages. Second, they quickly assumed a large portion of total farm mortgage debt—14.6% in 1924 and 19.1% in 1927.” By the late 1930s, they would

⁵⁰ But see Schneiberg, King and Smith (2008) and Clemens (1997: Chapter 5) for a discussion about other farm cooperatives, often more radical, that had been used to sell and market commodities in the Progressive Era. The works I cite in this section do not discuss whether the government set up a new system to circumvent or even undermine those more radical collectives, but that certainly deserves further study.

⁵¹ Some scholars write that the Land Banks are the secondary mortgage market for farm mortgages (they also write, for reasons that will become clearer below, that the Home Loan Banks are a secondary market for the S&Ls). However, I follow Jones and Grebler in asserting that while these Land Banks provided credit support, they were not technically serving as a secondary market for farm mortgages: “The Federal Land Banks served mainly the purpose of pooling the borrowings needed for the lending operations, substituting their credit for what would have been the much weaker credit of the individual Associations. In this sense the Banks perform central mortgage banking functions, but they do not operate as a secondary mortgage market by buying and selling farm mortgage loans.” (Jones and Grebler 1961: 108-109)

hold a third of the nation's farm mortgages (Jones and Grebler 1961: 110). The Federal Land Banks had originally been promoted as a way of supporting small farms, with loans capped at \$10,000. That amount would be raised to \$200,000, and then removed completely in 1959. Thus large industrial farms have come to benefit from this system (Jones and Grebler 1961: 109).

In addition to setting up the Federal Land Banks, the Federal Farm Loan Act allowed the government to charter private Joint Stock Land Banks. The goal was to ensure that the government did not displace private enterprise. These Joint Stock banks raised money on capital markets and lent directly to farmers. Although privately run, they were not entirely without government support; the legislation provided that the Joint Stock Land Banks' bonds would be tax exempt, and they were subject to federal regulation (Bulkley 1917: 140; Sparks 1932: 143). There were 88 of these Joint Stock Land Banks by 1931, and although these were investment banks and not allowed to take deposits, some of these Joint Stock Land Banks were set up by other commercial banks (Jones and Grebler 1961: 111).

The Federal Land Banks and the private Joint Stock Land Banks were both under the purview of a government office called the Federal Farm Loan Bureau, which was itself under the purview of the Federal Farm Loan Board (Studenski and Krooss [1952] 2003). The Bureau had a great deal of control over the practices of the Federal Land Banks (for example, it could set their interest rates), and also had some control over the Joint Stock Banks (for example, it had the power to grant or refuse them the right to issue bonds) (Sparks 1932: 116-117).

During the Depression, both the Federal Land Banks and the Joint Stock Banks, faced serious challenges, but only the Federal Land Banks successfully weathered them (Jones and Grebler 1961: 110-111). This was in part because the Land Banks' investors were assured by the government's support, and in part because the Joint Stock Banks seem to have run into more trouble. As a group the Joint Stock Banks suffered from more fraud and less investor confidence. Three of them had failed by 1927, and all were liquidated during the New Deal (Jones and Grebler 1961: 110).

The Importance of the Land Banks

The Federal Land Banks were an important precursor to the system of federal credit programs that developed during the New Deal (Jones and Grebler 1961: 110). Agricultural historian Allan Bogue has written that the FFLA was both the culmination of the radical agrarian populist movement and the start of a "new era in the history of farm land credit." (Bogue 1976: 93). The Land Bank system was copied as early as 1923 with the Federal Intermediate Credit Banks (FICB). Much like the Land Banks, with the FICB the government established 12 regional banks, but instead of providing mortgages, these banks specialized in shorter term (six month to three year) non-mortgage related loans to farmers (Studenski and Krooss [1952] 2003: 337-338).

These programs set a precedent that urban lenders would also seek to replicate. In the next chapter, I will discuss how this culminated in the creation of the Federal Home Loan Bank system. Moreover, the Land Banks were important because they supported longer-term, amortized loans. This would be replicated in New Deal housing finance

policies, and become one of the most important legacies of the federal credit policies (Jones and Grebler 1961: 111).

The FFLA is also interesting for what it reveals about the federal government at the time. As I noted in the previous chapter, the government had provided credit support in the nineteenth century, but primarily through state or local channels, and on an ad hoc basis. There had been a disastrous federal attempt to offer credit for the sale of government lands from 1800-1820, and a scandal-ridden set of railroad land grants of the 1870s. Other federal loans in the early twentieth century were also project-specific, but had been slightly more successful. In 1902 the Reclamation Act had authorized interest-free loans for water irrigation projects (Ippolito 1984: 151; Studenski and Krooss [1952] 2003: 265-266). In the early 1900s the U.S. government had lending programs related to World War I, Indian affairs, shipping, inland waterways, interstate commerce, international trade, and more railroads (Fetter 1941; Saulnier, Halcrow, and Jacoby 1957: 4-5). But the FFLA set up a new system of farm credit. It was unique in scope and style.

In many ways the Land Banks reflected the *laissez-faire* values of the government at this time. A private system of Joint Stock Banks was encouraged in order to make sure the government was not displacing private enterprise. The government's investment was to be temporary, lasting only until the cooperative Farm Loan Associations were large enough to hold all the stock in the Federal Land Banks. Once the system was set up, the government was supposed to stop being a financial backer and become more like a regulator of independent secondary banks. In form it looked much like the Federal Reserve Act of 1913, in which the government supported and mediated among the commercial banks.⁵²

Yet because of the Farm Loan Associations, the Farm Loan Act was somewhat more complicated, experimental, and interventionist than the Federal Reserve Act (Putnam 1916). The latter had been built around an existing system of banks, but the FFLA built up a new organizational base around it. "In spirit the act was revolutionary," writes Putnam, "its authors were convinced that American methods were not worth saving" (Putnam 1919: 57). Looked at from this perspective, with the Federal Land Banks, the U.S. government had set itself the task of reorganizing the financial underpinnings of one of the nation's largest and most important economic sectors. In this case the government did far more than ensure fair competition or support an existing system. It originated an entirely new system of farm credit. The previous federal lending programs were temporary band aids designed to solve narrower problems on a short-term basis. The projects funded by the loans (like dams and irrigation, railroads and canals) might last, but the system of financing would expire. With the Land Banks, it was the system of distributing funds for mortgage that would be the target of the regulation. Put differently, with the Land Banks, credit allocation was the target and not just the means of regulation.

If the FFLA shows the government acting as more than a referee, it nevertheless attests to how much the government felt compelled to try to meet the ideal of a *laissez-*

⁵² The question of how the Federal Land Banks relate to the establishment of the Federal Reserve Banks three years earlier is an interesting and important one that deserves further study and explication. However, since the Reserve Banks primarily address the issue of commercial banking, and the current study is more narrowly focused on the emergence of federal credit aid (as defined in the introduction), the former lies outside the scope of this analysis.

faire, referee-like government. In this case, the idea that the proper government was an arbiter was built into the law in multiple ways. Indirect support was chosen over the option, promoted by farmers, of direct loans. The government made a systematic attempt to organize farmers into groups that it could more comfortably collaborate with, the cooperative National Associations. The Treasury set up a system where its own backing would diminish and eventually disappear. The law chartered private Joint Stock Banks, and although that provision would be swept away with the New Deal, those private banks played a crucial role in legitimating the Land Bank system at a time when government intervention in the market was seen as much more suspect. In all, the government went to great lengths to set up a system where it could act like a referee as much as possible, especially in the future. In the process of doing all this, it set up a system where it would stay behind the scenes but step in as needed (as when the Treasury injected capital into the Land Banks in 1932). Through collaboration with private groups, it had made an important stride in the use of indirect policy tools for managing mortgage credit.

The FFLA was passed at the end of the golden era of farming. When European farming recovered after World War I, American farmers failed to scale back their production, glutting the market (Rucker and Pasour 2007; Sheingate 2001: 16). It was a classic crisis of overproduction, and the decline in U.S. agriculture was sudden and brutal. Farm income dropped by half and land values by a fifth in 1920 and 1921 (Rucker and Pasour 2007: 460-461; Saloutos 1982: 12). The prices would stabilize but not recover before the Depression and Dust bowl caused even greater catastrophes. In the following chapter I will discuss in greater detail how federal credit programs further intervened in the field of farm credit following the Great Depression. Before that, however, it is useful first to consider other important changes in the real estate market before the 1930s.

Government Planning and the Real Estate Lobby in World War I

The FFLA was not the only government involvement with mortgage credit during this time. The Federal Housing Ordinances of 1918 arranged for housing for laborers in industries critical for the war effort to ameliorate labor shortages in key industries like shipbuilding (Andrachek 1979: 170-172; Tierney 1941). Part of this effort included authorizing the Housing Division of the Emergency Fleet Corporation to lend money and guarantee loans to realty companies owned by the shipbuilders. The program was allocated \$75 million, and in the end it resulted in housing for around 55,000 workers of 24 shipyards and a turbine plant, provided through a mix of dorms, hotels, apartments, and homes. The shipbuilding companies retained ownership of the buildings (Andrachek 1979: 172). Later the government authorized another \$20 million of loans to transportation companies to help get the workers to the shipyards (Tierney 1941: 153).

The government at this time also experimented with building and selling homes directly to workers, a program that was applauded by labor and detested and criticized as potentially socialist by some real estate interests (Coleman 1962: 65-82). The U.S. Housing Corporation was chartered and granted \$100 million “to directly build, own, and manage housing it planned.” (Andrachek 1979: 172; Wood 1931: 68). In a plan to create 128 new structures, only forty of them began construction because the War ended three months into the program. Once the war ended, construction was stopped on any building not

already 75% complete, even though the nation faced a postwar housing shortage, because the program was branded as socialist. As the program was dissolved, a battle broke out over the rights of tenants versus corporations when it came to the privatization of these properties (Andracheck 1979; Wood 1931). Edith Elmer Wood has surmised that it was “the bugbear of government housing” that raised hostility for the U.S. Housing Corporation, but that left the Shipping Board generally free of criticism (Wood 1931: 78). Government involvement in housing was fine with real estate interests and conservatives, but only if it went through them.

In fact, throughout the entirety of the First World War, real estate experts and interests were deeply involved in the nation’s housing policy. In the early 1920s economic experts and industry professionals increasingly coalesce as an organized interest group. The S&Ls had organized into a trade group in 1893 with the United States Building and Loan League (USBLL) (Bodfish 1931: 140). In 1908 a group of realtors and developers had gathered at a Chicago YMCA to form the National Association of Real Estate Boards (NAREB) (Freund 2007: 51; Realtors 2008).⁵³In 1909 the National Conference of City Planners (NCCP) was formed, and by the 1920s it was a locus of organizing among planners and housing economists (Freund 2007: 50). In 1909 the more progressive National Housing Association was formed by Lawrence Veiller, a leader of the City Planning movement (Freund 2007: 50). These groups were joined by the Mortgage Bankers Association (1913) and the National Association of Mutual Savings Banks (1920) (Von Hoffman 2008: 4).

These organizations frequently worked with each other and with government officials to promote homeownership. A powerful and coordinated housing lobby was fast taking shape, one that would come to exercise a great deal of political influence (Gotham 2000: 301; Von Hoffman 2008). For example, in 1917 NAREB volunteered to help develop wartime housing programs, and its members ended up guiding and even leading many of these government programs. We also see this within the U.S. Housing Corporation and the Shipping Board, where rules for the design and building of the shipyard housing were set by the Bureau of Industrial Housing, which had in turn drawn from the expertise of Progressive Era housing activists and planners, including Veiller (Andracheck 1979: 172; Freund 2007: 50-51).

The largest of the wartime credit programs ended with the Armistice but the federal promotion of homeownership and a general policy of collaboration with the housing industry endured. In response to a brief postwar housing shortage in 1920, the Department of Labor worked with NAREB to launch the “Own Your Own Home” campaign. As part of this, the federal government financed war workers’ home buying, using local realtors to mediate (Weiss 1989; Wright 1983: 196). Herbert Hoover was secretary of Commerce, and he actively promoted these kinds of collaborative efforts. As David Freund explains, Hoover was “a leading figure in a movement to support a new “corporate” or “associative” state, in which private sector officials worked with government officials to guide the nation’s economic development” (Freund 2007: 73). If officials could help companies regulate themselves, this would obviate the need for extensive federal regulation.

⁵³ Note that the trade organization was originally named the National Association of Real Estate Exchanges, but changed the name in 1916 (Realtors 2008).

At Commerce, Hoover established a Building and Housing Division that became a locus of network building, collaborative planning, and information sharing between government officials and private real estate interests (Freund 2007: 74; Hawley 1974: 125; Luken and Vaughan 2005; Wright 1983: 196). The department continued to back the “Own Your Own Home” Campaign, but as it progressed the effort largely focused on educational campaigns that drummed up demand, promoted standardized production, and encouraged lenders to standardize their practices and make loans more widely (Freund 2007: 73-75). This was not just a technical agenda. The program was deeply normative. The Own Your Own Home movement continually re-inscribed the notion that homeownership created better citizens and a stronger nation.⁵⁴ Take, for example, Hoover’s forward to the Commerce Department’s 1923 pamphlet *How to Own Your Own Home*: “Maintaining a high percentage of individual home-owners is one of the searching tests that now challenge the people of the United States. The present large proportion of families that own their homes is both the foundation of a sound economic and social system and a guarantee that our society will continue to develop rationally as changing conditions demand” (quoted in Wright 1983: 193).

In 1923, Hoover himself became the President of a nonprofit called Better Homes in America, Inc. that promoted demonstrations of model homes around the country. Throughout the 1920s the government worked closely with various representatives of the housing industry to improve information flows and drive up demand for homeownership (Wright 1983: 196). At the same time, a group of private mortgage companies used mortgage bonds to finance an urban real estate frenzy, one that raged while state and federal regulators largely looked the other way.

Skyscrapers and Mortgage Bonds

In the 1920s, just as the agricultural sector was bottoming out, America’s cities were coming out of the housing shortage and entering an economic boom. Summarizing the 1920s real estate market, Rabinowitz called it “creative, expansionist, bombastic, deluding, self-congratulatory, evangelical, unregulated, and crazy” (Rabinowitz 1980: 39). This boom was not limited to cities (Rabinowitz 1980: 33-36). There was, for example, an infamous land rush in Florida that crashed in November 1935, driven largely by Standard Oil’s Henry M. Flagler. In Ohio, the Van Sweringen brothers drove the land values in Shaker Heights from \$240,000 to \$88 million in the 1920s. The most interesting bubble of the time for the purposes of this dissertation, however, was the explosion in urban building.

The first skyscrapers appeared in cities at the close of the 1870s. In the early twentieth century, as urban populations continued to grow, these buildings grew larger and taller as well (Bletter 1987; Rabinowitz 1980: 33). Technological advances like elevators, precisely calculated steel frames, and better means of fire control made it possible to build higher than ever before (Webster 1959). If the single detached home had come to represent the American family, the skyscraper was now a monument to American enterprise, industry and commerce (Bletter 1987; Wolner 1989). According to

⁵⁴ The intense moralization of homeownership in the Own Your Home Movement is vividly captured by Luken and Vaughan’s (2005) “institutional ethnography” of the program.

Edward Wolner (1989), many of the new generation of skyscrapers were not so much an effort to jettison an agricultural past, as much as they were part of the project of translating its most valued attributes – tenacity, hard work, upward mobility, and the “myth of the ‘self-made’ man” – into a new urban landscape. One did not have to agree that the new symbolic status of the skyscraper was desirable, or even relevant to its existence, to recognize that the buildings had come to represent a certain kind of American prowess. Lewis Mumford’s critique of the buildings is revealing because it speaks to both their cultural and material position at this time of transition:

More than anything, the mischief lay in the notion that on the foundation of practical needs the skyscraper could or should be translated into a ‘proud and soaring thing.’ This was giving the skyscraper a spiritual function to perform: whereas, in actuality, height in skyscrapers meant either a desire for centralized administration, a desire to increase ground rents, a desire for advertisement, or all three of these together - and none of these functions determines a ‘proud and soaring thing.’ (quoted in Bletter 1987: 116)

To raise the substantial funds needed to erect the buildings, mortgage companies issued stocks, and, more important for the purposes of this dissertation, raised funds by dividing a large mortgage into many smaller bonds that were sold in low denominations to small investors. This was a vast bond market: “There were thousands of individual bond issues sold to the general public, for which hundreds of thousands of investors put up billions of dollars” (Rabinowitz 1980: 41-42). To understand why so many small investors invested in them, however, it is first necessary to consider how the mortgage market at the time was changing.

Investors and Mortgage Bonds

Table 3.1 and figure 3.1 show that in the early twentieth century, a shift was underway in the organization of real estate finance, as specialized lending organizations continued to replace individual lenders as the primary source of housing finance (Weiss 1987: 31-32). If you looked at residential debt in cities, institutional lenders held 55% of the mortgage debt by 1905.⁵⁵ In part this trend was owed to the increasing presence of commercial banks and insurance companies that had begun in the previous century. Between 1900 and 1910, commercial banks doubled their share of residential mortgage debt, from 5% to 10%. As a group they invested more in mortgages, but were aware of the dangers of tying their deposits up in longer term mortgage investments and so were more restrained with their lending (Carter et al. 2006b).⁵⁶ As life insurance companies grew, they invested in more mortgages, but they were increasingly diversified, and so

⁵⁵ I return to Residential NonFarm market because it is the best estimate we have for years before 1925. Please note that this excludes real estate bonds), and see Appendix B and Chapter two for more complete discussions of the HSUS data.

⁵⁶ In 1913 many restrictions on commercial bank investing in real estate were repealed, but even before then those restrictions seem to have been interpreted rather loosely (Keehn and Smiley 1977).

also invested a larger portion of their portfolios in other instruments like railroad and government bonds (Saulnier 1950: 11).

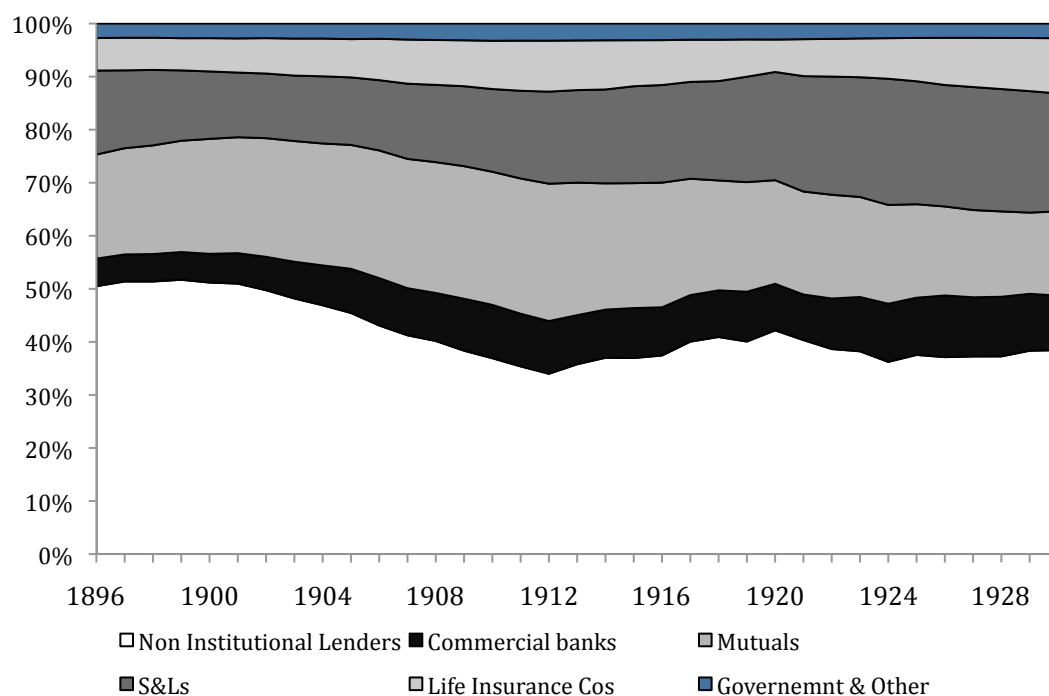
Mutual Savings Banks had a rising share of the nation's mortgage debt until about 1915, at which point their share started to decline. This seems to be mostly a function of changing demographics (Grebler, Winnick, and Blank 1956). During that decline, mutual savings banks increased their mortgage investments as a total percent of their portfolio, but their share of the total market declined because they were concentrated in the North and East, and residential construction in those regions slowed relative to the rest of the country (Grebler, Winnick, and Blank: 195-198).

Table 3.1: Proportion of Residential NonFarm Mortgage Debt (held outside of real estate bonds) by Holder, Selected Years, 1896-1930 ⁵⁷

Year	Total Debt (millions)	Non-institutional lenders	Commercial Banks	Mutual Banks	S&Ls	Life Insurance Cos	Other Institutions
1896	\$2,711	50%	5%	20%	16%	6%	3%
1900	\$2,917	51%	5%	22%	13%	6%	3%
1905	\$3,520	45%	8%	23%	13%	7%	3%
1910	\$4,426	37%	10%	25%	16%	9%	3%
1915	\$6,012	37%	9%	24%	18%	9%	3%
1920	\$9,120	42%	9%	20%	20%	6%	3%
1925	\$17,231	38%	11%	18%	23%	8%	3%
1930	\$27,649	38%	10%	16%	22%	10%	3%

⁵⁷ Source: Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, and Gavin Wright. 2006b. "Series Dc903-928: Debt on nonfarm structures, by type of debt, property, and holder: 1896-1952." in *Historical Statistics of the United States Millennial Edition Online*, edited by Michael R. Haines. New York: Cambridge University Press.

Figure 3.1: Proportion of Residential NonFarm Mortgage Debt (held outside of real estate bonds) by Holder, Selected Years, 1896-1930 ⁵⁸



Perhaps the most dramatic change of the first quarter of the twentieth century mortgage finance system was the transformation of the S&Ls. Their role in the housing market grew steadily in the first twenty years of the century, so that by the end they held about a fourth of the nation's mortgage debt. Even more interesting is how these organizations changed during this time. Studying thrifts⁵⁹ from 1865 to 1938 in California, Haveman and Rao (1997) trace the shift from groups organized around more rigid forms of "mutuality and enforced saving" to the more individualistic, bureaucratic, profit and efficiency oriented system. According to the authors, this was in part because the lenders needed to devise a form that would meet the demands of a more complex social world, that is a more mobile, heterogeneous "society of strangers" who often had unreliable income (Haveman and Rao 1997: 1637, 1644). The organizational forms that emerged did not, however, always reflect the best technical solution to a market problem. Rather, the organizational form of the thrifts also developed alongside broader social values (Haveman and Rao 1997). Mortgage lending came to fit the model of Progressive Era ideals of rationality and thrift, which promoted "efficiency and bureaucracy as well as equality and dispersion of power" (Haveman, Rao, and Paruchuri 2007). Participants became depositors who could enter and exit the group with more ease, hierarchical distinctions were introduced between classes of investors, and much more flexibility was

⁵⁸ Source: Ibid.

⁵⁹ Again, "Thrifts" is an umbrella term used to discuss an array of cooperative groups that organized savings and mortgage lending in the U.S. that included savings and loans, Building and Loans, and some cooperative banks (Bodfish 1931: 32, 66-72; Haveman and Rao 1997: 1608).

allowed with how one saved (Haveman and Rao 1997: 1617). In the first part of the twentieth century, thrifts were making strides towards what would become, in the middle of the century, a dominant position in the market. They held 13% of residential non-farm mortgage debt in 1900, and 22% by 1929 (Carter et al. 2006b).

These institutional investors – insurance companies, S&Ls, mutual savings banks, and commercial banks – preferred to invest directly in mortgages, and so largely avoided the mortgage bond market. The bond houses therefore turned to small investors to buy the debt they were brokering (Alger 1934: 103; Halliburton 1939: 4-6). In a certain light this makes a good deal of sense. Although they would not be the most sophisticated of buyers, many individuals were presumably not entirely strangers to the housing market, since non-institutional investors financed half of the real estate market in 1900. Also, World War I drives had introduced the general public to the bond market, with 25 million people investing in Liberty Bonds (Halliburton 1939: 6). Mortgage companies were able to capitalize on both trends, relying on small investors to buy bonds that financed dramatic new skylines. For \$100, a laborer in New York could own a share of the Empire State building or the Waldorf Astoria (though bonds backed by the Waldorf eventually defaulted) (Halliburton 1939: 24-26).

From the point of view of the mortgage companies, eager but unsophisticated clients were ideal because they allowed the companies a great deal of power and leeway (Halliburton 1939). To attract small investors bonds were issued in small denominations, and the bond houses advertised in magazines, including women's magazines (one firm reported that 20% of its customers were women) (Halliburton 1939: 24-25).⁶⁰

The Bond Houses

Investors, having purchased bonds, then relied on a handful of mortgage companies to direct and manage their investments. A few companies dominated the market for registered bonds. The largest by far was S. W. Strauss & Co. of Chicago. Next in size were American Bond and Mortgage Company, and G. L. Miller & Co., both of New York (Goetzmann and Newman 2009: 6). One study found that Strauss alone issued 65% of the bonds, while American Bond issued 13% and Miller issued 6% (Goetzmann and Newman 2009: 16). This market was highly concentrated by region, as well. Ernest Johnson (1936a; 1936b; 1936c) wrote one of the few early academic studies of this market. Focusing on bond issues with larger amounts and longer maturities,⁶¹ he estimated that between 1919 and 1934, \$4 billion worth was sold (Johnson 1936a: 44). He found that the market was concentrated in eight cities, with New York and Chicago alone constituting half of the nation's market (Johnson 1936b: 195).⁶²

At the center of this market were mortgage companies that specialized in issuing and distributing bonds backed by mortgages, having adopted techniques previously used to sell railroad bonds (Halliburton 1939: 22). Rabinowtiz (1980: 42) describes a typical

⁶⁰ See Halliburton (1939: 67-75) for a fascinating account of some of the more “devious” schemes used to sell these bonds.

⁶¹ Due to the limitations of available data, Johnson looked at long term securities (that is, with maturities of 5 years or longer), and large issues (\$1 million or larger), which he estimated to represent 70% of the national mortgage securities market (Johnson 1936a: 44).

⁶² The other cities were: Detroit, Los Angeles, Philadelphia, San Francisco, Washington, D.C., Boston, and Cleveland. (Johnson 1936c: 195)

business. Most often, a mortgage company would issue a mortgage for a large building and then issue many smaller bonds all backed by that single, large mortgage (or else sell off the mortgage in smaller slices). It was common for the mortgage company to guarantee payment of principle and interest on the bonds, and to have the authority to reorganize and manage the investment and trust in the case of a default.

In practice, there was a great deal of variation in the market. Some mortgage companies managed the entire process, including originating mortgages, brokering, underwriting, and marketing. Others specialized in one aspect of the transaction, such as overseeing a trust or just dealing with the marketing (Halliburton 1939: 10-15).⁶³ Some of the mortgage brokers were affiliated with larger Wall Street banks, and later, with some insurance companies (Halliburton 1939; Hertzog 2009: 14-16). Sometimes bonds were backed by a group of mortgages, though this seems to have been rare; the more common practice was to divide up one large mortgage into smaller pieces (Halliburton 1939: 16; Rabinowitz 1980: 42). Many bonds were sold without guarantees, or with implied, partial or contingent guarantees (Halliburton 1939: 76-79; Kniskern 1926). The type of mortgage used to back the bond was flexible. In addition to skyscrapers, bonds might be backed by hospitals, churches, theaters, stadiums, warehouses, schools, or homes. Because bond houses often had the right to substitute the collateral, the underlying asset could change without the investors' knowledge. The most in depth account of the market is a dissertation written by Robert Halliburton in 1939, who lists the "varied types" of bonds as including "first mortgage, first and refunding mortgage, general mortgage, leasehold mortgage, guaranteed obligation, holding company obligation, debenture, and collateral trust bond." It gets more complicated from there:

Permutations and combinations in great number result when these types are associated with types of subclassifications such as: construction and "completed" issues, new and seasoned issues, coupon and registered, serial and sinking fund, legal and non-legal for trust fund investment, secured and unsecured, new and refunding, long-term and short-term, convertible and non-convertible, callable and non-callable, closed and open-ended, defaulted and non-defaulted. (Halliburton 1939: 17)

It was, then, a vast, complex, and rather flexible market, in which mortgage companies seem to have been quick to offer a large array of investment options to eager but unsophisticated investors. The first and most common type of debt issued by these companies was a bond backed by a first mortgage (a *First Mortgage Fee Corporation Bond*), or more typically "a slice of a mortgage." (Halliburton 1939: 17, 19) But there were also experiments with other ways of organizing the rights to real estate debt. A *Land Trust Certificate*, for example, was technically not a bond, but rather was a derivation of a British technique wherein many investors owned a tract of land and shared the rents collected on it (Halliburton 1939: 19-22).

⁶³ Snowden (2009) classifies these companies into two groups: bond houses and guarantee companies. I have not used the same classification because, in view of Halliburton's detailed account, it seems that such a neat division fails to adequately capture the variability and diversity of corporate forms in use at the time.

Most important for this study, bond houses would also issue something called a *Participation Certificate* (PC) (Halliburton 1939: 17-19). With a Participation Certificate, an investor became a beneficiary of a trust, and that trust in turn invested in another trust that held the mortgage bond.⁶⁴ That is, a trust that held the entire large mortgage stood as an extra gateway between the ultimate borrower (the mortgage holder) and the ultimate investor (the holder of the PC). This made a PC a kind of subordinated debt, though Halliburton notes that holders of PCs seemed to be treated like bondholders in practice.

Not all PCs were the same, and their legal status was not necessarily obvious. In New York a regulatory commission reported that, “the language of the participation certificates . . . varied widely among the companies, and often within the same company.” (Alger 1934: 11) PCs seem to have been used primarily for two purposes around this time. First, to finance railway equipment, and second, to fund large buildings (Lyon 1938: 276). When it came to housing they seem to have been used largely to divide up a single large mortgage, but PCs could also be used to issue debt backed by a pool of mortgages, ones that could be substituted at the will of the trustee (Chamberlain and Edwards 1927: 455).

Chamberlain and Edwards (1927: 305-325) discuss the railroad bonds and trusts that were the immediate precursors to the real estate participation certificate. This type of financial instrument had its roots with the Schuylkill Company in 1845. It became more popular and changed in form in the 1870s. Railroad companies used these kinds of certificates – which started with the practice of using a lease held in a trust – to get around a set of legal and tax problems (especially those posed by the state of Pennsylvania). With these trusts investors held rights to flows of payments, rather than ownership of the collateral itself. This meant that they had a more tenuous claim on the collateralizing asset, but in exchange they didn’t have to pay the same kinds of taxes that owners did and were allowed to issue certain kinds of debt that might otherwise be precluded under existing law. Bonds backed by titles held in a trust (rather than certificates backed by leases) emerged out of this.⁶⁵

With real estate PCs in the 1920s, investors were not technically owners of the mortgage, and so they were in a more tenuous legal position if something went wrong. There was some legal confusion about what kind of rights the PC holder held, and some lawyers expressed concerns that a company might use these bonds in problematic ways. One regulator complained, “[t]he provisions of the certificates are certainly unintelligible to the layman, and the rights created thereby are perplexing to the lawyer.” (Alger 1934: 11-12). This type of bond is particularly important for the later reemergence of the market for mortgage bonds at the close of the 1960s, when some of the same concerns would be raised.

⁶⁴ Halliburton (1939: 17) explains: “The certificates differ from bonds in that they are issued by the trustee against the single bond of the borrower covering the entire loan. The bond, whether of large amount covering the entire loan, or issued in small denominations, is the direct obligation of the borrower. The mortgage certificate is also issued in small denominations but it is the obligation of the trustee only, and not of the borrower. And it is the trustees’ obligation to only to the extent of transmitting such money as the trustee receives from the borrower. The real estate bond houses and some Wall Street bond houses originated both real estate bonds and real estate mortgage certificates.”

⁶⁵ Chamberlain and Edwards (1927) also refer to these as “Real Estate First Collateral Trust Certificates” and compare these to English Investment Trust Certificates.

Boom and Bust

It is not clear exactly when this group of mortgage companies started dividing large mortgages into smaller bonds. Some say that the practice of dividing large mortgages into smaller slices started in the first decade of the twentieth century; others assert that it was introduced by Peabody Houghteling in 1893 for a site in Chicago called the Mallard WholeSale Store building (Halliburton 1939: 3; Rabinowitz 1980: 43).⁶⁶ The practice of guaranteeing mortgages was not necessarily new, but it reached new heights in New York in the 1920s (Alger 1934: 6-9).⁶⁷

Table 3.2: Real Estate Bonds as a Portion of Outstanding NonFarm (Residential and Commercial) Mortgage Debt, Selected Years⁶⁸

Year	Total Mortgage Debt (millions)	Real Estate Bonds (millions)	Real Estate Bonds as a % of mortgage debt
1896	\$4,415	\$15	0%
1905	\$5,577	\$60	1%
1910	\$6,906	\$100	1%
1915	\$9,305	\$230	2%
1920	\$14,100	\$584	4%
1925	\$27,589	\$2,905	11%
1930	\$44,044	\$6,318	14%
1935	\$32,615	\$4,200	13%
1940	\$32,786	\$2,800	8%
1945	\$32,642	\$1,850	6%
1950	\$68,033	\$1,300	2%

⁶⁶ To my knowledge, there is not yet any comparison between the mortgage bonds in the 1920s and the kinds of bonds issued in the nineteenth century by the property banks or mortgage companies. This is an unfortunate gap in the literature that certainly deserves further study.

⁶⁷ Since 1885, New York had allowed companies to guarantee real estate titles, and since 1892 it allowed insurance companies to guarantee the payment on some other kinds of debt. In 1904 New York State declared that it was legal to guarantee mortgage bonds, and in 1911 the same state made it legal for insurance companies to buy and sell mortgages (Alger 1934: 6-9; Canner and Passmore 1994: 884).

⁶⁸ **Source:** Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, and Gavin Wright. 2006b. "Series Dc903-928: Debt on nonfarm structures, by type of debt, property, and holder: 1896-1952." in *Historical Statistics of the United States Millennial Edition Online*, edited by Michael R. Haines. New York: Cambridge University Press. **Please Note** that these data are estimates, and the numbers before 1925 especially represents a best approximation (see Appendix B). **Also note** that Snowden (2009: 4) offers a breakdown of market share that includes real estate bonds using the Grebler, Blank, and Winnick (1956: 489) tables, but since I have not been able to reconstruct how the data for real estate bonds (from Grebler, Blank and Winnick 1956, table N1) has been integrated into the general market data (Grebler, Blank and Winnick 1956 table N2) I have not reproduced the figure here. Instead, I have followed the HSUS table Dc903-Dc928 in using the composite numbers. See also the documentation for Dc904.

Figure 3.2: Real Estate Bonds as a Portion of Outstanding NonFarm (Residential and Commercial) Mortgage Debt, 1896-1952⁶⁹

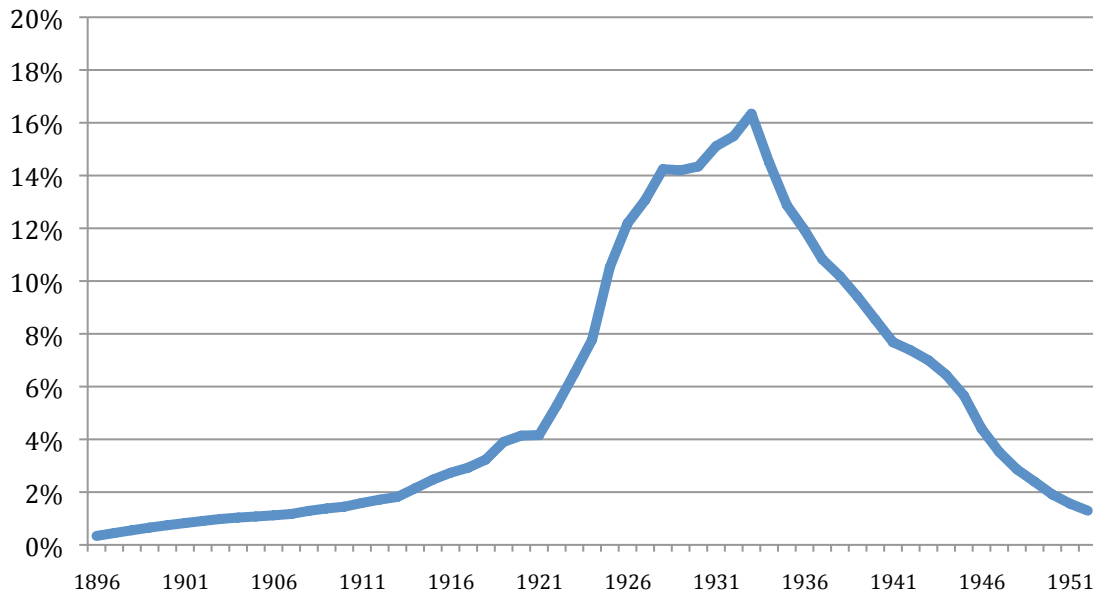


Figure 3.2 and table 3.2 show their rapid ascent. The market grew slowly until after the First World War, and then shot up. Market estimates vary, but by one estimate, in 1896, \$15 million of mortgage bonds made up less than a quarter of a percent of the nation's \$4 billion in nonfarm mortgage debt; by 1930 there were over \$6 billion in outstanding mortgage bonds, representing over 14% of all nonfarm mortgage debt that year (Carter et al. 2006b).⁷⁰ In 1933 mortgage bonds reached a peak of 16% of the residential nonfarm mortgage market,⁷¹ and then plummeted dramatically as the Great Depression played out. In 1950 there were \$1.5 billion mortgage bonds outstanding, but this made up less than 2% of the nation's booming housing nonfarm housing market.

This rising bond market helped fuel a dramatic rise in building and property values. Skyscrapers of large cities shot up: "More buildings taller than 70 meters were constructed in New York between 1922 and 1931 than in any other ten-year period before or since." (Goetzmann and Newman 2009: 2). There was a huge increase in nonfarm housing values during this time. From 1918 to 1926, there was a 400% increase

⁶⁹ **Source:** Ibid. **Please Note** that these numbers are estimates, and the data before 1925 in particular represent a best approximation (see Appendix B for more on this).

⁷⁰ See Rabinowitz (1980: 43) for alternate estimates. For example, the SEC in 1936 estimated the market size to be slightly over \$5 billion in 1931, and the Investment Bankers Association estimated that bonds represented 17.2% of national mortgage debt the same year.

⁷¹ **Note:** According to the Grebler-derived HSUS data, the amount of outstanding bonds reached its peak of \$44 billion in 1932. However, the bonds reach their peak market share at 16% in 1933. This indicates that the rest of the mortgage market declined faster than the bond market. One reason may be that bonds' trustees sometimes used their rights to substitute underlying collateral when a bond came under stress (see Halliburton 1939). So even though the urban mortgage bond bubble may have been more speculative and inflated than the rest of the mortgage market, it may well have had a lag before its decline because of longer maturities and substitution rights.

nationwide. Goetzmann and Newman (2009: 2) warn that this may understate the even more astronomical rises in certain states in regions, noting that between 1919 and 1925 in Miami, the average value of building permits grew almost 9,000%, rising from nearly \$89,000 to nearly \$8 million. Snowden (2009) estimates that between \$6 to \$10 billion of these bonds were issued by the 1930s, and notes that with one estimate putting the bond market for smaller residential mortgages only at \$2.5 million, it seems that mostly this market was organized around larger buildings in cities. Reviewing the skyscraper, Lewis Mumford derided the form both for its wastefulness and for the speculation it attracted: “Socially the skyscraper gave encouragement to all our characteristic American weaknesses: our love of abstract magnitude, our interest in land-gambling, our desire for conspicuous waste” (quoted in Bletter 1987: 116).

There is evidence that the housing bubble started to show distress before Black Tuesday, as the Attorney General went so far as to issue a warning about the bonds in 1927 (Snowden 2009: 11-12). The stock market crash certainly made the situation worse (Rabinowitz 1980: 45). Knowledge about the fallout of this market is surprisingly thin, but what we have suggests that the consequences were severe. Rabinowitz estimates that less than 20% of mortgage companies listed with Moody’s at the end of 1920 were around six years later (Rabinowitz 1980: 27). Goetzmann and Newman (2009: 17-18) investigated the market paint a sobering picture of the market’s problems:

Early commercial real estate securities brought economies of scale to small real estate investors, exposed the public to poorly supported assertions of asset value, depended on the financial strength of a few large intermediaries, and ultimately buckled under the top-heavy burden of greater demand for financial assets than for their underlying real properties . . . By nearly every measure, real estate securities were as toxic in the 1930s as they are now. Johnson (1936a) documents the dismal landscape for those unlucky enough to have been left with an allocation to commercial real estate debt. At least 80% of the outstanding securities issued in every year between 1920 and 1929 were failing to meet their contracts in 1936. Defaults were devastating. Recoverable value on those same issues ranged from approximately 80% for 1920-vintage bonds to less than 40% for 1928-vintage bonds. Trading utterly ceased. The Real Estate Board of New York attempted to start what was known as the New York Real Estate Securities Exchange in December of 1928, but by the 1930s, days would pass without a single transaction.

Once again, analyses of the failed market may seem familiar. The economic downturn revealed that the business was rife with fraud, corruption, and simple carelessness. Because the bond houses had no long term stake in the mortgages, but made a fortune in fees for selling them, they had failed to adequately gauge and police the credit and market risks of the borrower and collateral (Alger 1934: 12; Halliburton 1939: 7, 35). When issuing bonds, the mortgage companies often made excessively optimistic assumptions about occupancy and default rates based on the behavior of the market

before the boom had flooded it (Halliburton 1939: 33). In this way, the market represents an early example of what MacKenzie (2006; 2009) calls “counter performativity,” wherein economic tools and assumptions can make the market less efficient. For Mackenzie (2009), one of the main causes of the securitization crisis of the 2000s was a failure of financial engineers to recognize how their own actions belied the assumptions they used when issuing debt. Halliburton (1939: 33) and Hertzog (2009: 16) both have accounts that suggest a very similar thing happened in the 1920s. Hertzog, in particular, goes into this, explaining that Alger’s report for the Moreland Commission noted that one main mistake that the early mortgage guarantee companies made was that they failed to realize how their risks were systematic and so not independent: “[I]t must have been obvious to anyone who ever considered that matter, that any substantial losses by a mortgage guarantee company would be caused by a general depression in the real estate market which would weaken all mortgages and render them for a time at any rate illiquid” (Alger 1934:19, and cited in Hertzog 2009: 16).

There were other problems in the bond market as well. Appraisers inflated property valuations (Halliburton 1939: 44). Market participants who warned of over-valuation and fraud were dismissed, or worse, attacked for trying to undermine the nation’s prosperity (Halliburton 1939: 7). Mortgage companies were often highly leveraged and invested in speculative ventures (Halliburton 1939: 7, 47). They hid defaults, sometimes using investors’ money to lend more to borrowers in order to keep payments flowing. The brokers who oversaw the trusts would substitute types of collateral inappropriately, pay themselves off first with investors’ funds, and when a default would happen would “milk” the building by siphoning any remaining income flows from the building into their own accounts (Halliburton 1939: ch. 9).

Where were the regulators? The New York State Insurance department had authority to regulate the guaranteed bonds in New York, but refrained from doing so while the bubble expanded. After the crash, the New York state insurance regulator took control over eighteen struggling guarantee companies (Alger 1934). Those companies alone represented, at year end 1933, over \$810 million of debt divided into 342,159 securities held by 212,874 people; according to one report, “a large part of them are poor people or people of modest means” (Alger 1934: 2-3). The Securities and Exchange Commission put William Douglas and Abe Fortas in charge of their own investigation of the industry’s seven largest issuers (Rabinowitz 1980: 45-46). And a third commission in Congress that investigated the market lasted for years, and produced over “12,000 pages of testimony” (Rabinowitz 1980: 45).

The aftermath of this particular bubble generally got caught up in the turbulence of the Great Depression, and the impact of this particular market has yet to be adequately disentangled (White 2009).⁷² Rabinowitz (1980: 27) complains, “the data seems to have been swallowed up by the debacle.” Much of the material generated by the regulatory commissions remains understudied. We know that many mortgage companies were wiped out during this period, but there is a great need for more rigorous historical reviews of the regulatory and economic legacy of this crisis. Instead, these events had largely faded from public memory by the end of the postwar period. Writing about this market in 1980, Rabinowitz (1980: 56) marvels not just at the magnitude of the disaster, but at the

⁷² In view of the current crisis, economic historians seem to be revisiting this, however. See White (2009), Snowden (2009), and Goetzmann and Newman (2009).

nation's capacity to forget it as well: "Practically no one in the limelight of the post World War II period of Real Estate investment seems to have recalled – at least in their public statements – the episodes recounted in this chapter. Or perhaps they thought that no such conflicts of interest would ever be permitted again." One might wonder, then, if the failure of academics to attend to these events is implicated in our current debacle.

Conclusion

The early twentieth century was a time of considerable economic turmoil in the real estate industry. In the field of agriculture, the government took steps to build a more stable system of mortgage finance and devised a Land Bank system that carefully mixed interventionist tendencies with laissez-faire sensibilities. Unwilling to either leave agricultural finance alone or be caught directing its organization, the legislators developed a complex system of partnerships with private groups that allowed the government to position itself as a supporter, rather than a director, of farm credit. Private Joint Stock Banks could be formed, and could issue bonds exempt from taxation. Public Land Banks would be started with Treasury funds, but that backing would be phased out as private investors arose. The Land Banks would support farmers, but not directly, since a system of cooperatives would be created first. It is as if the government decided it would partner with private actors in the marketplace even if a viable partner did not exist. If it had to go out and create those organizations itself, so be it. If the federal government approached direct intervention in this case, it took great care to temper its own position. In the end, the Land Banks helped promote agricultural credit, though the field soon ran aground of the significant agricultural depression that followed World War I, and later the Great Depression.

In the field of urban finance, the government took a less direct course of action, focusing on promotional and educational efforts like the Own Your Own Home movement. Regulators failed to intervene in the housing bubble until *after* a speculative frenzy had led to a devastating economic crash. For the purposes of this dissertation, the real estate bubble of the 1920s is important as part of the history of mortgage bonds in the U.S. In the next chapter I will discuss in more detail how this crisis provides important clues to why a private market for mortgage bonds was dormant in the postwar era.

Despite significant experiments with the organization of mortgage credit, then, the field was not yet very stable. The paradox posited by Colean (1950) and detailed in the previous chapter – a tension between widespread property ownership and unsophisticated credit markets – remained a problem. Mortgage credit continued to be uncoordinated, patchy, and sometimes turbulent. The government, however, took steps to intervene in farm credit in ways that would become increasingly popular. As Miles Colean has noted, "the stage was set for some special intercession that would promise both cheap and plentiful credit and that would still protect the participants from catastrophe. The federal government alone could produce such a prodigy" (Colean 1950: 148). The next chapter details how the federal government took steps to create a more stable system of mortgage credit, and how, since the New Deal, direct credit aid has emerged as a major policy instrument of the federal government.

Chapter 4: The Rise of the Credit State, 1930s to the 1960s

In a number of cases, the Federal credit programs have pioneered in developing new credit fields.

*House Committee on Banking and Currency,
Federal Credit Programs, 1964*

A balanced housing supply is not a solution in itself . . . It is a framework for our society. It is the bricks and mortar base for a broad variety of services necessary for our people in this day and this century. . . . decent housing conditions are fundamental to a prosperous, educated, healthy citizenry. Housing is a beginning, it is a foundation upon which the nation can continue to upgrade itself and satisfy the promise of America.

*Robert C. Weaver, Secretary of the U.S. Department of
Housing and Urban Development, November 1966*

The Great Depression introduced a new generation of credit aid that included loan guarantees and insurance. Sociologists have extensively studied the New Deal (for a review, see Manza 2000), and have tended to focus empirically on specific policy domains like labor and social welfare (Amenta and Carruthers 1988; Amenta and Halfmann 2000; Quadagno 1984), industry (Dobbin 1993), agriculture (Gilbert and Howe 1991; Hooks 1990; Skocpol and Finegold 1982), and housing (Gotham 2000). Theoretically, these studies focus on the intersection and relative importance of institutional constraints (Weir 1992), the role of culture or economic expertise (Dobbin 1993; Weir and Skocpol 1985), social movements (Amenta and Young 1999), race and gender (Gotham 2000; Orloff 1996), and the division of power between classes and social groups (Block 1977). Overwhelmingly this literature focuses on the direct distribution of aid or the building of state administrative capacity, leaving the turn to credit programs in the New Deal largely unexamined. Credit programs like the Reconstruction Finance Corporation (RFC) are mentioned, but not taken seriously as a meaningful object of analysis in their own right. To the extent that credit programs are subject to analytical focus, it tends to be part of a larger analysis of race and inequality in America (Massey and Denton 1993; Oliver and Shapiro 2006; Stuart 2003; Valocchi 1994).

The extensive sociological literature on the New Deal has therefore overlooked how federal credit aid emerged at that moment as a major policy tool used to intervene in

the economy (and, as I will show in the next chapter, to manipulate the federal budget). Political sociologists often study state regulations, administration, political struggles, and programs with large or controversial expenditures. Except for the early years of the programs, credit programs do not generally represent large federal expenditures (I will explain why in more detail in the next chapter). And except for battles over racial covenants in the housing programs that emerged in the 1960s, they are not terribly controversial. For that reason they have been easy to overlook. Yet it is precisely those attributes – their near invisibility, their political and economic lightness – that make them politically important and sociologically revealing. Politicians, over decades and across ideological divides, have turned to credit programs because they do not ruffle feathers or cost precious budget dollars. Over the next two chapters I will show that in the U.S. credit programs are popular because they fade into the market and out of the budget. They are a major and hidden point of intervention in the U.S. economy, and it was out of this system that the modern securitization market emerged.

Below I outline the rise of the federal credit state. I begin with the mother of the Depression-era federal credit programs, the RFC, and then focus on changes in government management of mortgage credit and agricultural credit in the New Deal. I next outline major changes in federal credit in the postwar era and discuss its ramifications for the structure of the housing market and growth of credit markets (Appendix B contains timelines of this progression). While a single chapter cannot do justice to the complexity of the origins and development of these programs, I nevertheless hope to show that managing the allocation of credit is a complex and important aspect of the federal government's indirect interventionism, one deserving of further study by sociologists. Moreover, understanding credit programs is important if we are to fully understand the Johnson administration's turn to securitization, which I will discuss in the next chapter.

The Rise of the Federal Credit State in the New Deal

As part of the New Deal the federal government started systematically using loans and guarantees in an attempt to manage the Great Depression. Direct loans sometimes outpaced federal expenditures in the federal effort to help the struggling economy (Saulnier, Halcrow, and Jacoby 1957: 29). Of the 31 major New Deal programs identified by one historian, 15 were credit programs (Fishback 2007: 418-419). The largest of them was the RFC, created by President Hoover in February of 1932. The agency was modeled after the War Finance Corporation, which in the First World War lent money to banks and companies to encourage them to promote war related production (Fishback 2007; Studenski and Krooss [1952] 2003:300).

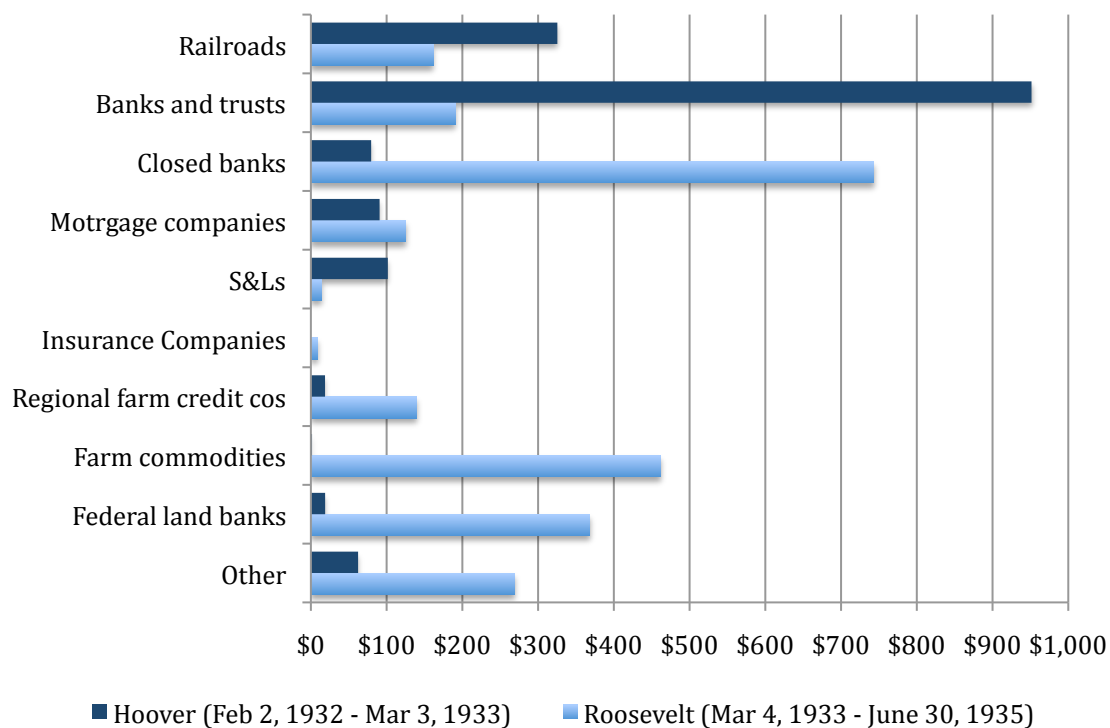
The RFC was originally created to lend to railroads and financial institutions that included credit unions, mortgage companies, and four thousand banks (Fishback 2007: 394). Commercial lending dropped sharply at the start of the Depression, with a 44% decline between 1929 and 1932 (Bosworth, Carron, and Rhyne 1987: 81, citing Studentiski and Kroos 1963). When banks struggled to repay their loans, the RFC purchased their preferred stock. Hoover was leery of the RFC, seeing its expansion as a potentially unmanageable and ill-advised intrusion of the government into private enterprise. He vetoed an early proposal to expand its lending, seeing the entrance of the

federal government into credit markets on such a large scale as a potentially disastrous mistake for a variety of reasons:

it would put the Federal government into private business, that the states and municipalities would dump their financial problems on the Federal government, that it would be impracticable and would establish a huge bureaucracy, that it would saddle the RFC with all the doubtful loans in the United States. (Studenski and Krooss [1952] 2003: 357)

As a result, Hoover was careful to keep RFC lending curtailed. Rather than extend the program, he limited the scope of its programs mostly to railroads and banks.

Figure 4.1: Reconstruction Finance Corporation, Selected Disbursements Under Hoover and Roosevelt, February 1932 through June 1935 (millions)⁷³



⁷³ **Source:** Patch, B. W. (1935). The R.F.C. under Hoover and Roosevelt. In Editorial research reports 1935 (Vol. II). Washington: CQ Press. Retrieved March 11, 2010, from CQ Press Electronic Library, CQ Researcher Online, <http://library.cqpress.com/cqresearcher/cqresre1935071700>.

It was the Roosevelt administration that put the RFC more broadly to use (Studenski and Krooss [1952] 2003). Roosevelt embraced direct lending and used it to support employment efforts, often through the backing of state and local projects (USHCBC 1964). As Figure 4.1 illustrates, under Roosevelt RFC support expanded from a focus on banks, trusts and railroads to include spending in a broader variety of sectors. Most notably, farm commodity financing increased from \$1.5 million under Hoover to over \$456 million under Roosevelt, and the financing of closed banks rose from almost \$80 million to nearly \$743 million. Another big winner under Roosevelt were the Land Banks, whose RFC disbursements rose from nearly \$19 million to nearly \$369 million.

One of the great advantages of the RFC was that it did not add to a federal budget that was already greatly extended. Thus Fishback notes that “[t]he Roosevelt administration immediately saw uses for the RFC and gave the off-budget corporation extraordinary leeway.” (Fishback 2007: 394). RFC had an immense impact, and owned over a third of U.S. banking capital by June of 1935 (Phillips 1994: 554). Additionally, the RFC was soon used to finance much of the New Deal, including the Public Works Administration and the Works Progress Administration, and provided \$300 million to cities (Fishback 2007: 394-5). It also funded large projects like the building of the Golden Gate Bridge and a power line linking Los Angeles to the Boulder Dam (Studenski and Krooss [1952] 2003).

The RFC became a site of innovation. Its mission was to provide credit wherever private markets were failing. Since it was given broad leeway in determining where, when, and how it would intervene, the agency “rapidly moved through successive generations of new target groups and forms of credit, continually refocusing on areas still lacking adequate service.” (Bosworth, Carron, and Rhyne 1987: 81) As it moved through the economy, the RFC paid special attention to manufacturing, medium-sized firms, and firms in the South and the West. It set a precedent for longer maturities than the private market, often offered lower interest rates, and tried new kinds of lending techniques (Bosworth, Carron, and Rhyne 1987: 81).

Because of the flexibility of its mandate, the RFC under Roosevelt quickly expanded to lend to a broad swath of the American economy:

By the mid-1930s, the RFC was making loans to banks, savings banks, building and loan associations, credit unions, railroads, industrial banks, farmers, commercial businesses, federal land banks, production credit associations, farm cooperatives, mortgage loan companies, insurance companies, school districts, and livestock corporations. (Olson 1988, quoted in Fishback 2007: 394)

Within the decade it became a financial behemoth, incubating other key lending agencies like the Export-Import Bank, established in 1934 to lend money abroad for the purchase of American products. RFC also incubated the Federal National Mortgage Corporation (Fannie Mae) and the Commodity Credit Corporation (CCC).

In the following two sections I focus on housing and agriculture in the New Deal, both because those were the largest credit programs, and because those programs matter the most for my case. However, it is important to note that Depression-era credit support

was not limited to housing and agriculture. As discussed above, the RFC provided credit support to American businesses, and spurred international trade through its subsidiary, the Export-Import Bank. Programs they sponsored that stabilized the banking industry, including the Federal Deposit Insurance Corporation (FDIC), had a positive effect on the supply of credit. The Rural Electrification Administration (REA) used loans and guarantees to electrically modernize the American home and to bring electricity to the 89% of farms that were without it in 1936 (Tobey 1996; USHCBC 1964).

Federal Credit, Housing, and the New Deal

The structure of mortgages in the 1920s left Americans particularly vulnerable to a severe economic downturn (Bartlett and Dearden 1989: 4; Green and Wachter 2005: 94). The amortized, long-term, low down payment home loans were still far from commonplace (Carliner 1998; Freund 2007: 104; Green and Wachter 2005; Jackson 1985: 204; Rabinowitz 1980: 65; Snowden 2009; Weiss 1989). Recall that mortgages tended to be three to ten years in length and covered 40 to 60% of the value of the property. It was not uncommon for families to take out smaller second and third mortgages to help cover the additional costs. Also recall that the principle of the loan was due in one large payment at the end, while earlier payments went toward paying down the interest. If borrowers did not have the money to pay off the large final bill, they would refinance. The key thing to note about the shorter mortgages is not that families usually paid off the loan in the first three to ten years, but that this structure gave lenders the option of exiting the exchange at regular intervals. In the midst of the Depression, many used this option and exited the market en masse.

In the early 1930s, the value of housing prices dropped by half, and lenders – particularly lenders of the less-secure second and third mortgages – responded by refusing to refinance, triggering a “wave of foreclosures” (Bartlett and Dearden 1989: 5; Green and Wachter 2005: 94-95). By 1933 new building had ground to a halt and families were losing their homes: Residential permits for construction dropped from 490,000 in 1928 to under 26,000 a year, while foreclosures were up by 71% from 1926 levels (Gotham 2000: 296-297); there were a thousand foreclosures a day in cities, and the nation’s farms, further ground down by the Dust Bowl, also had a rise in foreclosures (Bartlett and Dearden 1989: 5; Snowden 2009: 13). Between 1931 and 1935 an average of 250,000 homes foreclosed a year and by the end of that period twenty-seven states, many of them in the Midwest, placed moratoriums on foreclosures (Bartlett and Dearden 1989: 5; Green and Wachter 2005: 94-95). The federal government took steps to address the problem as well, and in the process restructured American housing finance. Table 4.1 summarizes the six organizations at the heart of New Deal housing policy. Each program is explained in more detail below.

Table 4.1: Summary of Selected Housing Programs, 1932-1938

Program	Description
Federal Home Loan Banks (FHLB) 1932	A network of reserve banks, regulated by the U.S. government, that provide credit support for S&Ls
Home Owners Loan Corp (HOLC) 1933	Emergency program (unwound in 1947) that traded government bonds for existing home mortgages in default, and then refinanced those mortgages
Federal Savings and Loan Insurance (FSLIC) 1934	Deposit insurance for S&Ls
FHA Insurance 1934	A program that offers insurance for qualified mortgages
RFC Mortgage Company 1935	Emergency program that bought and sold FHA-insured mortgages. Financed larger buildings; loaned money to holders of 1920s mortgage bonds, purchased 1920s mortgage bonds
Federal National Mortgage Association (Fannie Mae) 1938	Purchased FHA insured mortgages for new homes and resold them

Hoover's Response to the Housing Crisis: Federal Home Loan Banks

The first major federal housing policy of the era was the creation of The Federal Home Loan Bank system (FHLB) in 1932. Different groups had lobbied for a credit support system for urban mortgage lenders for over a decade (Jones and Grebler 1961: 111). S&Ls saw the Federal Land Bank legislation of 1916 (the program that supported farmers discussed in the previous chapter) and quickly realized that they too could benefit from a similar structure, wherein they borrowed from regional banks that in turn used tax-exempt bonds to draw in funds from investors around the nation. The first congressional bill for this was presented in 1919, and various groups tried repeatedly to set up some kind of regional mortgage bank over the next decade. A slew of other proposals were developed that offered different takes on the Federal Land Bank model, some creating national cooperatives, some excluding the S&Ls, some allowing them to borrow from the Federal Reserve Bank (FNMA 1966: 2; Jones and Grebler 1961: 112-113). None of these plans, however, were particularly popular with Congress or the President, and the Treasury objected to the proposal to exempt urban mortgage banks' bonds from certain taxes (FHA 1959: 1; Jones and Grebler 1961: 112). Moreover, despite a brief downturn in urban housing after World War I, the call for federal support was still a hard sell because the urban market was booming by early the 1920s.

The idea to create a system of urban mortgage banks now took center stage in the midst of the crisis of the 1930s (Jones and Grebler 1961: 113). Plans were reintroduced in August of 1931 at President Hoover's conference on Home Building and Home Ownership. The conference itself was an important event in the history of U.S. housing. It was immense, consisting of 25 different "fact-finding" committees and six coordinating

committees. The planning committee alone included 34 industry leaders, and 3,700 people attended the conference, which generated eleven volumes of reports (Fish 1979: 178). The program drew broadly from housing, real estate, economics, and zoning experts (Fish 1979: 178-182; Freund 2007: 103-104; Jackson 1985: 194-196; Jones and Grebler 1961: 113). As part of its review of housing, the conference revisited the question of an urban mortgage bank. The National Association of Home Builders (NAHB) wanted the government to lower the cost of housing without otherwise interfering with them. The S&Ls promoted a plan that would consolidate their position by excluding other kinds of lenders from government support. Other housing interests backed plans that were open to more groups and strategies. In the end, the administration compromised by promoting a less-exclusive version of the plan backed by the S&Ls, though within a few years a group of S&Ls managed to exclude other kinds of organizations (like commercial banks and certain building and loans) from the system (Snowden 2009: 4-6; Von Hoffman 2008).

David Freund's (2007) detailed look into the creation of the FHLB is very useful here. Freund points out that the regulations were designed and implemented through a series of partnerships, alliances, and meetings between private groups and bureaucrats. This, he argues, was an elaborate dance that allowed the government to assert that it was not intervening in markets even as it did so. The public-private partnerships allowed government officials to insist that they were bolstering commerce without directing it, that they were intervening "without distorting free markets." (Freund 2007: 106). This was reinforced by the way the participants at the Home Ownership conference framed the debate. Having reviewed the market, the housing experts concluded that the problem with housing in America was not lack of demand or supply, but failure of the market to bridge the two. The solution would be to follow the model of the FFLA and help the market be better coordinated. Freund explains how this framework served to underplay the extent of the government's intervention:

. . . to hear Bodfish and others describe it, federal discount operations would not alter existing market mechanisms and thus posed no threat to the free enterprise system. It was "distinctly not proposed that the Federal Government itself act directly," explained the committee on Slums, Large Scale Housing, and Decentralization in their endorsement of the [U. S. Building and Loan League] proposal. The government would merely "set up enabling machinery and establish general policies." Most importantly (and technically true), the proposed federal banks would not "directly lend money." In what became a common refrain at the conference and in Depression-era debates over federal selective credit programs, the committee described the government's new role as that of intermediary, as a force that would correct and free up sluggish markets, without disrupting or changing them. They also described federal improvement as temporary, necessary only until industry resumed its normal operations and consumers regained their confidence. (Freund 2007: 108)

We see here that the precedent set by the Federal Land Banks was as deeply moral as it was organizational. Haveman and Rao showed that the thrifts, in the Progressive Era, developed an organizational structure that met both technological needs as well as moral prescriptions (2007). Now, government forms of intervention would similarly find their expression in organizational models that complied with broader norms, in this case, norms of limited state intervention. The FHLB reproduced an array of organizational attributes that had previously served to justify the Federal Land Banks. Like the Federal Land Banks, the plan was guided by private hands, temporary, and avoided direct lending. When Freund says “the S&L industry was asked to design and operate a federal regulatory apparatus,” his point is not that private firms managed a feat of regulatory capture, but that the state was compelled to invite them to the table in part because it needed a beard (Freund 2007: 108).

This public-private alliance is, according to Freund, the hallmark of American housing regulation. From this point on, the government relied on the housing industry to help it develop and implement policy. Of course, this structured how problems were identified and framed, and one did not have to be a radical to wonder about whether that was fair (see also Gotham 2000: 303). The report of the Finance Committee of the Homeownership Conference contained a prescient dissenting statement at its end from no less an insider than Howard Kissell, the President of NAREB: “The members of this committee seem to have considered the entire home financing problem not from the point of view of the home buyer, but from the point of view of the investor who is worried about his security” (quoted in Fish 1979: 180). Thus from its early days, the public-private housing partnership tended to focus attention on the needs of the well organized and positioned real estate companies, rather than the needs of potential homeowners.

Roosevelt’s Emergency Measure: Direct Intervention at the HOLC

The FHLB was useful as a long-term solution to mortgage finance problems. Something else would need to be done to immediately staunch the flow of foreclosures. Hoover first tried to fix the problem in 1932 with the Emergency Relief and Construction Act which authorized the RFC to lend money to companies that agreed to build low income housing in slums, but because of a clash between the legislation and state tax laws, the program never got off the ground (Jackson 1980: 195). A more successful program was set up under Roosevelt the following year with the support and guidance of the real estate industry: The Home Owners Loan Corporation (HOLC). The U.S. government would buy and then refinance mortgages in default, trading HOLC bonds to lenders for the troubled debts (Tough 1951). The U.S. Treasury would supply \$200 million to fund the program, and HOLC was further authorized to create government-guaranteed, tax-exempt bonds to trade for mortgages or sell on capital markets (Freund 2007: 114-115). The program was vast, with 400 offices and a staff of 20,000. Forty percent of American with mortgages applied to the HOLC system for help within three years (Freund 2007: 112; Snowden 2009: 19). By 1936, a fifth of the nation’s nonfarm mortgages were converted into HOLC’s long-term (15 years), low interest rate (5%) amortizing loans (Freund 2007: 111-112).

The HOLC saved 800,000 homes from foreclosure (Freund 2007: 112-118). White families occupied most of those homes. That was because the HOLC codified and

institutionalized a system of land appraisals that systematically discriminated against minorities. The HOLC refused to buy mortgages in neighborhoods that it classified as having negligible value, which were typically urban neighborhoods with older buildings and mostly nonwhite populations. Those least desirable neighborhoods were color-coded on the HOLC maps with a red line, and the process of excluding minority families from government-supported housing programs became known as “redlining.” In 1951 the HOLC was unwound, replaced by a set of programs created through the National Housing Act of 1934. Those programs adopted the practice of redlining as well, and through that, locked African American families out of the postwar housing boom that moved a generation of working class whites into the suburbs and up the social ladder (Freund 2007: 112-118; Hays 1995: 89; Jackson 1985: 199-206).

Indirect Intervention: Redesigning Mortgage Finance with the National Housing Act

The National Housing Act (NHA) of 1934 set up a system of government support for housing finance through the Federal Housing Administration (FHA) and Fannie Mae. The legislation ushered in an era of stability in the U.S housing market. Many people had a hand in creating it. Among its designers and champions were politician and railroad heir Averell Harriman; Francis Perkins, by then the first woman on the Cabinet, as the Secretary of Labor; Marriner Eccles, named Chair of the Federal Reserve that same year; Winfield Rifler, economist and statistician who devised the plan for federal insurance; and architect-turned-economist Miles Colean, cited extensively in this dissertation (1980a; 1980b; Clark 1980; FHA 1959; Freund 2007: 124; Jackson 1985: 203).

The NHA was not just designed as a way to support families struggling to keep their homes. It was also meant to address unemployment and seed economic growth (Fish 1979: 200; Jackson 1985: 203). Marriner Eccles later wrote about it:

The significance of a new housing program that could revive the economy was not lost on President Roosevelt. He knew that almost a third of the unemployed were to be found in the building trades, and housing was by far the most important part of that trade. A program of new home construction, launched on an adequate scale, not only would gradually help put those men back to work *but would act as the wheel within the wheel to move the whole economic engine*. It would affect everyone, from the manufacturer of lace curtains to the manufacturer of lumber, bricks, furniture, cement, and electrical appliances. The mere shipment of these supplies would affect the railroads, which in turn would need the produce of steel mills for rails, freight cars, and so on. (Eccles 1951, quoted in Fish 1979: 200) [emphasis added]

Governing officials were learning how to use housing to manage the entire economy, a strategy that would remain long after the housing crisis receded. Eccles’s metaphor of housing as a “wheel within the wheel to move the whole economic engine” is revealing. In the postwar era housing would prime the pump of the U.S. economy (Cohen 2003: 73). And officials soon realized that if they could use housing to speed up the economy, they

could also use it to slow the economy down. The housing industry became the center of a set of “levers and pulleys” to alternatively speed up and slow down economic growth (Krippner forthcoming: 83-89).⁷⁴

The NHA was not only designed to help reduce unemployment – it was specifically designed to be a *low cost* means of doing so. Unlike many other New Deal endeavors, such as the Works Progress Administration, the new housing system would be self-sustaining and thus economical. In his first term, Roosevelt was still deeply concerned about balancing the budget (Cohen 2003: 55). The NHA was therefore designed to avoid adding to its expenditures (Fish 1979: 200) “The trick,” writes journalist Alyssa Katz, “was to find a way to juice up the production of housing, putting those men to work, but without spending government money.” (Katz 2009: 4) Jackson similarly reports that the legislation was created to increase private building without increasing federal expenditures (Jackson 1985: 203).

The NHA did not just have a feather-light effect on the budget. It also deferred to the model of restrained political intervention. Freund points out that, like previous efforts, this program was presented as a temporary one guided by private hands. The government would simply be a good referee of the market: “Supporters of selective credit programs portrayed the pre-Depression market as simply prone to abuse, rather than structurally incapable of supporting affordable loans and widespread homeownership, while the federal government’s role in creating and sustaining these new, more favorable conditions was effectively erased.” (Freund 2007: 119) Thus like the Federal Home Loan Banks and the Federal Land Banks, the NHA would present an image of the government as a catalyst for private enterprise, not a director of it.

At the core of the NHA was a set of insurance programs. To begin, the Federal Savings and Loan Insurance Company (FSLIC) was established to provide insurance for S&L depositors. Interestingly, previously the USBLL lobbied *against* this sort of government insurance, believing that the subsequent moral hazard would encourage carelessness and speculation. However, now they supported the legislation because they were even more worried that without it they would not compete with the FDIC-insured banks (Snowden 2009: 21). Whereas the FSLIC insured organizations, a second program insured individual mortgages through the Federal Housing Agency (FHA, later renamed the Federal Housing Administration). This was intended to encourage lending for new homes and home repairs for the estimated 13 million homes in need of improvements in 1934 (Studenski and Krooss [1952] 2003; USHCBC 1964). The FHA followed a uniform set of standards for appraisal and refused to insure anything other than the long term, low down payment, amortized mortgage. Previously these mortgage terms had been used by Europeans, the Land Banks, and some S&Ls; now these terms would become standard in the U.S. (Bodfish 1931; Freund 2007: 106; Jones and Grebler 1961; Snowden 2009).

⁷⁴ Specifically, officials would use Regulation Q, which set a limit on the interest rates that S&Ls could pay on deposits. I discuss Regulation Q in more detail in Chapter five.

With FHA insurance, the U.S. government used its own credit to stand in for individual borrowers and created a higher degree of standardization of mortgages. The hitch was that investors were not eager to deal in the “untested” FHA-insured loans (FNMA 1966: 4; Jones and Grebler 1961: 115). Federal insurance would help allay investors’ concerns about credit risk, but not their concerns about tying up their funds for longer periods of time. In fact, by backing longer-term loans, the government actually increased liquidity risks. The designers of the legislation figured that scared investors would be reassured if they could resell these mortgages, so instead of tying up funds for fifteen or more years, the FHA mortgages would be liquid (that is, easily converted into cash). To make this happen, the government would need a secondary market for mortgages, that is, a market where existing mortgages could be bought and sold. This could alleviate investors’ concerns about the FHA mortgages, and in turn attract funds to the housing industry, making it easier to integrate the nation’s local mortgage credit markets into a national capital market (Jones and Grebler 1961: 116-117). Encouraging this secondary market was therefore considered an absolutely vital part of the new legislation, and so Title II of the Act authorized the FHA to charter *private* National Associations to invest in FHA mortgages. It was an attempt to encourage a private secondary market to develop (Jones and Grebler 1961: 115).

This attempt to create a private secondary mortgage market was a complete failure. Jones and Grebler (1961: 116-117) explain that after a delayed start in setting rules and regulations, government officials repeatedly tried to revise the program’s requirements without any luck. They tried lowering capital requirements for the associations from \$5 to \$2 million. They tried to increase the leverage ratio from 1:10 to 1:12 and then 1:20. They granted National Associations broad exemptions from federal and state taxes. They authorized the RFC to buy stock in the National Associations and authorized the National Associations to originate FHA loans. None of it worked. The economic outlook of the Depression was too grim, the insured mortgages too new, and the investors too wary. Potential companies worried that the FHA would charter too many companies and that they would struggle against competitors; later these potential companies worried that the RFC or Fannie would undercut them, since the government affiliated companies would have superior credit and so could borrow more cheaply. The few applications for National Associations were never approved (Jones and Grebler 1961: 116; Snowden 2009: 23-24). In 1948 the charter for the private National Associations was revoked, but by then a federally run equivalent was over a decade old.⁷⁵

In 1935, the Roosevelt administration established what was supposed to be a federal system for buying mortgages, nominally to show that the National Association model could work (Snowden 2009: 23). Some members of the Roosevelt administration were also impatient with the failure of the National Associations to emerge and sought to

⁷⁵ Jones and Grebler (1961) do not discuss how the aftermath of the 1920s urban mortgage bond boom (discussed in the previous chapter) may have affected the failure of private National Associations to form. However, given the magnitude of the crash in bonds in the 1930s, it makes a great deal of sense that any attempt to set up independent mortgage brokers in a secondary market would face excessive cynicism, whereas a program involving the S&Ls (which had avoided the worst of the crisis) or a government program would fare better.

spur private companies into following suit, while others in the Administration seemed eager to garner any profits that could be gained from entering the field (Jones and Grebler 1961: 116-117).⁷⁶ The initial step toward a federal secondary market for mortgages was taken with the creation of the RFC Mortgage Company in 1935 (Jones and Grebler 1961: 117). This company was on the front lines, mopping up the mortgage bond craze of the 1920s (as discussed in Chapter three).⁷⁷ It financed construction, refinanced large buildings in distress, and issued loans to holders of the troubled mortgage bonds and certificates (Bodfish 1935). Congress also authorized the RFC Mortgage Company to buy and resell FHA mortgages, and by the time the RFC Mortgage Company was dissolved in 1947, it specialized in FHA mortgages: when the agency closed, it held loans worth \$433 million, almost two-thirds of which were federally underwritten (Jones and Grebler 1961: 117). The Company succeeded in demonstrating that mortgages could be bought and sold at a profit, and in that way may have served to encourage the private national associations. However, its mere presence seems to also have *discouraged* investors who worried about competing against a government agency with access to inexpensive Treasury financing (Jones and Grebler 1961: 117; Snowden 2009).

In 1938 Roosevelt created Fannie Mae as its own independent agency devoted to supporting FHA-mortgages.⁷⁸ It was initially named the National Mortgage Association, and within the year changed its name to Federal National Mortgage Association. Almost immediately traders started calling the company “Fanny May,” a derivation of its initials (Broderick 1938). In the 1970s the organization patented the spelling of the name as Fannie Mae to avoid confusion with a candy company named Fanny May (1973). The new agency bought its first mortgage on May 5th, 1938 (FNMA 1966: 9). At its inception, the main purpose of Fannie Mae was to temporarily revive the housing market, so unlike the RFC Mortgage Company, Fannie Mae was only authorized to buy mortgages on *new* houses (Jones and Grebler 1961: 118-121). By the end of 1938 it housed \$80 million in FHA mortgages, some of which were transferred from RFC (\$34 million). Most of those mortgages were paid off or sold in the 1940s, and by 1947 the agency recorded \$6 million in profits (Jones and Grebler 1961: 121). During this time Fannie Mae also made direct loans on a small amount of rental housing buildings, less than \$6 million by 1948 (Jones and Grebler 1961: 122).

The creation of Fannie Mae in the New Deal is interesting not because of what it was at the time, but because of what it would become. In the 1930s and 1940s Fannie Mae only played a miniscule role in the housing market, representing less than 1% of nonfarm housing loans before WWII (Jones and Grebler 1961: 122). Nevertheless, by supporting and brokering the FHA mortgages (Fannie bought 17% of them in 1938),

⁷⁶ This last reason seems especially plausible, given that Snowden (2009) reports that applications for National Associations at this time increased. Neither Snowden nor Jones and Grebler (1965) specify the grounds on which the FHA rejected the applications it did receive.

⁷⁷ It was started with a \$10 million and then \$25 million revolving fund, and allowed to borrow more from the RFC (Jones and Grebler 1961: 117).

⁷⁸ Fannie Mae was allowed to purchase uninsured mortgages, under the conditions that they were first mortgages worth 60% of the appraised value. The official history of Fannie explains in a footnote that it had not done so as of 1966, but does not clarify why (FNMA 1966: 10). In 1948, Fannie Mae’s secondary market operations were limited to purchasing new (as of April 30, 1948) insured or guaranteed mortgages (FNMA 1966: C1)

Fannie helped promote federal mortgage insurance. Moreover, Fannie would come to serve as the nation's only real buyer in the secondary mortgage market.

Fannie Mae was the last piece of the puzzle for the New Deal housing programs. Together the FHLB, HOLC, FSLIC, FHA, RFC Mortgage Company, and Fannie breathed new life into urban mortgage markets. Housing starts rose from 93,000 a year in 1933 to 619,000 a year in 1941 (Jackson 1985: 205). After World War II, the emergency programs were dissolved, but the Home Loan Banks, FHA insurance, and Fannie Mae remained to prop up a golden age of mortgage finance and housing in the postwar era.

Farm Credit and the New Deal

The Depression slammed into an agricultural sector that was already critically injured. Farm prices had already fallen by 41% at the start of the 1920s and plunged another 55% during the early 1930s (Rucker and Pasour 2007: 461). Before the 1920s only one-half of 1% of farms failed, and by 1932, that rate was up to 4% (Rucker and Pasour 2007: 461). Earlier U.S. agriculture policy emphasized research and development, with credit support limited to farm mortgages through the Land Banks (Rucker and Pasour 2007). In the New Deal, a much more extensive set of interventions that included systematic price support, land use, and payment programs took shape (Rucker and Pasour 2007). It started in 1933 with Roosevelt's Emergency Farm Mortgage Act, which provided relief by extending payments on farmers' loans. The administration then passed two acts that, together, transformed farm credit support: The Farm Credit Act and the Agricultural Adjustment Act (AAA) (Fishback 2007; Rucker and Pasour 2007).

The Farm Credit Act of 1933 reorganized agricultural lending in the U.S. by transforming the Farm Loan Board into the Farm Credit Administration (FCA). The FCA consolidated and centralized the organization of farm credit, and extended its reach, so that within only a few years the federal government had in some way been involved in half of the nation's farm loans (AIB 1934: 121-146; Fishback 2007: 402; Saloutos 1982: 269). Although these programs initially targeted only larger farms, by the end of the 1930s a set of new programs targeting smaller and low-income farms were established and then consolidated into the Farm Security Administration (Fishback 2007: 402-403). At the same time, the government established the Banks for Cooperatives. Like the Land Banks, which provided mortgages for farmers, and the FICB, which provided support for shorter term private loans to farmers, the Banks for Cooperatives provided another network of 12 banks to offer credit support to bank cooperatives (Fishback 2007: 402). In the same year Roosevelt established the Federal Farm Mortgage Corporation, which swapped its own guaranteed bonds for the non-guaranteed Land Bank bonds, providing additional funds for farm mortgages (FCA 2010; Preston 1936).

1933 also marked the ascent of a new kind of farm credit support that straddled the line between loans and grants. As part of the AAA, the government created a new agency called the Commodity Credit Corporation (CCC). This practice had roots in the Agricultural Marketing Act of 1929, which authorized the federal government to make loans to farm cooperatives (Nourse, Davis, and Black 1937: 151). The CCC, still in operation today, grants "non recourse" loans to farmers that are collateralized by the farmer's crops. It does so with a twist: the government sets the price of the crops. If the

real market value of the crop ends up being higher than the government's price, then the farmer can sell the crop on the market, repay the loan, and keep the profit. If the market price falls below the government price, then the farmer simply defaults on the loan and the government keeps the crops (that is why these are called "non recourse" loans – the government has no recourse but to take the crops). The CCC is a credit program in that the government issues loans, but it is a hybrid program that also resembles a direct subsidy insofar as the government knowingly lets farmers pay back their loans with collateral that does not fully cover the amount borrowed. In 1939 the CCC was transferred to the U.S. Department of Agriculture (USDA) and in 1948 it was reorganized as a federal corporation (CCC 2008).

The CCC is a good example of how credit support programs may motivate other kinds of programs. Through the CCC the federal government soon found itself the owner of a great reserve of goods, and it moved to unload them. School lunches and food stamps are the most well known of the farm subsidy-related food programs, but not the only ones (Rucker and Pasour 2007: 477). As early as 1933 the RFC lent \$15.4 million dollars (and committed to lend up to \$50 million) to the government of China to buy wheat, flour, and cotton (Nourse, Davis, and Black 1937: 191-192). In the 1930s the government also made loans to American exporters to sell cotton in Russia, wheat and flour in the Philippines, and prunes in Germany (where it was turned into "prune butter") (Nourse, Davis, and Black 1937: 191-194). Rucker and Pasour add that in 1954 the Food for Peace program began unloading government stores of commodities abroad, either directly through gifts to famine-struck countries or indirectly through loans with low interest rates and long maturities. Over the next two decades up to a third of exports were related to these programs (Rucker and Pasour 2007: 481).

Table 4.2: Federal Credit Aid by Sector, Program Type, and Period (in millions)⁷⁹

Sector	Program Type	1932-36	1937-41	1942-46	1947-50
Finance	Direct loans	\$3,681	\$256	\$55	\$8
Business	Direct loans	\$959	\$673	\$2,999	\$2,475
Business	Insured	\$74	\$86	\$1,878	\$452
Agriculture (mortgage)	Direct loans	\$2,165	\$604	\$740	\$881
Agriculture (other)	Direct loans	\$2,935	\$3,947	\$6,273	\$8,703
Private housing	Direct loans	\$3,435	\$1,646	\$1,505	\$3,803
Private housing	Insured	\$908	\$4,356	\$5,614	\$18,509
Local government	Direct loans	\$1,062	\$1,719	\$467	\$262
Local government	Insured	\$0	\$57	\$677	\$549
Misc	Direct loans	\$144	\$158	\$73	\$115
<i>Total</i>		\$15,363	\$13,502	\$20,281	\$35,757

⁷⁹ **Note:** "Insured" includes federal guarantee programs. **Source:** R. J. Salunier, H. O. Halcrow, and N. H. Jacoby, "Federal Lending and Loan Insurance" (Princeton: Princeton University Press, 1958); Appendix A; "Final Report on the Reconstruction Finance Corporation" (Washington: Government Printing Office, 1969), tables in appendix; and data presented in tables A-2, A-3, and A-4.; as cited in *Federal Credit Programs* (United States. Congress. House. Committee on Banking and Currency. 1964)

During World War II the growth of federal direct lending in the general economy slowed as attention shifted to the war effort. “V-loans” guaranteed by the Defense Department were initiated to promote wartime production and credit assistance, especially for housing and agriculture, and the RFC used credit supports to promote war-related housing and production. In the years after the Second World War, federal credit support transformed from a smaller system organized around direct loans to a much larger system organized around guarantees. Business and finance-oriented credit programs were overhauled, as the RFC was dismantled and replaced with more targeted agencies that focused less on finance and more on industry. Table 4.2 details the substantial changes federal credit programs went through between the Depression and the postwar era. During the Depression (1932 – 1936), federal credit programs mainly used direct loans to target the financial sector, farm and home mortgages, local governments, and businesses. Together, direct loans in these sectors made up 94% of federal credit aid (the rest was made up of insurance and guarantees for businesses and homes, and direct loans in other sectors). As the nation entered WWII, federal credit in the field of finance dropped precipitously from \$3.8 billion to \$256 million. Direct lending also declined for businesses, farm mortgages, and private housing; however, direct loans for non-housing related agriculture and local government actually increased, as did the use of insurance to support business, private housing, and local governments. As the nation exited and recovered from the War, the direct loans were increasingly used to support business and especially farms. The largest change after WWII, however, was the dramatic increase in private housing insurance, which made up over half of the nation’s \$35.8 billion in credit aid from 1947 to 1950. The stage was set for the spread of these programs throughout the postwar era.

Federal Credit in the Postwar Era: Growth and Guarantees

Throughout the postwar era, credit support transformed from a smaller system organized around direct loans to a much larger a system organized around guarantees. Business credit was overhauled as the RFC was dismantled and more targeted agencies took its place. Farm and housing supports ballooned after the war, as federal guarantees of private loans became an increasingly popular political strategy for managing the economy. Notably, the government also turned to credit programs to promote education.

Given that the postwar era is marked by significant expansion, it is somewhat ironic that it began with a large step back in the use of federal credit – the unwinding of the RFC in 1953. The RFC was planned as a temporary agency and was not meant to outlast the crisis of the great Depression. The lending agency got a reprieve during WWII, when it was extended and used to finance aspects of the war effort and defense-related housing (Fishback 2007: 395). In 1953 it was finally dismantled, with many of its loans and its most central functions spun off into two smaller, more targeted government agencies: the Export-Import Bank and the Small Business Administration.

One important agency to emerge out of the RFC was the Export-Import Bank (Bosworth, Carron, and Rhyne 1987: 81). Starting as an RFC subsidiary, the Bank housed RFC loans to foreign countries and continued to encourage American exports by lending money abroad for the purchase of American commodities. As an independent

agency, it continued to issue long-term loans. One of its specialties was taking on politically-related risks that scared away private lenders but not the U.S. government, which had access to additional means of coercing payments out of other governments and corporations (Bosworth, Carron, and Rhyne 1987: 81). Since the 1940s, the Bank has been instrumental in financing the sale of capital intensive purchases like aircraft and energy equipment abroad (Bosworth, Carron, and Rhyne 1987: 98).

A second agency, the Small Business Administration (SBA), was formed to promote small businesses because they “faced special problems in obtaining credit and were essential to the competitive, entrepreneurial character of the American economy” (Bosworth, Carron, and Rhyne 1987: 82). The SBA used mainly direct loans in the 1950s and 1960s, but started to rely increasingly on guarantees to somewhat marginal borrowers in the 1970s (Bosworth, Carron, and Rhyne 1987: 85). Although business credit programs were, on the whole, scaled back in the postwar era, there were some new programs established to support economically depressed parts of the country. This was not just through the SBA. The Economic Development Administration and the Farmers Home Administration both provided business support, as did new programs that targeted the Merchant Marines, atomic energy, disaster relief, and, through the creation of the U.S. Agency for International Development (USAID) in 1961, foreign aid.⁸⁰

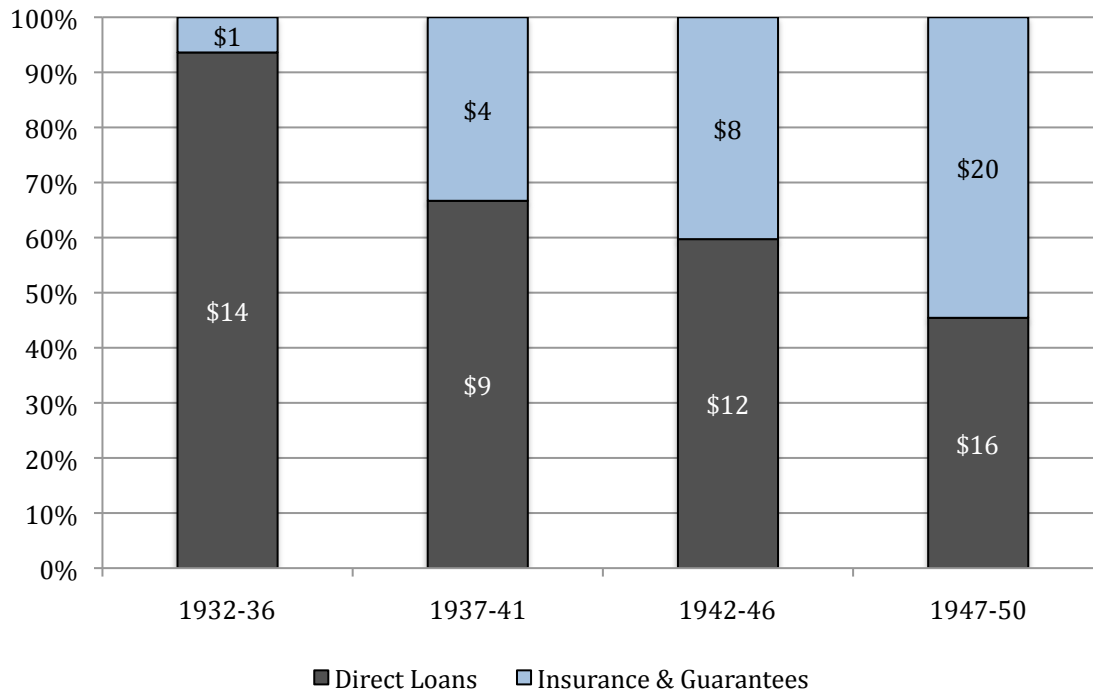
The use of credit programs to support higher education originated in 1961 as part of a Cold War effort to make sure that Americans had the scientific and educational acumen to compete with the Russians. As part of Johnson’s War on Poverty, college loans were recast as integral to promoting equality, though this was somewhat controversial at the time among progressives, who preferred free education and worried that the loan programs endorsed the notion that “individuals should pay for their education” (Bosworth, Carron, and Rhyne 1987: 130). After having been extended to non-defense purposes in 1965, the Government Student Loan programs took off despite some initial resistance, and soon expanded to include most of the middle class (i.e., the use of loans was no longer limited to educational purposes deemed militarily important). Having massively expanded in the 1970s, these programs, they note, constituted “a revolutionary change in the financing of postsecondary education” (Bosworth, Carron, and Rhyne 1987: 129).

In the area of farm loans, there was a large increase in the use of direct loan programs directly following the Second World War: expenditures increased to \$8.7 billion, up from \$2.9 billion the Depression years, as shown in table 4.2. Another substantial change in federal agricultural credit in the postwar era was the creation of the Farmers Home Administration (FmHA) in 1961 to complement the FCA by providing subsidized loans to the rural poor in 1961 (Bosworth, Carron, and Rhyne 1987: 116).⁸¹

⁸⁰ In the 1960s state and local governments increasingly used their capacity to issue tax-exempt bonds (interest on federal and state bonds has been tax-exempt since 1913) to fund private business efforts. While these programs lie outside of the current analysis, which is instead focused on federal credit programs, it is worth noting that this form of financing was used to promote the growth of industries, hospitals, mortgages, student loans, and more (Ippolito 1984: 40)

⁸¹ By the 1980s FmHA’s scope was greatly extended as it came to issue loans to wealthier people, and for emergency lending, housing, and community development projects like water and waste treatment (Bosworth, Carron, and Rhyne 1987: 116).

Figure 4.2: Direct and Insured Loans as a Portion of Federal Credit Aid, 1932-1950
(in billions) ⁸²



The most dramatic change in federal credit programs occurred in the field of housing. After the War the Veterans' Administration (VA) guaranteed home, farm, and business loans to veterans. Worried that the housing levels would fall to prewar levels, and facing another postwar housing shortage as soldiers and war workers returned home, the government used FHA and VA mortgage guarantees to encourage homeownership (Cohen 2003: 141; Nenno 1979: 252; Quigley 2006). The two housing insurance and guarantee programs drove a dramatic rise in the use of guarantees and insurance. When it comes to housing, it is useful to consider figure 4.2 and table 4.2 together. Between 1932 and 1936 the government issued a combined \$14.3 billion in direct loans, and guaranteed just under a \$1 billion of loans. In the years following the war (1947-50) it issued \$16 billion of direct loans, but that was a relatively modest rise in comparison to the use of guarantees, which shot up to \$19.5 billion, about \$18.5 billion (or, 95%) of which in that four year period was from housing.

It is worth pausing to consider the special importance of the VA in driving the postwar housing market. In her study of the rise of American consumer culture in the postwar era, Lizabeth Cohen (2003: 137-165) stresses that the GI Bill gave the veterans of WWII unique access to education and property ownership, pleasing both veterans and the housing industry, all with very little cost to the U.S. government. Over four million veterans (that is, 28% of the 16 million WWII Veterans) used the VA home loan

⁸² **Source:** R. J. Saulnier, H. O. Halcrow, and N. H. Jacoby, "Federal Lending and Loan Insurance" (Princeton: Princeton University Press, 1958); Appendix A; "Final Report on the Reconstruction Finance Corporation" (Washington: Government Printing Office, 1969), tables in appendix; and data presented in tables A-2, A-3, and A-4, as cited in Federal Credit Programs (USHCBC 1964).

program. Between the end of the war and 1952, the VA guaranteed 2.5 million mortgages, and it backed a fifth of single family homes by 1966 (Cohen 2003: 141).

In 1948 Fannie Mae was authorized to buy loans guaranteed by the VA. The same year, the original NHA plan to back National Associations was set aside (FNMA 1966: 8-11). Fannie Mae alone would dominate as the nation's secondary market for mortgages. Fannie Mae's job was to buy up FHA and VA mortgages in downturns and then hold them until it was a better time to sell. Doing so was "a means of leveling out the peaks and valleys of available home financing" (FNMA 1966: 14). Fannie Mae was simultaneously envisioned as a means to move money around the country, ameliorating the ongoing problems of localism and high interest rates in the West. In the 1950s it also started buying and making advance commitments for special public housing programs, disaster relief programs, and military housing.⁸³ By 1954 Fannie Mae had a \$2.5 billion portfolio, two-thirds of which were VA mortgages (Jones and Grebler 1961: 123).

The Structure of the Federal Credit Market in the 1960s

In 1963 the U.S. House surveyed federal credit agencies. The resulting report offers a remarkably fine-grained look into the world of these programs (USHCBC 1964). The surveyors found that the government contained 74 separate credit aid programs, 51 of which issued loans directly in June of 1963. As of June 1962, the government held \$30 billion in assets and insured or guaranteed another \$70 billion, three quarters of which derived from the FHA and VA (PCBC 1967; USHCBC 1964).⁸⁴ Combined, the \$100 billion represented 14.5% of all outstanding private borrowings in the U.S. in 1962 (\$687.6) (CEA 1964: C-52).

Commenting on the scope of federal credit aid, the committee noted, "the credit programs extended to every segment of the American economy – financial institutions, agriculture, business, private housing, State and local government, international trade, and individual households" (USHCBC 1964: 5). By the middle of the 1960s, federal credit aid had evolved into a sprawling, decentralized web of programs that offered a mix of guarantees, insurance, and loans. Jurisdictional overlaps sometimes led to competition between agencies and this complex system allowed for variation and flexibility that fostered innovations in the management of credit lending (USHCBC 1964). For example, each agency used its own accounting methods to determine its own reserves. At one extreme were five programs without any reserves; at the other was the FHA, which calculated reserves that assumed a Depression-level crisis. While many had limits on monetary ceilings or number of grants, fifteen agencies had no statutory limits, among them the FHA and VA. Some programs were funded through appropriations, others through the Treasury or capital markets. Within the subgroup of direct loans programs the type of support offered varied widely, from the CCC's non-recourse loan programs that were unlikely to ever be repaid, to \$12 billion in USAID's non-commercial loans where

⁸³ For a detailed account of Fannie Mae's business practices and congressional authorizations in the 1950s and early 1960s, see Jones and Grebler (1961: 123-127) and Fannie Mae's 1966 booklet, *Background and History of the Federal National Mortgage Association*.

⁸⁴ The report on *Federal Credit Programs* (House 1964) generally excluded non-recourse loans out of the Commodity Credit Corporation, and non-commercial foreign loans (like those out of USAID) from calculations, since those programs were effectively grants and more like direct expenditures than a form of credit support.

the likelihood of default was unknown, to more traditional commercial loans at the Export-Import Bank and Fannie Mae (USHCBC 1964). Even the less exotic commercial loans contained a wide array of terms. For example, loans to low-income people and businesses were subsidized in a variety of ways that included longer terms, smaller down payments, and lower-than-market rates (OMB 1965: 305).

In his review of federal credit programs in the early 1970s, President of the Minneapolis Fed Bruce MacLaury similarly notes that the complexity of these programs had contributed greatly to a proliferation of types of government debt instruments:

Even in the relatively narrow context of a discussion on Federal debt management, the term "Federal agencies" covers a broad and diverse range of debt instruments. At one end of the spectrum one finds the direct obligations of government-owned agencies such as the Export-Import Bank, TVA, and the Postal Service - obligations that are virtually indistinguishable in credit standing from direct obligations of the U.S. Government itself. At the other end are the notes of private issuers, such as SBICs that are guaranteed by a government agency, in this case the Small Business Administration. In between fall every sort and description of instrument, distinguished by differing degrees of access to the Treasury in case of default, of insurance coverage as to interest and principal, of market-ability based on size of issue, minimum denomination, etc., and differing degrees of explicitness in the extent to which the obligations are guaranteed, if at all. (MacLaury 1973: 92)

As I will show in the next chapter, it was one of these many kinds of debt instruments that evolved into the modern mortgage-backed security.

The Impact of the Federal Credit Programs

At first glance the impact of these programs may seem obvious. New Deal emergency loan programs stemmed a tide of foreclosures and bankruptcies during the Depression. The REA modernized the American home and brought electricity to farms that were overwhelmingly in the dark. FHA and VA loans helped promote more sophisticated forms of lending, promoted suburbanization, and helped a generation of families move up the social ladder. School loan programs promoted a rise in college education. But how do we know whether these changes would have happened anyway through private channels? What is the real effect of these programs on U.S. credit markets?

The extent and quality of the financial impact of these programs is much debated, and the complex, decentralized nature of the programs create data collection problems that make drawing definitive conclusions especially difficult (see discussions in Bosworth, Carron, and Rhyne 1987; Ippolito 1984; MacLaury 1973; Saulnier, Halcrow, and Jacoby 1957). This problem has worsened over time. Two hundred new federal credit

initiatives were launched between 1965 and 1982, and by the 1980s there were an estimated 350 separate government credit programs, issuing 154 types of loans in what Hardin and Denzau have called a “sprawling, bureaucratic morass” (Hardin and Denzau 1981: 2-3; Ippolito 1984). Like their predecessors, these programs varied by type, subsidies, and accounting methods; a lack of reliable or consistent data collection got in the way of precisely measuring how credit programs as a group affect credit markets. To work around this, economists have carefully drawn from the data available (most often this was government reports by the CBO, and a special appendix to the federal budget detailing credit programs), and sometimes zeroed in on specific programs in order to get a grasp on the economic ramifications of federal credit aid.⁸⁵ Still, given these data collection problems, it is not surprising that Americans have largely failed to note the extent of government intervention in the economy happening through this set of indirect policy tools.

Some economists have argued that it is easy to overstate the extent to which governmental credit programs have helped borrowers. From this perspective, any benefits derived from federal credit are largely or even completely offset, since government programs may crowd out private investors who otherwise would have entered the market, or simply redirect (rather than expand) access to credit (Belongia and Gilbert 1990; CBO 1978; CBO and Shillingburg 1978; Gale 1991; Hardin and Denzau 1981; Ippolito 1984; Schwarz 1992). For example, some argue that Fannie Mae mainly simply displaces private companies that would otherwise do the job if they had not been pushed out of the market by a government entity (Bennett and DiLorenzo 1982; Leonard and Rhyne 2006). Some have warned that the proliferation of types of federal debt issuances within these programs are detrimental to the economy because they have at points made it difficult for the Treasury to manage levels of federal debt (Kauffman 1973; MacLaury 1973; Saulnier, Halcrow, and Jacoby 1957), or have inadvertently driven up interest rates

⁸⁵ The theories I discuss in this section are mostly those of academic economists and government research offices. That is because sociologists have largely ignored the impact of federal credit programs as a whole, focusing instead more narrowly on their role as part of the distribution of housing or racial inequality, while economists have sought to pin down the general economic impact of these programs as a whole. This has been especially true since the late 1970s and early 1980s, when federal credit programs became the subject of greater public debate than they previously had been. In part the programs had become more controversial because of an increase in the use of guarantees since the 1970s (Ippolito 1984). Political fights over deficits in the Reagan era led to a greater amount of attention to all forms of federal spending, just as credit-based bailouts of New York City and Lockheed called attention to the off-budget status of most credit programs (Leonard and Rhyne 2006). Finally, a crisis for the nation’s farmers – driven by mounting inflation, a land-value bubble, and sharply declining incomes among farmers – called attention to the large subsidies hidden in the farm credit programs in the 1980s (Bosworth, Carron, and Rhyne 1987). All contributed to an uptick in economic studies of federal credit.

Many of these debates are specifically oriented towards the hidden political costs of the programs, an issue I address below. In the next few pages I deal exclusively with debates about the affect of these programs on credit markets. Note as well that this chapter largely does not consider the implications of the rise of federal credit programs for theories of markets and societies – that is because the implications therein are best understood in the context of both the rise of federal credit and the emergence of the MBS, which I address in the following chapter. Finally, this chapter also does not consider the more recent history of credit programs because, for the purposes of this dissertation, my interest is focused on how the early rise of credit programs affected the history of the current securitization market.

(Hardin and Denzau 1981; Kane 1977; Saulnier, Halcrow, and Jacoby 1957: 29).⁸⁶ Others argue that the benefits of these programs could be more cheaply and effectively gained through alternative means, like direct grants (Bosworth, Carron, and Rhyne 1987), tax exemptions (Lombra and Wasylenko 1984), or even deregulation (Kane 1977; Williamson 1994). Proponents of free-market policies warn against “substituting political judgments for the discipline of the market” (Hardin and Denzau 1981: 1), and insist that government credit supports skew incentives and court moral hazard (see especially Bennett and DiLorenzo 1982; Bosworth, Carron, and Rhyne 1987: 173).

Those who think the programs have positive economic results argue that federal credit programs do not displace private credit, but rather expand markets into new frontiers. One argument is that by bringing new borrowers into the lower end of the market these programs benefited many homeowners who did not directly receive credit aid.⁸⁷ Writing of these programs in the 1950s, Saulnier, Halcrow, and Jacoby (1957: 29, 34) put forth another line of defense: that these programs have, on the whole, effectively bolstered the economy during economic downturns, especially in the housing and agricultural sectors. There is also evidence that some of the unintended consequences of these programs may have general secondary effects, such as when farm price supports helped spur food stamp programs.

The Institutional Legacy of the Credit Programs

From the standpoint of economic sociology, the most interesting thing about these programs is that, historically, they changed the rules of the game in credit markets, and expanded how American companies lent money, and to whom (Saulnier, Halcrow, and Jacoby 1957: 44). The congressional report on *Federal Credit Programs* details how this happened. These programs helped individual borrowers build credit histories and expanded lenders’ willingness to accept new kinds of borrowers, loans and risks:

From the viewpoint of the borrower, this private financing provides him with an opportunity to show the private lender that he is capable of administering borrowed funds and thereby helps to build a good credit record. In the future this credit reputation could enhance the possibility of his obtaining private loans at interest rates and other terms that are generally reserved for the better credit risks. . . . From the viewpoint of the lender, these credits serve to acquaint it with the financial attributes of borrowers or of types of loans to which heretofore it has not been accustomed. Familiarity coupled with a favorable loan experience might, in

⁸⁶ This argument applies not only direct loans but also to guarantees. As explained by R.T. McManar: “While the myth seems to persist that guaranteed borrowings are somewhat less different from direct federal borrowings and involves less government intervention in the marketplace, this is simply not so. Every dollar of government guaranteed debt financed in the public marketplace is like treasury borrowing demand and exerts similar upward pressure on interest rates.” (quoted in Hardin and Denzau 1981)

⁸⁷ Another defense is that since the 1970s the housing programs have served to correct patterns of discrimination in private markets. So, for example, housing programs are defended on grounds that they are less discriminatory than conventional markets (Quigley 2006: 12). One problem with this argument, however, is that it elides the history of discrimination within these programs.

time, induce such lenders to make similar type loans on favorable terms, perhaps without reliance on Federal participation or insurance. . . . Furthermore, Federal credit administration also involves working with private lenders to induce them to alter their requirements or to change their concepts in order to participate in loans being made or insured by the Federal credit agency. (USHCBC 1964: 86)

In addition to this, government programs pioneered many lending techniques we now take for granted. The most famous example of this is the use of long-term, low down payment, amortized loans. Even though other groups had at times used these kinds of terms before the Federal Land Banks, FHA and VA, it was the government programs that consistently led the way in popularizing their use. This becomes clear if we take a closer look at mortgages on existing homes purchased in the postwar era. Table 4.3 shows that FHA and VA insured loans consistently led the conventional loans (that is, loans not backed by government insurance or guarantees) with longer maturities and larger amounts (Carter et al. 2006a). Conventional loans in 1950 had a median maturity of twelve years and a Loan-To-Value (hereafter LTV) ratio of 64%. In the same year, a government-guaranteed mortgage had an average maturity that was nearly twice as long (20 years), with substantially higher average LTV ratios: 76% at FHA and 86% at the VA. By 1964 conventional loans looked more like the FHA guaranteed loans issued fourteen years earlier, with a median maturity of 20 years and a LTV of 76%. By that time the government guaranteed loans had even looser terms, with an average maturity of nearly 30 years, and LTVs of over 90%.⁸⁸

Early business programs followed a similar pattern (Saulnier, Halcrow, and Jacoby 1957). In the early 20th century, bankers relied on promissory notes paid in a lump sum in a year or else renewed. Against this, programs like the RFC helped popularize new, more flexible ways of lending. The VA, through its business loans, taught bankers “how to make these [amortizing] small business term loans safely and profitably.” (Saulnier, Halcrow, and Jacoby 1957: 44) The Export-Import Bank led the way in issuing medium and long-term loans abroad. A similar transformation occurred in agriculture, where farm mortgages and production loans similarly came to have lower interest rates, longer tenures, and looser terms (Saulnier, Halcrow, and Jacoby 1957: 44).

⁸⁸ Note that it is possible another social change drove the rise in LTV ratios and maturities in both the government and non-government market. However, like other scholars (Freund 2007; Saulnier, Halcrow, and Jacoby 1957), I believe that the government programs led the way in the adoption of these practices suggests that they were nevertheless important pioneers in the field.

Table 4.3: Mortgages for Existing Homes by Maturity and Loan-To-Value Ratio, Selected Years⁸⁹

Year	Maturity			Loan-to-Value Ratio		
	FHA (Average)	VA (Average)	Conventional (Median)	FHA (Average)	VA (Average)	Conventional (Median)
1950	20.2	19.7	12.3	76.4	86.4	64.6
1952	19.7	18.7	13.9	76.1	80.3	64.1
1954	20.1	21.4	14.6	77.8	86.8	65.2
1958	24.2	22.3	15.5	88.1	87.4	68.9
1960	25.8	23.6	16.5	90.5	90.7	72
1962	27.4	26.6	18.8	92.1	94.9	75.1
1964	28.4	27.7	20.9	92.8	96.2	76.1
1966	28.4	27.8	22.2	93	96.8	74.5

The credit programs did not just lead the way in offering more liberal credit terms. From their inception, they also did the important work of standardizing loans. This occurred when insurance programs like the FHA and VA established that they would guarantee only one kind of standardized mortgage and the HOLC bought up troubled mortgages during the Depression and converted them into new kinds of mortgages (Carruthers and Stinchcombe 1999).⁹⁰ As investments go, mortgages are relatively complex ones, because each mortgage carries a unique value and set of risks based on the property, structure, and borrower. In creating new, standardized lending practices the government created a new degree of homogeneity that stripped away some extra complexity in the market, and this appealed to potential investors. When federal programs provided credit support, substituting the federal government's top-notch credit for a slew of private borrowers, they stripped away another, even more tricky layer of complexity, and so further spurred investment. That is, as Carruthers and Stinchcombe have noted, they helped create a shared set of understandings and rules about mortgages that enabled money to flow through the mortgage market (Carruthers and Stinchcombe 1999). Some scholars who insistently critique the development of federal credit programs since the 1970s nevertheless recognize that the programs played a significant role in developing American credit markets throughout the postwar period.⁹¹

⁸⁹ **Source:** "Terms on nonfarm home mortgages, by type of mortgage and holder: 1920–1967." Table Dc1192-1209 in Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, Gavin Wright, and Kenneth A. Snowden. 2006a. "Historical Statistics of the United States." New York: Cambridge University Press.

⁹⁰ This also happened as early as 1916, when the Federal Land Bank System started standardizing terms on farm mortgages, and again later when the government issued securities backed by pools of loans through the RFC, SBA, Export-Import Bank, and Fannie Mae. I will discuss this in more detail in the next chapter.

⁹¹ For these scholars, the problem is that the federal credit programs were allowed to continue after having achieved the goal of seeding the market, and that the federal programs may use subsidies to unfairly compete with private enterprise (Bosworth, Carron, and Rhyne 1987: 84). In a similar vein, a review of housing credit programs concludes that the government played a seminal role in developing housing markets, even though the programs later had increasingly small effects (Quigley 2006).

Another legacy of the credit programs is the interest groups that sprung up around them. Many scholars have observed that these programs develop constituencies who fight to protect and extend them; this in turn becomes one of reasons why the programs proliferate (Bosworth, Carron, and Rhyne 1987; Hardin and Denzau 1981; Ippolito 1984; Saulnier, Halcrow, and Jacoby 1957). Take, for example, school loan programs, which were initially developed for defense and the War on Poverty. They soon came to serve as an entitlement for the middle class, and a low-cost way for politicians to appease middle class constituents (Bosworth, Carron, and Rhyne 1987: 130).

This pattern is not unusual or unique to credit policies (Pierson 1993; Schultze 1983). One of the most important insights of political science and sociology is that interest groups often spring up in response to a specific set of policies, with one of the most well known examples of this being how veterans became organized as a group in part as a response to the creation of Civil War pensions (Skocpol 1992: 58-60). However, what is unusual about many of the credit programs is that, in general, they do not require as much in the way of federal expenditures to maintain as other kinds of programs, and as a result there is less to check these programs once they are established. I discuss this further in the next chapter, when considering the budgetary ramifications of the credit programs in more detail.

Structuring the Postwar Housing Market

In the previous two chapters I detailed the development of the nation's patchwork market for housing finance. Commercial banks, mutual banks, insurance companies, S&Ls and mortgage companies together only made up about half the market. After the New Deal a completely different structure emerged. Table 4.4 shows that from 1940 to 1970, the S&Ls nearly tripled their market share. By the middle of the 1960s they held about a third of the nation's housing debt. Life insurance companies', commercial banks', and mutual banks' market share fluctuated during the postwar era, but by 1970 they all held positions very similar to the ones they held in the 1940s: somewhere between 13% and 16% of the nation's mortgages. After WWII, the federal government only directly held about 5% to 8% of the nation's mortgages at a time.⁹² Perhaps the clearest trend in Table 4.4 is the decline of the non-institutional investor (this includes individuals and non-market specialists, like non-profit organizations), who held about a third of the nation's mortgages in 1940. By 1970, this had declined to 17% of the market. This number is very low considering the predominance of individuals as mortgage lenders in the nineteenth century (see chapter 2), but given the academic and popular attention given to institutional lenders (like S&Ls, Mutual Banks, and Insurance Companies) in the postwar era, we might be surprised that this residual category of lenders still held about a sixth of the nation's mortgage debt.

⁹² Note that the government held most of its housing mortgages at the time in Fannie Mae, which bought and then resold mortgages; this means that the outstanding amount of mortgages held in the government represents net holdings, rather than gross purchases. The federal government's holdings of direct mortgages should not be confused with an analysis of its role in shaping the housing market, which is more directly addressed later in this chapter.

Table 4.4: Mortgage Debt by Type of Holder, Selected Years, 1940-1970 (billions)⁹³

Year	S&Ls	Mutual Banks	Commercial Banks	Life Insurance Cos	Fed. Gov't	Individuals & Other	Total	Total 1960 dollars
1940	11%	13%	13%	16%	13%	33%	\$36.5	\$78.4
1945	15%	12%	14%	19%	7%	34%	\$35.5	\$59.8
1950	19%	11%	19%	22%	4%	25%	\$72.8	\$92.6
1955	24%	13%	16%	23%	4%	19%	\$130.1	\$145.9
1960	29%	13%	14%	20%	6%	18%	\$207.6	\$207.6
1965	33%	13%	15%	18%	4%	17%	\$333.6	\$311.2
1970	32%	12%	16%	16%	8%	17%	\$474.4	\$524.8

Organizationally, the postwar housing market was effectively divided into two camps, each with their own kind of federal credit support, that together held three-fourths of the nation's mortgage debt by 1960 (Cacy 1967; Jones and Grebler 1961: 27-52; Schwartz 2006: 53; Snowden 2009). On one side there was the S&Ls, which continued to operate locally and hold mortgages in their portfolios. For access to additional credit the S&Ls relied on the FHLB to sell bonds exempt from state and local taxes, and then direct those funds to the S&Ls.⁹⁴ As Table 4.4 shows, between 1940 and 1960 the share of the national mortgage debt that they held rose from 11% to 29% (Carter et al. 2006: Dc929-949). Overwhelmingly they issued *conventional* loans, that is, loans that were not guaranteed or insured by the government.

At the center of the second side of the market were mortgage brokers, the organizational descendents of the fast-and-loose mortgage companies of the 1920s housing boom discussed in the previous chapter. The few mortgage companies that survived both the housing crash of the 1920s and the Depression regrouped as a more conservative lot. They gathered around the FHA and devised a new business plan where they effectively became extensions of larger institutional investors (the life insurance companies, commercial banks, and mutual banks), ones that earned the bulk of their income through fees garnered from the ongoing servicing of mortgages (Klaman 1959; Snowden 2009). As part of this more conservative makeover, they stopped selling to small investors altogether. Klaman (1957: 7) offers two reasons for this: the FHA loans had such long maturities that individuals were not interested in owning them, and small investors were not allowed to invest in FHA and VA loans in any case.

⁹³ **Source:** "Table Dc929-949: Mortgage debt, by type of property, holder, and financing: 1939-1999" in Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, Gavin Wright, and Kenneth A. Snowden. 2006a. "Historical Statistics of the United States." New York: Cambridge University Press. **Note:** This includes Farm and NonFarm, Residential and Commercial Mortgages.

⁹⁴ Note that the mortgage bonds are not themselves resold, so this system has no real secondary market, even though it does have credit support.

The mortgage brokers were not in the secondary mortgage market so much as they were intermediaries in the primary market issuing mortgages on behalf of other institutions.⁹⁵ The mortgages they issued were typically insured by the FHA or VA and were called *conforming* because they conformed to government standards.⁹⁶ Whereas the FHLB provided support for the S&Ls, Fannie Mae provided credit for the conforming market by buying and selling loans – that is, by serving as the secondary market. Jones and Grebler (1961: 34) estimated in 1961 that four-fifths of Fannie Mae’s loans were bought from mortgage companies.

A mess of state, local and federal regulations of mortgages, investment companies and tax rules made switching back and forth between the two systems relatively difficult. That is, the information costs that structured the postwar housing market were not just about the borrower and the house and the land: they were also knowing how the mortgage would be taxed in that state, knowing the kind of red tape needed to get it approved by the FHA or VA, knowing the rules that determined the kinds and amounts of mortgages that a given type of company could invest in and so on. The S&Ls were limited to acting locally, but benefited from a great deal of expertise and flexibility therein. For example, they did not have restrictions on LTV ratios like other lenders did (Jones and Grebler 1961: 47). The conforming market was not restricted by where it could invest, but because their primary lines of business were banking or insurance, these investors faced federal and state restrictions on the types of mortgages they could hold – limits that often included major exemptions for government-backed loans. Conforming loans, due to certain limits on the rates they could charge, were not as profitable as the conventional loans, but because they were excluded from other limits on lending, insurance companies and banks had an incentive to invest in them anyway. Sometimes the mortgage brokers traded in non-guaranteed loans and sometimes the S&Ls issued loans insured by the government, but overall it was more effective for each group to specialize and two somewhat acrimonious camps emerged. Jones and Grebler (1961: 47, 119) note that the groups have “divergent loyalties” and “competitive jealousies” that “have a definite bearing on proposals to create new or to reform existing institutions in the secondary market.”

While the government agencies created stability and helped to connect local mortgage markets to the nation’s capital markets (the latter through the FHLB and Fannie Mae), the government programs made strides in integrating national credit markets, helping to create the conditions for a boom in housing (Bosworth, Carron, and Rhyne

⁹⁵ Why didn’t the mortgage companies successfully develop their own secondary market? The answer is not entirely clear. Some say the reason the market never developed was because Fannie Mae displaced them or crowded out private competitors (Jones and Grebler 1961: 200; Snowden 2009: 22). Some firms had taken steps to do so in the 1950s but the market never took off. Grebler and Jones consider this question, and find that while the mortgages companies seem undercapitalized for the task, there was to be no real reason why they shouldn’t be able to make it work. While a full treatment of this question would require more independent research into the private sector that lies beyond the current scope of this project, it seems plausible that they failed to do this in the 1930s and 1940s because they were scared off by the earlier boom and bust, and that by the 1950s there was little incentive to do this in a stable field where they had a reliable source of income and could take their business strategy for granted.

⁹⁶ Note that scholars have shown that these standards relied on formulas for property values that tended to privilege white families in the suburbs and disadvantage non-white, urban, and lower-income families (see, especially, Freund 2008; Massey and Denton 1993; Oliver and Schapiro 2006). I will return to this point in more detail below.

1987: 14). Between 1940 and 1960, nonfarm homeownership increased from 44% to 62%, and outstanding mortgage debt ballooned from \$36 billion to over \$207 billion (Bureau of the Census 2004: Dc929-949; Carter et al. 2006a). At the close of WWII in 1944 single-family housing starts were at 114,000. In six years they shot up to 1,692,000 (Jackson 1985: 233).

Owning a home was a massive boost up the social ladder, one that was given disproportionately to veterans over non-veterans, men over women, and again, whites over African-Americans (Cohen 2003). By using formulas that favored new buildings and all-white neighborhoods, these programs played a crucial role in encouraging suburbanization (Jackson 1980).⁹⁷ They supported white flight from cities, created urban ghettos, and facilitated an accumulation of wealth among whites that in turn underscored gains in income and education (Conley 2001; Fischer et al. 1996: 139-141; Jackson 1980; Massey and Denton 1993; Oliver and Shapiro 2006; Pager and Shepherd 2008).⁹⁸ As consumer credit became increasingly mainstreamed in the postwar era, owning a home took on additional value: “a VA loan was a gift of collateral.” (Cohen 2003: 141). And as tax rates rose after the war, interest rate deductions on mortgages added to the benefit (Cohen 2003: 136-139; Fischer et al. 1996). Moreover, in a nation where homeownership has been entwined with democratic ideals, that exclusion from housing is much more than the denial of opportunity to accumulate wealth. It is the denial of one’s identity as a citizen and complete person (Dreier 1982; Harvey 2008; Purser 2010; Roy 2003).

The structure of public-private partnership in housing served to camouflage the extent of the government’s involvement in the housing boom: it also hid the extent of the government’s role in helping whites accumulate wealth and relegating African Americans to urban ghettos:

Federal interventions did more than simply structure opportunity; paradoxically, they also helped popularize the ideal that government interventions were *not* providing considerable benefits

⁹⁷ Some have argued that white segregation was fundamentally driven by a desire to protect property values. However, historian David Freund (2007) makes a convincing case otherwise. Freund shows that the evolution of housing market tools in the twentieth century helped transform racial discrimination from a logic based on bodily difference to a logic based on market value. The latter allowed whites to benefit from racist institutions without endorsing openly racist ideologies. But it would be a mistake, Freund insists, to think that the market either supplanted racism or served as a simple cover for it. Instead, he painstakingly demonstrates how a “racially constructed theory of property,” which first emerged in the burgeoning field of land-use economics in the early 1900s, became established (Freund 2007: 129). Whites “could not conceive” of neighborhoods with African American families as having value. Nor could they conceive of the ideal borrower – a person of character, reliable enough to repay a large debt – as being anything other than a white man. Walking us through the history of race, property, and lending, Freund shows that racism was built into the very structure of U.S. housing finance. Like DNA, it was hidden but powerfully generative. The U.S. government did not create this racial theory of value, but played an instrumental role in institutionalizing it.

⁹⁸ The role of the postwar housing programs in supporting homeownership and inequality has been well detailed by scholars. For their importance in promoting suburbanization, see Jackson, Chapters 10-12. Freund offers a brilliant discussion of how this transformed the practice of racism among northern whites. See Cohen for a discussion of the relationship between housing, suburbanization and consumer culture in postwar America. For more on how tax law reinforced the benefits of homeownership, see Howard (1997) and Fischer et al. (1996: 136-141). Massey and Denton (1993) and Oliver and Schapiro (2006) have produced landmark sociological studies of how these programs promote racial stratification.

to white people. Public officials, their private sector allies, and even federal appraisal guidelines assured whites that state interventions neither made suburban growth possible nor helped segregate the fast growing metropolis by race. They promoted a story that urban and suburban outcomes resulted solely from impersonal market forces. Not surprisingly, white homeowners, particularly in the suburbs, embraced this narrative and made it a central refrain in local debates about housing, race, and inequality. It was this story about market-driven growth and market-driven inequality that enabled countless white people to insist that their support for exclusion was not a racist act. (Freund 2007: 9)

Government housing agencies worked with a set of organizations representing home-builders and mortgage lenders, organizations that had gained a good deal of influence in the first half of the twentieth century (Von Hoffman 2008; Weiss 1987). This promoted the notion that the housing programs were not interfering with or directing in the market, and that whites had pulled themselves up by their bootstraps, without government help, as David Freund (2007) explains.

An Example of the Hidden Credit State: Fannie Mae in the Postwar Era

The structure of Fannie Mae is a great example of how indirect policy tools serve to camouflage the government's role in bolstering markets. As Fannie Mae grew it incorporated a variety of functions, some of which conflicted, creating a somewhat schizophrenic agency. Take, for example, Fannie's complex relationship to monetary and fiscal policy. Fannie Mae's charter was to inject money into the mortgage market during downturns, and then resell those mortgages: that meant it affected the money supply (Cole 1979: 292). Albert Cole, who was head of the Housing and Home Finance Agency (the precursor to the Department of Housing and Urban Development) from 1953 to 1959 thus noted that "Fannie Mae had a sensitive position in the Executive Branch as its activities played an important part in the monetary and fiscal policy as viewed by the Congress, the Treasury, and the Federal Reserve System . . . [T]he Administration, by exercising its judgment through the HHFA, had an important stake in FNMA's marketing policy." (Cole 1979: 292) Fannie Mae's activities were not always coordinated with the Federal Reserve. For example, in 1954 it sold off a large group of mortgages at a time when the Fed was trying to ease credit (Jones and Grebler 1961: 126). However, sometimes Fannie Mae was directly used in this capacity: from 1957 to 1959 Fannie Mae spent over \$2.5 billion in order to offset an economic downturn (Cole 1979: 292-293). This contradictory nature was a tricky compromise that government officials negotiated over time.

Table 4.5: The Structure of Fannie Mae, 1954-1968

Program	Description	Financing
Management and Liquidation	Warehoused and sold \$2 billion of loans from 1954 and earlier	Treasury and FNMA bonds
Special Assistance Programs	Supported specially designated programs, like defense and special needs housing.	Treasury (congressional and presidential authorization)
Secondary Market Operations (SMO)	Managed the secondary market for new FHA and VA loans mortgages through buying, selling, issuing and warehousing debt	As of 1954 it started to phase out Treasury holdings through sale of stock to companies that use FNMA

In recognition of its multifaceted nature, and in response to the economic recession of 1952-1953, in 1954 Fannie Mae was reorganized into three branches, each with a distinct objective (Aaron 1972: 92; Carliner 1998: 308; Freund 2007: 192; Jones and Grebler 1961: 127-128; Vidger 1961). The three branches are listed in table 4.5. The Management and Liquidation (M&L) branch was a warehousing and sales agent for government-owned loans accumulated through the old RFC programs and other credit agencies. The Special Assistance (SA) branch supported favored government projects like defense and special needs housing, and was funded by the Treasury. The Secondary Market Operations (SMO) was in charge of buying and selling FHA and VA loans.

Fannie Mae's SMO branch is especially interesting because it was its own organizational hybrid. In the 1954 reorganization, the SMO branch was set up as a quasi-private corporation that was supposed to eventually become fully private. In practice, this meant that government officials ran the SMO branch, and that the branch also issued stock that was privately owned. Any company that Fannie Mae bought mortgages from was required to buy Fannie Mae common stock in turn (first to the tune of 3% of the amount of the sale, then later to 1-2%) (Jones and Grebler 1961: 36). It was also authorized to issue its own debt, and by the end of 1960 its common stock amounted to \$73 million, and it had issued \$2.2 million in bonds (Jones and Grebler 1961: 131). The SMO, like a private corporation, was not supposed to provide subsidies by buying mortgages at favorable prices. Instead it was directed to be self-supporting and buy mortgages at market rates. Yet for all the talk of being an independent company, Fannie Mae's SMO function was, in the end, fully part of the U.S. government (in the next chapter I will discuss in some detail how Fannie Mae came to be spun off from the federal government in 1968). The Treasury held all of its preferred voting stock. The Secretary of the Department of Housing and Urban Development was the Chair of its Board of Directors and appointed the other four board members (FNMA 1966: 41-42). Moreover, Fannie was authorized to borrow up to \$1 billion from the Treasury.

Fannie Mae's status was fundamentally ambiguous.⁹⁹ Its SMO branch was a private corporation directed by a government official and housed within a government agency. Because it was halfway between public and private, its meaning was effectively

⁹⁹ The ambiguous nature of Fannie Mae was compounded by the way it was reported on the federal budget, a point that I will explain in more detail in the next chapter.

up for grabs, and was easily misrecognized as capitalism at work. The federal government created a hybrid corporate form, and then Americans looked at it through laissez-faire glasses. In other words, the cultural dispositions that gave rise to public-private partnerships also meant that Americans tended to then classify that hybrid as “market” and not “state.” This made it possible for Americans to largely overlook the importance of the federal government in the housing market, and so facilitated the notion that the nation was laissez-faire.¹⁰⁰

Conclusion

The expansion of property ownership before the New Deal was fitful and turbulent, but in the years after the Second World War, federal programs counteracted the sting of credit shortages and provided a safety net for homebuyers and sellers. Fligstein (2001) has argued that governments are key to creating order and stability in markets, as they play a pivotal role in setting and legitimating the institutional structures that provide stability. This has certainly been the case with mortgage credit. Credit programs helped create this stability by changing the rules of the game in mortgage finance. From a sociological standpoint, changing the rules of the game is no small thing. Sociologists have argued that a good way to think of markets is as a field, that is, as a social space where people compete as they strive toward a shared goal (Bourdieu and Wacquant 1992; Fligstein 2001). Any given field is organized by institutions, which are rules, common understandings, and regular practices that render the field navigable and sensible for those in it:

Most generally, we may say fields emerge whenever we find a set of institutions that individuals tend to traverse in predictable ways with minimal dislocation of subjectivity. In all cases, the field is something that spans and coordinates institutions by allowing individuals to understand their past, current, and future situations in terms of position, trajectory, and similarity or closeness. (Martin 2003: 39)

To the extent that U.S. housing finance constitutes a coherent and stable field that is connected to national capital markets, it has been profoundly structured by federal credit programs that pioneered its central institutions: the length and structure of loans, who is considered a viable borrower, and the way payments are structured. In doing so, these programs helped shape where and how Americans lived and the distribution of resources and opportunities among groups. They were able to exert such a powerful influence by innovating an indirect, collaborative method that assured the populace that the free market was supported but not directed.

¹⁰⁰ This is not to say that similar programs do not exist in other nations. However, comparative studies of political and economic life (see Dobbin 1994 and Fourcade 2009, for example) would suggest that how these practices are implemented and what they mean might take very different form in other contexts. One of the implications of this dissertation is a comparative study of credit programs would allow for additional insight into the extent to which this pattern is unique to or distinct in the U.S.

According to Kevin Gotham Fox, in the 1990s the credit program USAID would work to promote a more global system of housing finance:

The U.S. federal government, through the United States Agency for International Development (USAID), has played a key role in encouraging the development of international real estate standards, housing policies, private property rights, and real estate financing mechanisms. Since 1992, the USAID has partnered with national groups such as the U.S.-based National Association of Realtors (NAR), the largest trade organization in the world, and European groups such as the European-based International Real Property Foundation (IRPF), the Eastern European Real Property Foundation (EERPF), and the Central European Real Estate Association (CEREAN) to support real estate privatization efforts in nations such as Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia, Moldova, Georgia, and Ukraine. Partnerships between the USAID and other groups also aim to establish professional ethical standards, appraisal standards, licensing laws, lending practices, mortgage finance systems, and regulatory institutions to attract and retain foreign real estate investment. (Gotham 2006: 253)

This suggests that the events recounted in this chapter increasingly matter globally, not just because other nations have come to invest in the U.S. market, but because programs like USAID may reproduce the American system of public-private partnerships around the world.

Government credit lending before the New Deal had been scattered but not insignificant, even on the federal level. Throughout the nineteenth century the federal government used loans and guarantees to support industry, especially for capital-intensive publicly used transportation projects like canals and railroads. At the close of World War I, credit aid even crossed the nation's borders, with the U.S. government lending money to Cuba, Nicaragua, and Argentina to sell off excess war supplies and help encourage trade (Fetter 1925). But that credit lending, on the whole, had been temporary, uncoordinated, scandal-ridden, and local. In the previous chapter I argued that the Federal Farm Loan Act of 1916 heralded a shift in this field, as mortgage lending became a target and not just a tool of federal intervention. In this chapter I showed how federal credit aid became a tool the federal government systematically used to intervene in the economy during the New Deal, a trend that continued in the postwar era.

Federal credit aid is an important facet of government intervention in the economy. Credit programs were a seminal part of the New Deal, and they proliferated in the postwar era, when they were used to support education, international trade and development, and industry. They have had a profound affect on the structure of the mortgage market and on the distribution of opportunity for upward mobility in the United States. Beyond this, credit programs help shed light on why government intervention in the U.S. economy is so commonly misrecognized: because the government frequently

relies on very complex hybrid forms, collaboration with private actors, and tools like guarantees whose ephemeral nature contribute to a massive cultural blind-spot.

There are two final points I would like to make about them. First, sometimes public-private collaborations, hybrid corporations, and other kinds of indirect market policies are seen as an *alternative* to advanced industrial capitalism, or as a stage that a developing nation goes through on its way to defining clearer boundaries between the state and the market (see, for example, Stark 1996). The above chapter suggests in contrast these mixed forms are in fact something that advanced and developing economies share, though the specific forms they might take in a given time or place may vary. The flip side of this is that we should not expect indirect forms like credit programs and hybrid corporations to be unique to the United States, but rather that we should expect to find them in a variety of countries where they might be used for a variety of reasons and understood in a variety of ways.

Second, sometimes scholars interpret the use of indirect policy tools in the U.S. as a recent phenomenon, or specifically as a reaction to Neoliberalism (see, for example, Block 2008; Krippner 2007). But this chapter suggests that the use of indirect policy tools and credit programs are part of a long tradition of statecraft in the U.S. That these kinds of tools have been consistently used within the federal government since 1916, and that the greatest push forward in their use happened under Roosevelt in the New Deal, suggests that deeper underlying causes may be at play. In the introduction I proposed three of those underlying causes: a general distrust of state intervention, paired with a fractured government, and the structure of U.S. budget politics. The next chapter shows how those forces influenced the nature of the Johnson Administration's housing reforms in the late 1960s.

Chapter 5: Transformation, 1960-1968

Understanding the present requires resurrecting the discarded ghost of budgets past.

Aaron Wildavsky, 1987

While there is nothing inherently wrong in trying to devise characteristics for securities that will make them more marketable, the rub comes when the ultimate objective is to create securities that are indistinguishable from direct government debt, and yet still preserve some rationale for not counting the issues as a means of financing budget deficits or against the Federal debt ceiling - a clear case of trying to have one's cake and eat it too.

Bruce MacLaury, Chair, Federal Reserve Bank of Boston, 1973

It should be clear by now that the housing sector is not just about dwellings, but that it holds a special place in the American economy and imagination. As happened at earlier points in American history, in the postwar era groups that otherwise disagreed found that they could agree on homeownership as a shared goal, in part because it promised prosperity for all while demanding sacrifice from none. Elizabeth Cohen argues that from the 1940s through the 1970s, consumerism built on the foundation of suburban homeownership became a civil religion in the U.S. Its appeal, she argued, was not just that it promised prosperity, but that “it promised the socially progressive end of economic equality without requiring politically progressive means of redistributing existing wealth.” (Cohen 2003: 127) Americans continued to define themselves in terms of homeownership, and American politicians continued to encourage them to do so. A good example of this is the Housing Act of 1949, which promised a “decent home and suitable living environment for every American family” (Aaron 1972: 2, 38; Truman 1949; Von Hoffman 2000: 306). Here again the government was careful to use partnerships with the housing industry and to avoid stepping on their toes. In announcing the Act, President Truman assured the public that this would “supplement” but not displace the market:

The Housing Act of 1949 also establishes as a national objective the achievement as soon as feasible of a decent home and a suitable living environment for every American family, and sets forth the policies to be followed in advancing toward that goal. These policies are thoroughly consistent with American ideals and

traditions. They recognize and preserve local responsibility, and the primary role of private enterprise, in meeting the Nation's housing needs. But they also recognize clearly the necessity for appropriate Federal aid to supplement the resources of communities and private enterprise. (Truman 1949)

The Jeffersonian ideal of the yeoman farmer that transformed into a cult of homeownership in the nineteenth century again morphed to reflect the changing times. It now came to represent a new age of prosperity grounded in consumerism of families living in suburban detached single-family homes that were, of course, well-stocked with consumer goods (Cohen 2003: 73). Problems in the housing market therefore had deeply symbolic ramifications.

By the 1960s the nation's system of credit support discussed in the previous chapter was showing signs of strain (Aaron 1972; Cohen 2003: 235; Green and Wachter 2005; Krippner forthcoming: 89-105; Sellon and VanNahmen 1988: 100-104). The Federal Home Loan Banks and Fannie Mae had eased the problem of localism by encouraging more eastern investors to invest in the mortgage market. They had not cured the problem, however, and old concerns about the patchwork market once again came into sharp focus as locally-organized S&Ls took an increasingly large share of the mortgage market at the same time that pension funds and institutional investors increasingly concentrated funds on Wall Street (Sellon and VanNahmen 1988). Reserves of capital were locked up in accounts on the East Coast, leaving homebuilders in the rapidly developing Sunbelt starved for credit. Some worried that the system could not accommodate the growing needs of the baby boomers as they settled down and had children (Aaron 1972: 1; Ranieri 1996).

These endemic problems were further exacerbated by periodic credit crunches. The worst was in 1966, when yields on US Treasury bills rose above 4 percent for the first time in over 20 years. This was a problem for S&Ls because, in order to discourage speculation, they were limited in the kinds of returns they could pay to their investors. These ceiling on rates of return were first set by the Federal Home Loan Banks, and after 1966, set by the Federal Reserve through a statute called "Regulation Q" (Haveman 1992: 55; Krippner forthcoming: 86). Higher Treasury bill yield rates meant that small investors could now get higher returns if they invested in other bonds instead of deposits, whose returns were capped (Haveman 1992: 55; Krippner forthcoming: 86-87). To make matters worse, new kinds of financial instruments, like negotiable Certificates of Deposit and the Eurodollar market, were now competing with the S&Ls for investors (Krippner forthcoming: 89-99). As interest rates rose, and other organizations promised higher rates of returns than the S&Ls, funds poured out of local accounts leaving the S&Ls with less to lend to people who wanted to buy homes, a process called disintermediation (Green and Wachter 2005). The subsequent credit shortage in housing caused the biggest dip in home building in 20 years (Fish 1979; Green and Wachter 2005).

This was an economic problem that had ramifications beyond the housing sector. In the postwar period housing was indeed the "wheel within the wheel to move the whole economic engine," as Marriner Eccles had put it. By the 1960s it was clear that changes in mortgage finance affected the whole economy. Krippner explains:

When a healthy economic expansion turned to excess and inflationary pressures stirred in the economy, market interest rates offered on Treasury bills and corporate debt instruments rose above Regulation Q ceilings, prompting the withdrawal of funds from depository institutions as investors sought instruments carrying a competitive rate of return. In such circumstances, rising market rates could cause a sudden outflow of deposits from commercial banks and thrifts. These episodes of “disintermediation”—so called because they disrupted the typical function of savings institutions, which was to *intermediate* between suppliers and users of funds—contracted the capital available for new lending, affecting mortgage loans especially severely. An acute recession in the construction and housing industries quickly dampened activity in other sectors, restraining the broader economy. As the economy slowed and market interest rates fell, the mechanism would quickly go into reverse: market interest rates below regulated ceilings drew capital back into depository institutions, which began lending anew, restarting economic expansion. (Krippner forthcoming: 86-87)

Armed with this knowledge, the government manipulated rates at the S&Ls through Regulation Q to alternately slow down or speed up the economy. Since housing was the pump primer for the economy, politicians were painfully aware that a problem with that sector could have severe economic ramifications.

If politicians were not already sensitive to the importance of housing in the U.S., they could count on a powerful housing lobby to remind them (Cohen 2003: 158; Von Hoffman 2008). Following a massive consolidation of the homebuilding industry during the Second World War, and the turn toward large tract-development in the model of Levittown, large homebuilders and construction companies had joined lenders as heavy-hitters in the field of housing finance:

Residential construction in the United States had always been highly fragmented in comparison with other industries, and dominated by small and poorly organized house builders who had to subcontract much of the work because their low volume did not justify hiring of all the craftsmen needed to put up a dwelling. In housing, as in other areas of the economy, World War II was beneficial to large businesses. Whereas before 1945, the typical contractor had put up fewer than five houses per year, by 1959, the median single-family homebuilder put up 22 structures. As early as 1949, fully 70 percent of new homes were constructed by only 10 percent of the firms (a percentage that would remain roughly stable for the next three decades), and by 1955 subdivisions accounted for more than three-quarters of all new housing in metropolitan areas. (Jackson 1985: 233)

The National Association of Home Builders (NAHB) accordingly grew in importance in the 1960s (Von Hoffman 2008: 4).¹⁰¹ The various housing groups were known for infighting, but they found in the 1950s that they all could agree that housing growth was good while direct government subsidies were bad (Von Hoffman 2008). In the 1950s housing groups started to figure out that housing reform based on a policy of homeownership and private development (versus public housing) was very much in their interest, and so pressured Washington to promote low income housing in addition to stabilizing the market for the middle class (Von Hoffman 2008).

The civil rights movement underscored the shortcomings and high stakes of housing policy. At the close of the 1960s, policymakers and academics diagnosed poor living conditions and government-supported housing discrimination as engines of racial inequality, and the Kerner Commission identified the resulting poor housing conditions as a main cause of urban race riots (Katz 2009: 7; Massey and Denton 1993: 193). As Martin Luther King protested poor living conditions in Chicago, Illinois Senate candidate Charles Percy argued that renting was akin to slavery, and that homeownership for African-Americans was an integral part of achieving equality and social stability: “For a man who owns his own home acquires with it a new dignity. He begins to take pride in what is his own, and pride in conserving it and improving it for his children. He becomes a more steadfast and concerned citizen of his community. He becomes more self-confident and self-reliant. The mere act of becoming a homeowner transforms him” (quoted in Katz 2009: 8). After years of lobbying from civil rights groups, in 1962 President Kennedy signed an executive order that banned discrimination within the government housing programs (Freund 2007: 178, 373-374; Massey and Denton 1993: 186-195). While these rules were not well enforced, the role of housing in promoting racial inequality was nevertheless increasingly clear. In 1966, when Lyndon Johnson appointed Robert Weaver as the first African American in the Cabinet, it was perhaps not a coincidence that it was as the head of the newly formed Department of Housing and Urban Development.

Thus in the 1960s President Johnson came under tremendous pressure to find a solution to the escalating set of housing problems that resulted in reoccurring credit crunches throughout the nation and especially poor living conditions for African Americans. This combination of social injustice and market problems posed by housing finance posed a difficult conundrum for a progressive president like Lyndon B. Johnson – especially once it combined with a fiscal crisis. For at the same time that the nation’s old problem with housing credit was reasserting itself, Johnson was unwilling to cut the Great Society Programs and Vietnam War expenses. Congress increasingly used the high cost of Vietnam as leverage to try to get Johnson to cut the Great Society programs, and Johnson’s budget inched towards the debt ceiling. This made it more difficult for him to address an increasingly expensive housing problem. The contentious institutional structure of budgeting in the U.S., as much as economic and cultural imperatives, would become crucial for organizing the Johnson administration’s response to the housing problem and led him toward securitization.

In the face of this tangle of problems, the Johnson administration eventually decided to support private investment in mortgages, hoping the market would now be

¹⁰¹ For more on the rise of homebuilders in the 1950s and 1960s, see Rabinowitz (1980: 106-126).

able to meet America's housing needs. The Housing and Urban Development Act of 1968 was a turning point in American housing finance. It quietly dismantled the system of direct government mortgage purchases through Fannie Mae that had stood since the New Deal. In its place, the Act laid the foundation for a new kind of secondary mortgage market organized around a privatized Fannie Mae and bonds backed by pools of mortgages called mortgage-backed securities (MBS). These bonds were in fact an iteration of the participation certificates (PCs) that had fueled the disastrous real estate bubble of the 1920s (discussed in Chapter 3) and had been quietly used within the U.S. government throughout the postwar era to manipulate the size of the federal budget.

In most accounts of the privatization of Fannie Mae and the creation of securitization, budgetary politics are either absent or else discussed briefly as an exogenous pressure that comes into play only at the close of the 1960s. But my research indicates that the federal budget had a more extensive influence on America's MBS, and indeed, that to truly understand the Housing and Urban Development Act of 1968, you need to understand also the political battles over the budgetary treatment of asset sales in the Federal Credit Programs.

Below I introduce why balancing the budget posed a particularly large concern for American politicians, and how they devised various means of hiding the size of federal expenditures while still continuing to stimulate in the economy. I next explain how credit programs served as a particularly useful way to intervene in the economy while circumventing the budgeting process. Here I outline the various techniques used within credit programs to do so, showing how since the 1930s government officials used asset sales (with pools and participations) to hide the extent of budget expenditures.

In the second half of the chapter, I show how President Johnson turned to these techniques as a solution to the nation's mounting fiscal and housing problems in the middle of the 1960s. With the Participation Sales Act of 1966, Johnson sought the right to sell off all of the loans held by the federal government and use the income to offset the size of the federal budget. Republicans balked and a political controversy erupted over the accounting for PCs. In the fallout, Johnson's own Commission on Budget Concepts ruled that he could not use asset sales to offset the deficit. Johnson needed a new solution to his budget and housing problems. The solution his men devised in response would transform American housing finance. They immediately spun-off Fannie Mae, and devised a plan to get private capital to take the place of government funds in the secondary mortgage market, using a version of its own controversial debt instruments to do so. That is, the government set out to build a viable private market for Mortgage-Backed Securities (MBS), and provided an array of supports for it. Before explaining all of that, however, it is necessary to first understand the relationship between the federal credit programs and the federal budget.

The 'Nameless Revolution' in Budgeting

Federal credit programs were not just ways of promoting credit markets, as discussed in the previous chapter. They were also tools for manipulating the federal budget. According to Aaron Wildavsky and Carolyn Webber (1986), the drive to achieve a balanced budget is a hallmark of early American Exceptionalism, the lynchpin of a civil

war era political compromise between those who wanted to expand the federal government and others who were leery of its potential for overreaching. The norm to match expenditures with income, except during times of war, persisted until the 1960s, though not unchanged. Notably, following the Great Depression and the introduction of Keynesian thinking, the idea expanded to allow for balance at the level of full employment – unbalanced, yes, but not without the expectation of returning to balance when economic crisis subsided (Ippolito 2003). In all, this served to limit the size of the U.S. government. “Given the public’s natural antipathy toward taxes,” writes Ippolito, “balanced budgets meant limited budgets.” (Ippolito 1984: xiii-xiv) When politicians are forced to raise taxes to fund spending, the political ramifications serve as a powerful check against the growth of government.

The pressure to balance the budget posed a problem for politicians. We know from Polanyi (1957) that economies do not self-regulate, and that their viability depends on continual management from governments (see Krippner 2007). The norm of a balanced budget constrained how much a government could spend in order to manage the economy. As a result politicians had to solve economic problems without adding significantly to the budget. Unless given the green light to spend in a time of war or severe economic crisis, they had to avoid spending, or else hide the extent of those expenditures. At the same time, the division of budgetary power between the executive and legislative branches made budgeting a high-stakes, conflict-ridden game between them (Schick 2007). These factors combined to create an incentive for budget gimmickry.

The norm of balancing the budget began to erode following the Second World War (Wildavsky and Swedlow 2001). The issue was not just that deficits became the norm following the 1960s; it was that a new set of techniques emerged that undermined budgeting altogether, and allowed government officials to spend even more than appeared on the budget. While earmarking and special funds have long been used to get around the budget process, the 1960s introduced of a new set of strategies that more fully undermined the comprehensive reporting of public spending in budgets around the world. Webber and Wildavsky classified these strategies into four types: tax exemptions that forgo revenues, entitlements that fall outside of annual controls, loan guarantees and credit pledges, and quasi-public “off-budget” corporations. Together, the practices served to undermine the role of the budget as a comprehensive account of spending. It was, according to Wildavsky and Swedlow (2001: 241), “a nameless revolution in budgeting.”

How Have Federal Credit Programs Affected the Federal Budget?

Federal credit programs were a key part of this “nameless revolution,” in part because they often did not add to the deficit. On the whole, many of the credit programs have little impact on the budget. Since the initial outlays for credit programs are repaid or offset by fees and interest payments, they tend to cover their operating costs, if not immediately then in the long-term (OMB 1963: 305). This light budgetary footprint became a powerful draw of the programs. MacLaury (1973: 211) writes, “Indeed, there is little doubt that the single most important factor that explains the growth and proliferation of Federal credit assistance is the desire to see programs funded with a minimum use of scarce budget dollars.” This point is continually reiterated among those who study the

budgetary impact of federal credit programs (Bosworth, Carron, and Rhyne 1987; Ippolito 1984; Leonard and Rhyne 2006). This ability to intervene in the economy without adding to the budget made credit programs a terrifically useful tool for politicians who were still expected to avoid excessive deficits. It also has made critics very nervous.

Critics of federal credit programs worry that removing the connection between a program and taxes, be it through budget gimmickry or running the program in an actuarially sound way, detaches that program from the main force that would otherwise limit its growth, as Ippolito (1984) has argued. As a result, there is very little to check the expansion of off-budget activities. Once established, these programs create a group of people with very concrete reasons for continuing or expanding it. Any opponents to the programs are left to argue abstractions about government power and budgeting, and often lose the battle.

Critics also worry that these very large credit programs could cost the nation more than anyone realizes. Recall from Chapter four that problems with collecting data from the decentralized web of idiosyncratic credit programs confounded those who sought to understand their affect on the economy. The same information problems have historically made it very difficult to pin down their exact costs to the government (Bosworth, Carron, and Rhyne 1987; Ippolito 1984; MacLaury 1973). One problem has to do with the structure of the federal budget. Bosworth, Carron and Rhyne (1987) explain that some of the problem is that the budget is a cash flow document, which is particularly bad at capturing the real costs and benefits of something like a loan, which is paid back. Forcing loans into that format distorts more than it clarifies, they argue, and so conclude that we should abandon the effort to include the loans on the unified budget and instead use a separate balance sheet wherein only their subsidies are included in government costs

Further, inconsistent and improper accounting among these many programs means that otherwise difficult data collection problems become nearly impossible to solve. This is an especially big problem when it comes to items like interest rate differentials that would not show up as direct spending on the budget in any case. When the government offers below-market interest rates, it is very difficult to measure the extent to which the government is subsidizing loans or is losing money (Ippolito 1984). Costs incurred by defaults on government loans are similarly difficult to gauge, in part because of inconsistent reporting among the programs, because many of them account for defaults and late payments differently, and extend repayments rather than report defaults on their books (Bosworth, Carron, and Rhyne 1987: 19). When the CBO reviewed these programs in 1978, they determined that even *estimating* default rates was impossible: “There are no good estimates of the default experience of guarantee programs. A study prepared for CBO surveyed the experiences of 22 major loan guarantee programs. Its principal conclusion was that differences in definitions and data collection procedures make it impossible to compile estimates of defaults and claims paid.”

Thus the issue is not just that these programs are excluded from the budget: it is that the information collected from these programs is so poor that we do not even know what the effect on the budget would be if they were accounted for differently. Behind known government deficits, then, lurked the specter of another deficit run in the off-budget programs. Thus many scholars have warned that this system constitutes a kind of “Hidden Spending” (Ippolito 1984), an “Underground Federal Government” (Bennett and

DiLorenzo 1982), a “Shadow Budget” (Leonard and Rhyne 2006), or a “Stealth Budget” (Webb 2002).

This marriage of bad information and great political advantages has encouraged politicians to pick these programs for questionable reasons. As Ippolito explains, without any “consensus on economic impact . . . or information about the budgetary costs” credit programs get designed “for budgetary rather than programmatic reasons.” (Ippolito 1984: xiv) This happens with the choice of whether or not to use credit support in the first place. It also happens with the choice of what kind of credit program, with what kind of funding, to use:

Fiscal considerations, i.e. impact on the Federal budget and on the public debt, heavily influence the decision as to whether Federal credit assistance is to be financed through Treasury-financed direct loans, market-financed direct loans, or Federal loan guarantees. Efforts to circumvent the budget and the public debt through the use of market-financed direct loans or Federal loan guarantees result in increased interest costs. (USHCBC 1964: xvii)

Even in the 1960s government reports openly noted that credit programs were being set up to have a small affect on the budget, regardless of whether that particular set up would be most effective on the ground or the least expensive option for the government in the long-run (USHCBC 1964: xvii).

While the credit programs as a group had a small affect on the budget, the various types of credit aid did so for different reasons. Below I outline the ways different programs affected the budget, in order to show how selling pools of government held assets became a favored way of erasing credit programs from the federal budget and avoiding congressional oversight.

Guarantees and the Budget

Guarantees and insurance programs generally contributed the least to the deficit; this helped make them extremely popular. These include three kinds of programs. First are actuarially sound insurance programs, like FHA housing insurance, which have long generated enough in fees and premiums to cover their operating expenses. Second are subsidized insurance programs, such as certain small business, student loan, and urban renewal programs, in which the government deliberately charges rates below what they believe would cover the attendant risks (CBO and Shillingburg 1978). A third kind of federal guarantee, which had been used often in the nineteenth century and regained popularity in the 1970s, was one-off guarantees of private loans to large entities for capital-intensive projects like railroads. In the 1970s this was used for a slew of energy related projects that ranged from new coalmines to research on hybrid cars to research on geothermal and nuclear energy. Large loans from the government have also been used to provide emergency bailouts (early examples include Lockheed, Chrysler, New York City). With all of these guarantee programs, the cost would only show up on the budget if the Treasury got involved to cover absorbed losses in excess of held reserves. The extra

political value derived from their off-budget status likely contributed to the rapid growth of these programs; from 1961 to 1966 alone, their liabilities shot up 75% (OMB 1965).

Inflation only partly accounts for the rise in these programs. Understanding the budgetary impact of credit programs helps us understand why the government responded to inflation in the particular ways that it did – why officials turned so often to credit programs, and within that general purview, relied so heavily on guarantees and insurance. MacLaury notes that in 1966 and again in 1969 credit crunches pushed government officials to find a way to use credit programs to improve the flow of capital. Yet even when recognizing this, MacLaury concludes that the primary motor behind the growth of guarantees and new instruments is an effort to stimulate the economy while avoiding increasing the budget (MacLaury 1973: 214). Since guarantees add the least to the budget, they have come to replace grants and direct loans as forms of intervention, especially in the field of housing. In fact, he posits that these programs have moved through a “typical life cycle” of a credit program, wherein the government support of a given program (like construction) moves increasingly off the budget, as grants give way to direct loans, which then give way to guarantee programs (MacLaury 1973: 214).

Direct Loans

The budgetary ramifications of the direct loan programs were more complicated. In the long run some of these programs were very efficient. They brought in revenues, which gave them a low net cost, and many programs were able to use collections and fees to cover their operating expenses (OMB 1963: 305-307). However, in years when the government issued a great deal of loans, disbursements ran ahead of collections and repayments and the net difference would typically be reported as expenditures on the budget.¹⁰² Even though these programs would eventually generate funds, their immediate budgetary footprint could put them in danger of being cut. This created an incentive to use guarantees over direct loans.

Another option was to fund direct loan programs through the capital markets. Since the Depression, the RFC had supplemented its direct loan program with “participation loans,” which allowed banks to issue or own part of a much larger loan. RFC also developed a “deferred participation” program, wherein a private lender issued loans on the condition that the government would agree to purchase a portion of the loan at a later date if the lending company wanted to sell it (that is, the RFC used put-options to encourage private lending). Participations were also used by the Federal Reserve Banks, and to advance public housing, urban renewal, college housing, public facility loans and others. Still, the use of participations was small compared to two other strategies: the use of corporate structure to remove an agency from a budget, and the sale of government assets. Below I explain both in more detail.

Off-Budget Corporations

Perhaps the most well known way of erasing an agency from the budget is by converting a government agency to a semi-private corporation or by allowing the agency

¹⁰² In 1964, about half of the 74 credit programs were able to use revolving funds that allowed them to recycle their revenues back into their programs (USHCBC 1964: 2)

to issue its own debt (instead of relying on the Treasury for funds). This is not just done with credit programs. The U.S. post office is an example of a non-credit related off-budget corporation. Many of the programs I have discussed in this dissertation, including the Federal Land Banks, the FICB, the Banks for Cooperatives, and the FHLB were financed through the capital markets, and so classified as private corporations that did not have to be included in the administrative budget. This has often been heralded as a very efficient use of private capital in lieu of public funds, but since the agencies had to pay more than the Treasury to borrow funds, these companies effectively sacrifice economic capital for political reasons.

Off-budget status can be organized in a variety of ways. One of the most well known is through the creation of a Government Sponsored Enterprise (GSE). GSEs are privately owned, but follow a mission that is set by governmental charter. The Treasury may have a say in their operations, and GSEs may include government officials on their boards of directors. In return, GSEs benefit from a slew of tax, regulatory, and market advantages. Perhaps more importantly, their close relationship to the government means that investors see them as especially safe investments, and so let them borrow funds at rates lower than those granted to other private enterprises (CBO and Shillingburg 1978). Table 5.1 lists agencies and companies that have been granted GSE status in the U.S.; Fannie Mae is perhaps the most well known of the group, and it is certainly the most important GSE for the purposes of this dissertation. Fannie was taken partially off budget starting in 1954 when it was authorized to issue stock and debt, but it did not actually become a GSE until the Housing and Urban Development Act of 1964 reorganized it as a privately-owned entity.¹⁰³

Table 5.1: Government-Sponsored Enterprises

Fannie Mae	Federal National Mortgage Association. Founded as a government agency in 1938. Certain operations privatized in 1954. Spun off from government with GSE status in 1968. Placed under conservatorship 2008.
Freddie Mac	Federal Home Loan Mortgage Corporation. Founded as a GSE in 1970, placed under conservatorship 2008.
Farmer Mac	Federal Agricultural Mortgage Corporation. Created in 1987.
FHLB	Federal Home Loan Banks. Created in 1932.
Sallie Mae	Student Loan Marketing Association. Created as a GSE in 1972, phased out of GSE status in 2004.
Farm Credit System	Federal Land Banks
	Federal Intermediate Credit Banks
	Banks for Cooperatives

¹⁰³ I will discuss the reasons for the Fannie Mae spinoff in more detail below.

For politicians, keeping a governmental agency off the budget, as a GSE or otherwise, can be useful for many reasons. To begin, officials have realized that moving a controversial program off budget could protect it from cuts. This is well illustrated by political battles over rural development programs in the early 1970s, detailed by Dennis Ippolito (1984: 72-75). When the Nixon administration balked at paying for very expensive, highly subsidized rural electrification and telephone loans through Rural Electrification Administration (REA), it proposed to replace the expensive direct loan program with a set of less-expensive guarantee-based programs. Congress responded by entirely excluding the loans from the budget (Ippolito 1984: 75). Congress got to have its loans, and Nixon got to have his preferred budget numbers. Off-budget status in this case was a compromise that provided political shelter to a vulnerable program.

Off budget status can be used to protect programs not just from being cut but also from oversight. This is clear, for example, with fights over the Export-Import bank in the 1970s (Ippolito 1984). In 1971, the House and Government Accounting Office moved to limit Export-Import Bank spending, and in response the Senate and President worked together to move the agency off budget, and so free it from congressional control. The Senate and the Nixon administration saw the Export-Import Bank as an important tool for promoting U.S. exports, especially in the Communist Bloc. When its loans to communist countries later became “major political embarrassments,” the agency was moved back on the budget so as to more easily control what had become, in the words of a Congressional Budget Office report, “a tool of foreign policy” (quoted in Ippolito 1984: 71).

Off-budget status had the additional benefit of providing flexibility with the budgeting process. Frischknecht (1953) makes this point in his review of the Commodity Credit Corporation (CCC). The federal budget is planned a year ahead, while the CCC’s budget varies at the last minute depending on crop and market conditions. When CCC was given corporate status, the structure was “merely a plausible fiction which serves to justify an unconventional method of financing what is in substance an integral line operation of the United States Department of Agriculture.” (Frischknecht 1953: 569). He explains:

. . . if the CCC were an unincorporated line agency in the Department of Agriculture it would still be possible for Congress to finance its operations through an authorization to borrow, such as that enjoyed by the Treasury Department; nothing about the nature of a line agency makes it mandatory that it be financed through annual appropriations. But it is probable that Congressmen would not understand this. They are accustomed to planning and controlling the line operations of unincorporated agencies through the annual budget. If the CCC were not incorporated, there would be a great deal of pressure to review and plan its operations in the conventional way. Congressmen can, however, understand the appropriateness of the possession of permanent capital resources by a corporation. *At the level of financial control, therefore, the legal form of the corporation is useful to the CCC, not because it confers legal personality or autonomy, but because it renders plausible to Congressmen an unconventional type of financing.* The “flexibility”

afforded by the corporate form is simply flexibility of the financial resources of the CCC, and analytically this flexibility is not derived from the corporate form. (Frischknecht 1953: 564) [emphasis added]

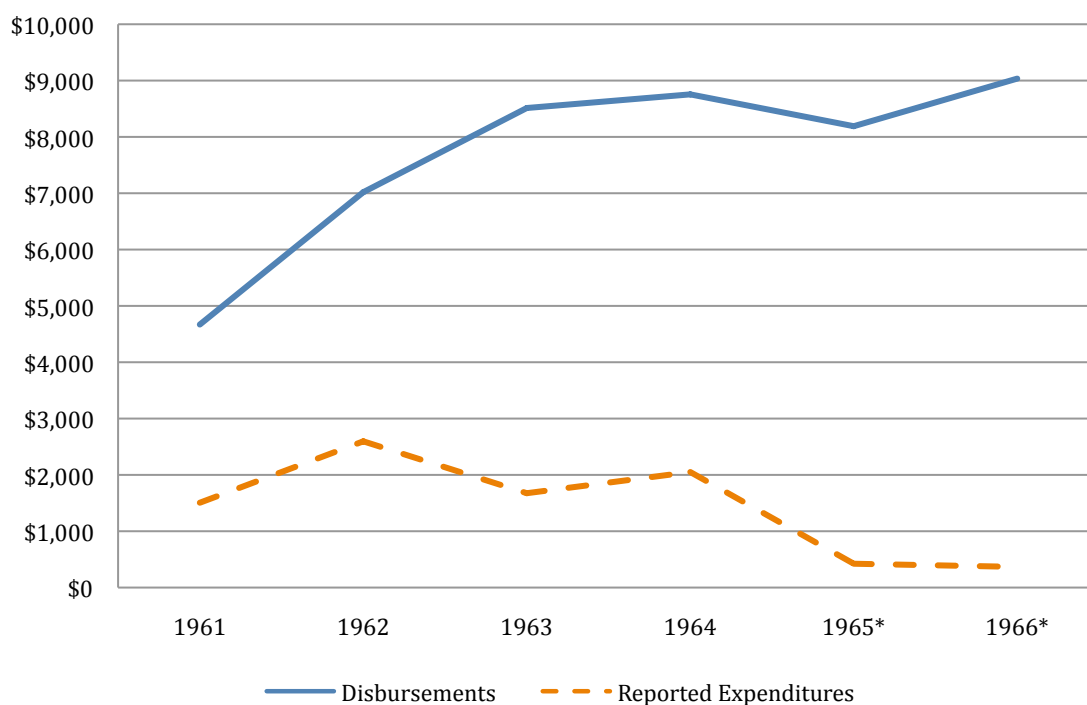
Frischknecht's fascinating insight is that what mattered for the CCC, when it was established as a government corporation, was not that it appeared to be private. On the contrary, he argues the CCC "has never been more than a lending and purchasing agent for the execution of the financial side of price-support programs" (Frischknecht 1953: 569). What matters was that the private form rendered the budgeting process intelligible to those who govern.

Asset Sales and The Budget

Another strategy for sidestepping the budget is to sell government assets. This would prove to be an especially flexible tool for managing the budget, because income from the sales were typically counted like collections and netted against expenditures, lowering the size of the deficit. Seymour Harris (1956) reports that \$364 million of assets were sold under President Truman, and \$1.78 billion were sold under Eisenhower. Both sold off accumulated assets to balance accounts. Kennedy and Johnson also relied on asset sales to lessen the size of the budget deficit. In 1963 substantial increases of lending from USAID were offset by sales at the Export-Import bank and the VA; through the use of netting, the government was able to report a relatively modest \$1.8 billion in credit expenditures for the upcoming year, even though they expected \$8.1 billion in disbursements (Tickton 1955). This was typical of the era, as the difference between outlays and reported expenditures for credit programs on the federal budget widened considerably from 1961 to 1966, as figure 5.1 demonstrates. As the 1960s progressed, asset sales increasingly made up the difference. In 1963, loan sales made up 16.5% of what was classified on government reports as repayments. By 1968 that number shot up to over 73%, meaning that nearly three-fourths of the income in the loan programs was coming from sales, not actual repayments.

The majority of these sales were through the Export-Import Bank and Fannie Mae because those agencies had the best, most sellable loans: "Most of the loans held by other federal credit programs have interest rates, maturities, or other terms which make them currently unattractive to private lenders except at sacrifice prices" (OMB 1965). Selling other government assets was useful but not always practicable. The federal credit system was made up of 74 programs and this decentralization meant high transaction costs (USHCBC 1964). Additionally, selling subsidized loans, and loans to people with lower credit, was often expensive and difficult. As officials sought to expand the sale of loans, they discovered that they needed a better way to sell them. Seeking new ways of tapping capital markets and selling off assets, they experimented with tailoring debt instruments to fit their needs. In fact, these experiments started early on. In the following section I show that officials in the credit programs, almost from the inception of those programs, had tried using various kinds of pooling techniques and debt instruments – including participation certificates.

Figure 5.1: Actual Disbursements versus Reported Expenditures of Credit Programs, 1961-1966 (millions) ¹⁰⁴



The Rise of Pools and Participation Certificates

To my knowledge, the first federal sale of bonds backed by pools of government assets happened in the 1930s, when the CCC sold off asset streams from pools of commodity loans, mainly cotton (CBO 1978). The RFC was the next government agency to sell bonds collateralized by pools of loans in 1953. At the time RFC was being disbanded and the government needed to do something with the over \$2 billion worth of assets it held or administered. Its foreign loans went to the Export Import Bank, its disaster loans went to the Small Business Administration, and its mortgages went to Fannie Mae (USHCBC 1964: 203). 2,848 leftover smaller loans totaling \$73.4 million were collected into a “RFC Loan pool,” which collateralized certificates of interest that bore a 3% interest rate.

On September 28, 1953, the loans and securities portfolio of RFC, net of the assets later transferred (as described above), amounted to 6,650 loans, securities, and commitments totaling \$618.6 million. There were 4,628 direct business loans and commitments outstanding amounting to \$395.5 million and RFC was committed,

¹⁰⁴ **Note:** Asterisks denote that amounts for 1965 and 1966 are estimates. Actual amounts are provided from 1961-1964. **Source:** *Special Analyses: Budget of the United States Government*, Washington, D.C.: Executive Office of the President. 1963, 1964, 1965, 1966

on a deferred basis, to purchase participating shares in 1,676 business loans for \$26.4 million. The outstanding balances on these loans ranged from under \$100 to \$48.4 million. To dispose of the smaller business loans in its portfolio RFC with the cooperation of a committee of commercial bankers appointed by the American Bankers Association and the Association of Reserve City Bankers established an "RFC Loan Pool." For this pool 2,848 loans, with individual balances outstanding, except for 2, under \$500,000 and aggregating \$73.4 million outstanding, were selected. To obtain immediate cash on these loans, the "pool" sold certificates of interest, bearing interest at the rate of 3% percent per annum to nearly 1,000 banks and private investors. The certificates, each representing an undivided share of the pool loans, totaled \$47.2 million and were retired by July 5, 1956, out of repayment of the pool loans. In effect, the certificates of interest arrangement gave the participants a 3%-percent return on short-term loans, collateralized to the extent of 156 percent by loan assets whose repayment was reasonably assured. In December 1953 the Treasury 90-day bill rate was 1.63 percent; the interest rate on 9-12 month Treasury obligations was 1.61 percent; and the interest rate on 3-5 year Treasury obligations was 2.20 percent. (USHCBC 1964: 203)

These were sold in September 1953.

A month later the CCC used a similar structure to sell certificates of interest that were collateralized by a pool of its loans. This was apparently an emergency measure taken in order to counter a budget overage of over \$1 billion. However, the pool was poorly structured and the U.S. government ended up repurchasing the loans from investors the next year for \$1.5 billion (Tickton 1955). Despite this failure, agencies continued to experiment with these new debt instruments.

In 1962 the Export Import Bank adapted the use of the pooling technique, this time using the same kind of participation certificates (PCs) that fueled the 1920s mortgage boom. In this case pooling was useful because the Bank did not have to release the names of the countries whose loans were being sold off. This anonymity allowed both the U.S. government and those countries to avoid potential political embarrassment from the sale (Tickton 1955). Two years later the Omnibus Housing Act of 1964 authorized Fannie Mae to sell off participations in \$300 million in mortgages. As the *Wall Street Journal* reported, this "concentrated the benefit" of repayments on those loans into 1964 and offset \$300 million of spending in 1964 (Jessen 1964). The law was passed on September second, and the PCs were sold by October 19th (FNMA 1966: A16-A-17). The next year President Johnson sent Robert Weaver a letter saying that he was "extremely pleased" about the PC sales *because of their budgetary results*. Looking ahead, he wrote: "As you know, the receipts generated by this offering will reduce our 1965 budget expenditures and this make a substantial contribution toward achieving our 1965 expenditure goal." (quoted in FNMA 1966: 45) By the end of 1965, the U.S. government sold \$1.2 billion of PCs (FNMA 1966: 17).

The Controversy over Federal Participation Certificates

As costs of the Vietnam War and Great Society programs pushed the budget towards the debt ceiling, the Johnson Administration moved to massively expand the use of PCs with the Participation Sales Act of 1966 (1966c; Janssen 1966a).¹⁰⁵ Johnson saw lending programs as a key element of his Great Society agenda. A governmental staff paper later commented on this,

It is clear that the Executive Branch of the Government considers the Participation Sales Act as a tremendous breakthrough in financial management of Federal lending programs. It is also clear to many that Federal lending will be an increasingly important vehicle for the expression of public priorities in coming years. . . .

Financing of Federal lending programs by direct Treasury debt issuance, of course, means financing under the public debt limit. Financing by the issuance of agency issues is outside of the debt limit. Therefore, in addition to the obvious desirability of having a business-type enterprise stand on its own feet by doing its own borrowing, a further incentive is given to a preference for agency borrowing as a way to get around the debt limit when that limit is pinching the treasury rather badly. (BOB 1967b: 12, 15)

Thus it seems that Johnson fully grasped the potential of finance as a means of intervention into the market, one that would allow him to assert his priorities while avoiding congressional accountability and a fast approaching debt limit.

In its original form, the Participation Sales Act would have authorized Fannie Mae to sell \$33 billion in loans held throughout the US government. Johnson touted it as a way to save money by substituting private for public credit:

The Participation Sales Act of 1966 will permit us to conserve our budget resources by substituting private for public credit while still meeting urgent credit needs in the most efficient and economical manner possible. It will enable us to make the credit market stronger, more competitive, and better able to serve the needs of our growing economy. But above all, the legislation will benefit millions of taxpayers and the many vital programs supported by Federal credit. The Act will help us move this Nation forward and bring a better life to all the people. (Johnson 1966)

¹⁰⁵ The analysis in this section draws primarily from original archival research at the President Johnson Archives and the National archives in summer and fall of 2008, and the personal papers of Sherman Maisel. See Appendix A for more details. I have supplemented this with accounts from historical newspapers. For a complimentary account of the Participation Sales Act of 1966 and the PCBC, see CBO 1978: 87-91.

Yet this proposal faced fierce resistance from Republicans, and the final version of the bill allowed Fannie to broker only \$11 billion worth of loans from six agencies. Still, that would have given Johnson plenty of leeway. In 1965 the permanent debt limit was \$285 billion, but the year started with a temporary debt limit of \$324 billion (CQ 1966). By the end of the year Congress raised the debt limited was to \$328 billion. In 1966 they raised it again to \$330 billion, and then up to \$336 billion for 1967. So in a time where Johnson and Congress are continually negotiating over the budget limit in \$2 to \$6 billion increments, the capacity to lower the budget by \$11 billion over a series of years could be extremely valuable.

At the center of the debate about the Participation Sales Act was concern over how to account for the participation sales in the Federal Budget. Part of the problem was that the PCs were issued with a guarantee of payment of principal and interest from the government. This meant that in the last instance the Treasury would be on the hook if something went wrong with these deals. Some looked at this arrangement and asked: If the government processed the loans and retained their risks, then had it really sold the assets? And if this wasn't a real sale – if the Treasury was really on the hook just as it was for other government bonds – then wasn't this just another way of raising money? By this logic, the government hadn't reduced expenditures at all. It had done the opposite – it had issued a new kind of debt. Instead of spending less, it owed more.

First in committee and later on the floor, Republicans rallied against PCs. Many longstanding debates about how to best finance and account for credit programs found voice in their objections. Republicans branded this a dangerous budgetary gimmick designed to “camouflage” the full extent of the Administration's spending, as a kind of “backdoor” accounting that bypassed appropriations while it concentrated power in the hands of the President. The sales were thought to render the budget ceiling toothless and the deficit meaningless. In a statement of his individual view, Rep. Paul Fino articulated how private capital could be used to manipulate public accounts. “Like all ‘crisis economics’ proposals,” he said, “this scheme blends economic shakiness with political opportunism.” He continued:

The real reason for private capital being desired is that while Treasury borrowing would be of no budget camouflage assistance, private funds obtained through pool participation sales refinancing can be chalked up on the plus side of the budget ledger.

Under the guise of “recruiting” private capital to share the burden of Government capital, the administration is offering a program the real thrust of which, in budget deficit years, the extent of the budget deficit can be camouflaged by receipts gained from a sale of Government assets for private funds. I hardly need to add that this is a mechanism for economic and political fraud. (USHCBC 1966: 33)

Republicans further recycled concerns about the high costs of financing outside of the Treasury. Since Fannie Mae could not issue debt as cheaply as the Treasury, and since the government would have to subsidize some of the deals, participation sales meant the

government would be paying a premium to hide the size of the budget: “What really happens though the participation device is that pooled assets are not sold, they are really refinanced in a more costly way because Fannie Mae cannot borrow as cheaply as the US Treasury” (USHCBC 1966: 18).

Republicans insisted that if this were a true sale of assets they would have supported it, but that this was not a true sale. They objected that the purchaser would not receive a title to the pooled asset or a pro rata interest in the pool, but rather “interest at a rate stated in the participation certificate” (USHCBC 1966: 18). They further noted that, “the agency pooling the loan continues to bear the responsibility and burden of servicing the loans. The agency pooling the loans remains exposed to the risks of default.” (USHCBC 1966: 18). Finally, they warned that the credit protection ran into moral hazard problems: since any bad debts were backed with credit protection from the government, they would sell at the same price as a good debt. The Minority Statement, House Banking and Currency Committee Report on the *Sale of Participations in Government Agency Loan Pools* decried the dangers of the abuse of credit protections:

. . . It makes no difference as to what the quality of these assets are. It makes no difference as to whether maturities are “short” or “long.” It makes no difference what the rate of interest on the asset is. The poorest of them and the most desirable from an investment point of view could be pooled and participations sold against them. They would be just as readily marketable and they would sell at the same rate of interest as participations sold against a pool of the best of these assets. The reason for this is that the investment quality of the participations is established by the FNMA [Fannie Mae] guarantee of the participations, in turn backed by an unlimited draw on the U.S. Treasury, rather than by whatever the quality of the assets pooled.

This is a neat gimmick. Indirectly government credit could be used to effect a reduction in the Federal debt.

The miracles of bookkeeping are indeed marvelous! (USHCBC 1966: 22)

Publicly, Democrats conceded that PCs padded the budget, but they also insisted that the primary impetus behind the bill was to bring private funds into the market (CQ 1966: 129-135; Johnson 1966). Privately they were sometimes more candid. In a letter to Johnson’s Special Assistant Barefoot Saunders, Democratic Representative Brock Adams explained, “The deficit is so bad that many of us who believe that these assets should be used either for emergencies or for long-term benefits and not to simply cover operating deficits have supported them because of the emergency caused by the Viet Nam spending” (Adams 1966). Privately they also stated that they were doing just what earlier Presidents had done. In a telephone conversation that February with Gerald Ford, at the time a Congressman representing Michigan, Johnson pressed the Republicans to back off the PC issue. “You folks started this under Eisenhower,” Johnson reminded him, before making it clear exactly how he thought he was being treated by his opponents: “I’m a country girl. I can feel it when you’re doing it to me” (Johnson and Ford 1967).

A close look at what happened when it was time for the government to sell PCs in 1967 suggests that for the White House, manipulating the budget indeed took precedence over drawing private funds into the mortgage market. Recall that rising mortgage rates had caused a credit crunch in housing in 1966. In response Fannie Mae had purchased over \$4 billion worth of mortgages. Johnson was eager to offset this, even in part. But selling participations in mortgages would divert funds from private investments, making money even tighter. The housing industry objected, and the Treasury sent a memo to the President telling him to avoid issuing PCs until market conditions changed (Janssen 1966b). Johnson now had to choose between what was best for the housing market and what was best for his budget. In a game of “financial chicken,” the White House delayed the sale of PCs hoping for better market conditions to come around. (1967b). But regardless of what state the market was in, they would only delay the sale of PCs until the middle of 1967 so as make sure the sales could be counted in the budget. At this point, the administration worked to reduce the impact of the sale on the housing market. Johnson and the Treasury considered *selling all the PCs back to the government*, but rejected this as a possibility because it would cause political embarrassment (1966d). Instead they had the Trusts invest in a smaller portion of the PCs (1966b; 1966g). Contrary to his statements about bringing private funds into the housing market, in 1967 Johnson released as few PCs onto the market as he could politically get away with.

Reviewing the Budget

Johnson won the battle over PCs, but it cost him. His credibility gap, so infamously associated with the Vietnam War, now caused problems with the budget. A staff paper prepared for a presidential commission to review the budget points to this:

Whether or not the criticism is valid, it may be fairly said that the treatment of participation certificate sales as a reduction in budget expenditures and budget deficit, particularly since they have become sizable in amount, has perhaps done more to undermine public and congressional confidence in the integrity of budget totals than any single other issue. (BOB 1967b)

Henry Fowler, head of the Treasury, tried to convince Johnson that the best way to handle the PC controversy was to openly address it. He sent a memo to the White House explaining that debates about the budget were increasingly heated and acrimonious, citing the participation sales act as a “prime example” of this (Fowler 1967). In order to smooth the waters he recommended the President convene a special committee to review the budget. Fowler argued that the political advantages of a more transparent budget (and, through that, protection from accusations of budget gimmickry) outweighed the potential negative of less flexibility. And in a phone conversation with the President, Fowler warned that the Republicans would continue to use the issue to “try to make some great common cause out of this budget gimmickry business.” Fowler calmly made his case to the President:

I've told Charlie Schultz that you should set up [a committee] amending the budget to provide a way of handling of certain controversial items in the budget. No sense in your getting blamed for what Kennedy did, Eisenhower did, Truman did. As long as that budget accounting act is as loose . . . It has its advantages and it does have flexibility, but I think the best answer to the Republicans on this is to say, 'We're perfectly ready to go by the book if someone will write the book. But the book hasn't been written.' They're going to make a big issue out of this. (Johnson and Fowler 1967)

Johnson was swayed. Three months later the White House announced that it had appointed the President's Commission on Budgetary Concepts (PCBC) to make a "thorough study" of the Federal Budget (PCBC 1967: 105). It would be headed by banker David Kennedy, and its members would include the heads of the Treasury, Bureau of the Budget, and General Accounting Office. The Chair and two minority members of the Appropriations committee would also serve on the PCBC, alongside a set of private experts.

The Commission called for a complete overhaul of the federal budget and the creation of the new "Unified Budget." This would be the most significant change in federal budgeting since the executive budget was created in 1921. The Commission's members reached consensus on everything *except* PCs (BOB n.d.: 29). Over the strenuous objections of the Secretary of the Treasury, Henry Fowler, and the Director of the Bureau of the Budget, Charles Schultze, the Commission concluded that PCs were not a true sale of assets, which meant they were liabilities:

In one sense, the sale of shares in a pool of loans is but a short, logical step beyond the sale of the asset itself; but it is a crucial step. When an asset is sold, the Federal Government retains no equity in it although it usually guarantees the loans it sells. When it is pooled, however – and participation certificates sold in the pool – the ownership (though not the beneficial equity) is still retained by the federal government. Interest payments on the loan continue to flow to the Government and the Government continues not only to incur servicing costs but also to assume fully the risk of default on any individual loan as far as the investor in the participation certificate is concerned. (PCBC 1967: 55)

The PCBC had concluded that if the government serviced the loans and held the risk, then the government owned those mortgages. This refuted the logic that ownership inhered in revenues and so could be parsed from risks and removed from balance sheets. This ruling would not merely prevent PCs from being used as budgetary reductions; now considered a liability, they would add to the deficit. This ruling was therefore a *political* problem for the Johnson administration (Treasury n.d.: 15).¹⁰⁶

¹⁰⁶ See, for example, the Administrative History of the Treasury: "This was an extremely difficult issue because of its political connotations." (Treasury n.d.:15)

The PCBC's decision triggered both the privatization of Fannie Mae and the decision to use mortgage-backed securities instead of PCs. Johnson's men recognized that the new accounting treatment meant that Fannie Mae's secondary market operations (that is, the part of Fannie Mae that purchased extant mortgages) would become very difficult to fund if they were listed on the budget without offsets (Lapin 1968). At the same time, they felt that disregarding the President's own commission would be a "political impossibility" and a "major tactical mistake" (1968a; Pierson 1968). They had to find a new solution to their problem with the budget.

Reimagining Housing Finance

A series of committees about mortgage finance had been meeting since 1966. Headed by James Duesenberry of the Council of Economic Advisors, who worked closely with Sherman Maisel of the Federal Reserve, the committees had been working through various options for reforming housing finance, which included replacing Fannie Mae with a private company, as well as the possibility of creating a long term mortgage-backed bond to replace the PC. Following the PCBC's ruling, these committees were given priority.

At this point things moved quickly. Before the Commission's report was even published, Duesenberry and Maisel convened as part of a Mortgage Finance Task Force. Among the many issues repeatedly considered by the Task Force was how to ease investors' credit concerns, and how to adjust or replace the PC, so that investors had access to a debt instrument that was more broadly useful (1967c; CEA 1967a; CEA 1967b; CEA 1967c; CEA 1967d; Maisel 1967). The new bond they discussed would eventually take the form of Pass-Through Certificates, which many people consider to be the first modern MBS. The Senate Housing and Currency Committee would later comment on the potential usefulness of these new instruments, arguing that if private companies started using them in large amounts, they could help attract more capital to mortgage markets (USSCBC 1968: 79).

At the same time as the government moved forward with its plan to develop a market for a new kind of mortgage bond, the White House began working with the Department of Housing and Urban Development and the Bureau of the Budget to spin off Fannie Mae (Lapin 1967). Fannie Mae would be split into two organizations. Functions considered essential to the government would be incorporated into a new government agency, the Government National Mortgage Association, or Ginnie Mae. This new agency would be authorized to guarantee MBS issued by approved private companies for mortgages already insured by the FHA or VA. Thus the pools as planned at this point involved two kinds of governmental guarantees: (i) the FHA and VA's insurance of the loans going into the MBS pool, and (ii) a guarantee from Ginnie Mae of the return of principal and interest. The first guarantee protected the company issuing the debt in the case that homeowners defaulted; the second guarantee of the pool itself protected investors if a company that issued the securitized bonds defaulted (Black, Garbade, and Silber 1981). Johnson's men had earlier considered eliminating the second government guarantee, because they worried that it could raise the very accounting objections they were working to solve (1966e). But the bankers they consulted insisted that investors would rather buy Treasury securities and would only invest with some kind of guarantee

(1966e; CEA 1967c). The White House, under pressure to avoid the debt ceiling, went ahead with the second guarantee. One government official later boasted, “the double federal guarantee should produce a virtually riskless security with broad market acceptability.”(BOB 1967a) Eventually investors became comfortable enough with MBS that they no longer required such strong support. Still, the historical data suggests that these guarantees helped normalize and establish the MBS market in the first place.

Whereas Ginnie Mae would retain essential government functions, the rest of Fannie Mae was to be reorganized. The spin-off planning committee believed that Fannie would need to be highly leveraged to be successful, so that it could still act like the government in its activities. They proposed to congress that Fannie Mae should have no debt to equity ratio; if that met resistance they suggested a ratio of 25 to 1 (1968b). Even at the dawn of the securitization market, MBS promoted a high degree of leverage.

Table 5.2 summarizes the differences between the government PCs before 1968, and the early MBS. One big difference was the legal status of the trustee; since Fannie Mae was now a GSE, the trust was considered outside the boundaries of the federal government. Another big difference was that the cash flows of the MBS were designed to reflect a true sale of assets. To that end, investors received a pro rata share of the pool and funds passed *directly* from the pool into the hands of investors. The payments were no longer adjustable. Yet the credit risks associated with its new mortgage bonds would continue to be largely absorbed by the government, just as with the earlier PCs. A Ginnie Mae guarantee and a \$2.25 billion line of credit at Fannie Mae (and later at Freddie Mac)¹⁰⁷ meant that the Treasury was on the hook if there was a credit problem with these pools. But because Fannie Mae was issuing the bonds, and was now privately owned, and because the sales were structured differently, these debt instruments would not be considered government liabilities under the guidelines laid out by the PCBC.

Table 5.2: Comparing Government Pools and Early MBS

Category	Government Pools	Early MBS
Originator	Private Companies	Private Companies
Credit Risk Holder	U.S. Government	U.S. Government
Holder of Assets	Government Trust	Private Trust
Cash flows	Adjustable	Pass-through
Accounted for as a liability?	1953-1967: No, 1968: Yes	No

¹⁰⁷ In 1970 Freddie Mac was created in the same model as Fannie Mae. It was created under the FHLBB, in part because savings and loans preferred to work through the FHLBB rather than with Fannie, which had traditionally been aligned with the mortgage companies and other investors that purchased FHA and VA insured loans. It was actually Freddie that took the lead in the issuance of MBS throughout the 1970s, while Fannie largely stuck to portfolio lending until the 1980s.

The structure, while somewhat confusing, had a few accounting advantages. Since Fannie Mae's MBS were held in a trust, involved direct pass-through of sales, and had a credit guarantee, the new Fannie Mae did not have to account for the MBS towards its debt-to-equity ratio – even though the GSE's bonds were exempt from taxes that would otherwise make this sort of arrangement more expensive. This would have lasting implications for MBS in America, as this trust and payment structure would justify the removal of MBS from companies' balance sheets while also excluding them from certain tax restrictions. The second big advantage was for the federal budget. Removing Fannie Mae would mean that \$1.4 billion of its planned expenditures would not be included on the federal budget totals for the next year, even though the government held close ties with Fannie Mae, offered it a line of credit, and provided credit guarantees of its MBS through Ginnie Mae (1969; Janssen 1968; Janssen 1969b). Going forward, Fannie would still be charged with promoting the nation's secondary mortgage market through its charter, but it was free to act without considering the federal budget (1969; Janssen 1968; Janssen 1969b). In effect, the U.S. government absorbed a great deal of mortgage market risk, but conceded the profits to private shareholders.

Debates about the status of Fannie Mae and the proper accounting for those bonds did not end with the spin-off of Fannie Mae. The Nixon administration would later tell the *Wall Street Journal* that Fannie Mae was effectively a shadow government agency, privatized only to hide the size of the federal budget (Janssen 1969a). In 1971 the Federal Reserve suggested that the government reclassify GNMA securities in order to include them on the budgetary outlay totals; this was thought to pave the way towards putting *all* of the government's insured and guaranteed securities on the books, including the FHA and VA loans, to the amount of \$25 billion annually (in comparison, the MBS at this time would add only \$2 billion annually to the budget). The Treasury, OMB, and HUD strenuously objected: "We are absolutely unconvinced by this classification and appalled by the consequences." (Hill 1971) My point here is not that these MBS necessarily belonged on the budget. Rather, the important thing to note is that the U.S. government was working in an accounting grey area that could have been classified in different ways. Government officials, perhaps not unsurprisingly, seem to have picked the classification that served their interests. In doing so, they advanced a multipurpose financial tool that would have wide applicability once all the kinks were worked out.¹⁰⁸

Conclusion

When the Senate passed the Housing and Urban Development Act of 1968, President Johnson sent an open letter to Senator Sparkman congratulating him. In that letter, Johnson proclaimed that "the promise of hope and home moves a little closer to reality for millions of poor American families" (Johnson 1968). The legislation was primarily conceived as a means of promoting urban renewal and public housing. The

¹⁰⁸ Debates about how to properly account for government assets did not end with the PCBC either. Neither Nixon nor the legislative branch were as politically beholden to the committee's ruling, and so it was easier for both to circumvent it in other ways, for example with instruments called Certificates of Beneficial Ownership and with the Federal Financing Bank (see, for example, CBO 1978: Chapter 3; Ippolito 1984: 135).

overhaul of Fannie Mae was not even mentioned in this document. There was no recognition that, with Fannie Mae, the administration was driven by an urgent need to get public funds out of the housing market. Facing a fiscal crisis caused by the Vietnam War and the Great Society programs, Johnson first tried to solve his budgetary problems by using a weaker version of privatization, one that used debt instruments to tap private funds and remove the impact of Fannie Mae on the budget, but that kept control of housing finance squarely in government hands. It was only when this effort failed that Johnson spun-off Fannie Mae and laid the foundation for the American MBS market. Even then, the government continued to absorb mortgage risks in less direct but still significant ways.

President Johnson was not running *towards the market* so much as he was running *away from the budget*. He turned to securitization for pragmatic reasons. Given that the alternative was cheap Treasury money, securitization was more politically expedient than fiscally sound in the early years. In this case, the turn towards privatization and financial markets wasn't a passionate love affair with free markets, as much as it was a politically driven marriage of convenience. The importance of the budget in these events suggests that much might be gained by refocusing our attention on this crucial institution.

Chapter 6: Conclusion

Modern policy-makers' ingenuity . . . has created mechanisms for spending unknown in past ages; and extensive use of such devices has made modern budgets into things of shreds and patches.

Carolyn Webber and Aaron Wildavsky, 1986

The basic form of the mortgage-backed security was in place by 1970. A group of assets would be combined into a pool and investors purchased the right to revenues accruing from the pool. The pool benefited from some kind of credit protection, a provision that reassured investors that they could still get paid even if assets in the pool defaulted or lost their value. Since all of this was done through a group of assets held in shell company, called a Special Purpose Vehicle, that was thought not to contain any risks, neither the buyer nor seller had to hold reserves equivalent to the amount required if they directly owned those collateralizing assets.

The U.S. government was not the only entity to use complex debt instruments to sell mortgages and shuffle around assets in the postwar period. Still, at the end of the 1960s, it put its weight behind the market, and doing so, the government played an important role in helping mortgage bonds enter the mainstream. In the late 1960s and throughout the 1970s the government and a select group of investors worked hard to convince the business world at large that it was a good idea to invest in these securities and, through them, in the housing market. They used government guarantees to advance the market. Some of the most important developments in securitization throughout the 1970s and 1980s – experiments with over-collateralization, insurance contracts, and, most importantly, tranching – were intended to create risk management tools robust enough to take the place of the Ginnie Mae guarantee.¹⁰⁹

The provisions that made Pass-Throughs a true sale followed the logic of the PCBC's ruling. These provisions also made Pass-Throughs difficult for private companies to use. Most thrifts still could not sell their assets without absorbing large losses, since their portfolios were made up of long term mortgages held at fixed rates set lower than the high nominal interest rates of the inflation-plagued decade (Sellon and VanNahmen 1988). At the same time, potential investors (namely mutual and pension funds) also didn't like how the payments flowed through, as this clashed with their bookkeeping and reporting schedules. The legal terms of the sale, however, required that the payments flow directly through to the investors, and this could not legally be changed without legally invalidating the entire deal structure or changing its tax treatment. In response to these problems investment bankers worked with thrifts to create Mortgage-Backed Bonds (MBB) in 1977 (Sellon and VanNahmen 1988). Instead of actually selling

¹⁰⁹ Entrepreneurs also worked to change tax laws, better manage prepayment risks, and educate investors.

ownership of the mortgages to the new investors, as they had done with government Pass-Throughs, the MBBs left the ownership of the mortgages with the originating company, and simply sold bonds that were collateralized by them. The thrifts could now leverage the value of their existing mortgages without selling them off at a loss. The structure of the MBB, of course, bears a striking resemblance to the once-maligned government participation certificates of the 1950s and 60s.

A series of regulatory changes between the 1970s and 2000s (such as those that allowed adjustable rate mortgages, and those that controlled interest rate ceilings, and relaxed oversight of financial institutions) stripped away government controls in the housing and financial markets. Low interest rates encouraged investors from around the world to pour money into American housing markets. The credit agencies that were supposed to police the market were swayed by conflicts of interests and failed to adequately evaluate risks. In this environment, securitization served as a powerful accelerant. I suspect that by the close of the 1990s the same things that made the MBS such an efficient solution for Johnson – a capacity to parse risk and ownership, the ability to move unwanted assets off a balance sheet, a level of obscurity that rendered these deals unintelligible to the lay person, and, most of all, a structure that justified a more risky, highly leveraged position – all served to fuel the subprime market and credit bubble.

Attending to the place of credit lending and budget politics in these events matters because it has implications for how we think about the ultimate misuse of MBS. When the U.S. government turned to credit lending to help promote its markets in the early twentieth century, it had ramifications far beyond the immediate development of housing or agriculture or small businesses. The government's credit programs helped change the techniques and concepts used across credit markets. They also reshaped the boundaries of the federal budget and promoted the use of MBS, one of the most important financial technologies of our time. It is true that MBS were designed to manage risks and encourage lending. It is also true that they were designed to remove assets from balance sheets and increase leverage. So if we find today that MBS have made it difficult to measure what risks companies hold, or that they have encouraged companies to assume a higher ratio of obligations to equity, we would do well to remember that, to some extent, this is exactly what MBS were designed to do. When the government spun off Fannie Mae, it wanted to back the risk for the market without having to take any of the consequences on its balance sheet; it took on an immense amount of contingent risk, and owned up to none of it. If the balance sheets of today's banks are things of shreds and patches, it is in part because they have followed the lead of the federal budget.

Lyndon B. Johnson was not the first President to use accounting tricks and off-budget corporations to manipulate the federal budget. After all, the executive budget was barely a decade old when FDR used the RFC to fund a significant part of the New Deal off budget. Kennedy, Eisenhower and Truman all used asset sales to offset expenditures. Lyndon B. Johnson was also not the first American politician to promote homeownership as the measure of the American Dream but balk at the notion of providing credit for it. That tradition, which goes all the way back to Thomas Jefferson, meant that much of the Western frontier was settled in a speculative fever. Finally, Lyndon B. Johnson did not originate the technique of using indirect policy tools to intervene in the economy – tools that effectively hid the role of the government. Almost as soon as the federal government extended its reach in the Progressive Era, it started

managing the economy at arm's length, as the creation of the Federal Land Banks in 1916 reveals.

Since the tensions that Johnson faced in 1968 were old ones, it was perhaps fitting that he used an old set of tools to try to deflect them. He had a difficult choice between funding a troubled housing sector, the Great Society Programs, and the Vietnam War. He tried to salvage them all by using indirect policy tools that obviated the need for anyone to account for the costs and risks that entailed. Securitization was a legacy of that choice, and as such, it too is part of a long American tradition, despite how modern it seems. Ideologically and structurally, securitization mirrored the government programs that had incubated it. Both securitization and the American government are sprawling structures with fractured cores that involve a web of complex mechanisms that render them nearly unintelligible. Both promise equal opportunity without redistribution of resources.

Studying both budget and credit programs offers a chance to see how people work with existing cultural and institutional boundaries to innovate new strategies of governance, how in the process of doing so they draw and redraw the boundaries of the state, and how that in turn affects people's sense of themselves and their experiences. It seems that having flexibility at the borders of the government is the very thing that has allowed Americans to continue telling themselves an exceptional story despite extensive state interventions: that they are free individuals who live largely unfettered and unaided by the state.

Looking Ahead

Each of the main contentions of this dissertation raises as many questions as it answers. Below I review five of the most important possibilities for future research raised in these pages.

What Happens In Other Places and Times?

I have argued that federal credit programs are important sites of intervention in the U.S. economy, ones that have been understudied by sociologists. I have laid out the basic trajectory of their development, detailed their relationship with the federal budget, and discussed how we can think of them as one of many indirect policy tools. Still, we are at the early stages of understanding what is a vast and complicated set of policies, and there is much work to be done on this topic. For example, we know that credit aid and indirect policy tools are used in other countries, but we still do not know much about how their use differs from their use in the U.S. A cross-national comparison of the development of indirect policy tools would be of value because it will enrich our understanding of how these forms are used, and how they related to different kinds of budgeting processes, and the conditions under which officials in the U.S. and in other nation's chose to mark or elide the presence of the state in a given domain.

I hope to have shown that both indirect policy tools and national budgets are themselves diagnostic instruments that scholars can use to better understand how the exercise of public power is organized in different times and spaces. Studying both budget and credit programs offers a chance, then, to see how people innovate strategies of

government, and how they draw and redraw the boundaries of the state in the process. The extent to which these efforts serve to reinforce or disrupt the stories people tell themselves in a given locale will be fascinating to see.

How Do All of the Credit Programs Affect Social Stratification?

I have told the story of how the federal government came to back a private secondary mortgage market organized around securitization. Johnson's strategy was shaped by a budget crisis. Rather than make a difficult choice between fully funding a troubled housing sector, the Great Society Programs, and the Vietnam War, Johnson tried to find a way to have them all. The privatization of Fannie Mae and the rise of securitization through the GSEs are two of the legacies of that choice. I believe that in this way the tensions of the Johnson Administration were written into the structure of securitization: its very form embodies the promise of opportunity without redistribution.

I have argued that, with the Housing and Urban Development Act of 1968, the Johnson administration was addressing a set of problems with mortgage credit rooted in the revolutionary period. That housing finance in America has long been unstable and speculative has not dislodged the notion of homeownership as the ultimate symbol of a strong, moral, and decent citizen. One implication of this is that we should consider whether such high levels of homeownership should remain a national priority; if near-universal homeownership does remain a national priority, we must take seriously the task of finding fair and responsible ways of extending credit to poorer people. That is, if as a nation we do not find a fair way of providing credit to all Americans, or if we do not alternately sever the connection between homeownership and social status, we make it easier for this particular kind of bubble to occur again.

In terms of research, this raises questions about the use of credit programs, hybrid corporate forms, and indirect policy tools for the distribution of resources. Scholars have already done excellent work showing how a set of housing credit programs – the FHA, VA, and Fannie Mae – have shaped stratification in America since the New Deal (see, especially, Cohen 2003; Freund 2007; Jackson 1985; Massey and Denton 1993; Oliver and Shapiro 2006). Expanding this analysis to consider how a broader range of credit programs has mattered for social stratification – and for the distribution of financial risks and profits among social groups – is an important next step.

Where were the Private Companies?

One interesting but as yet unanswered question is why it was the federal government, and not private companies, who led the way in the use of securitization in the United States. The best investigation of this I've come across is from Grebler and Jones (1961). They concluded that the mortgage companies in the 1950s, though undercapitalized, should have been able to create a secondary mortgage market, and are unable to come to a definitive conclusion as to why they have not.

One possibility for the absence of a private market is that the mortgage companies were effectively crowded out or scared away by Fannie Mae, and later Freddie Mac. As I discussed in Chapter Five, when the Johnson Administration decided to reorganize Fannie Mae in 1968 they met with industry leaders, who informed the government

officials that private companies were working on these kinds of financial instruments. The Johnson Administration, however, went ahead with a plan to put Fannie Mae at the center of the market – a plan that would of course leave the federal government additional control of the mortgage market. By this logic, a private market never emerged because government programs crowded them out.

Crowding out is not the only possible explanation, however. I have shown, for example, that the mortgage companies who would have been the natural leaders in this field seem to have been scared away from the practice after the mortgage bond crisis of the 1920s. In the postwar era they seem to have been locked into a business model wherein they were effectively extensions of the commercial banks and insurance companies (see Chapter Four). It is possible that while the field was stable they had little incentive to innovate in this direction, but when the field was thrown into chaos in the late 1970s and early 1980s (during the S&L crisis) they imagined new possibilities for action in the field.

Surely the tangle of state and federal regulations and tax codes that surrounded mortgage finance are an important part of this story. We know from Lewis Ranieri's account of the burgeoning market in the 1970s and 1980s that early entrepreneurs spent a great deal of time and effort getting laws changed. For example, Ranieri recollects that in 1984 Salomon Brother's promoted the Secondary Mortgage Market Enhancement Act (SMMEA), which made it legal for investors to purchase these bonds, overriding laws against this in many states. The story of another proposed piece of legislation – the Trust for Investments in Mortgages (TIMS), which targeted the tax code and was drafted by Salomon, speaks to this as well. When an analyst at the Treasury named Andy Furer objected to the legislation, Salomon Brothers hired him and had him rewrite it. It passed as part of the Tax Reform Act of 1986, and it created a structure called a REMIC (Real Estate Mortgage Investment Conduit) that could issue MBS without having many of the old tax and accounting problems that plagued earlier efforts. Ranieri notes that with this legislation the businessman had "won total flexibility" (1996: 37-38). If correct, this would cause us to rethink what some of the innovation in the 1970s and 1980s was really about. It could be that the real trick might not have been in managing risk or sweet talking investors, but in changing laws. One important question then becomes why investors move to get certain laws changed at certain times.

A final possibility has to do with innovation and legitimacy. We know from accounts of the early industry that entrepreneurs put a great deal of work into convincing potential buyers that these complicated new instruments weren't overly risky, and that they offered a good value. Laurence Fink (1996), who worked at FirstBoston in the early eighties, argues that educating investors was as important as legal and technological developments in the early days. Fink (1996: 122) reports that "Investor seminars were conducted, research pieces disseminated, conferences hosted, and sales calls made in record numbers." Ranieri similarly recollects, "It was difficult to sell mortgage securities in the early days of the mortgage securitization market due to its complexities and the lack of investor knowledge. It was necessary to convince investors that our mortgage-backed securities represented significantly better relative value than other securities in their portfolios . . ." (1996: 36) As part of this, they had to figure out complicated new bookkeeping techniques that made the deals seem less palatable to investors, and most importantly, figure out better ways of managing the credit and prepayment risks that

mortgage bonds entailed. It seems that until potential buyers were familiar with the instrument, the added comfort of a government guarantee was needed to get them to purchase it (indeed, as I show in Chapter Five, this is exactly what business leaders told the Johnson Administration).

Since there is evidence for each of these possibilities, it is likely that the answer lies in some combination of them. Further research is needed to definitively tease this out. We need to know much more about complex debt instruments among commercial banks and other financial firms throughout American history before we can answer these questions. The gaps in our knowledge are significant. This dissertation has been limited to describing broad historical changes in broad strokes before the Johnson Era. More detailed historical accounts of the mortgage bonds created by Southern Property banks and mortgage companies in the nineteenth century, a comprehensive review of the regulatory response to the mortgage bond crash in New York in the 1920s, and an account of the use of complex debt instruments among commercial banks and other financial firms in the postwar era will open new possibilities for analysis, and make it possible to bear down on the mechanisms driving these changes over time. Pairing a better understanding of the successes and failures of private firms in capital markets with a more expansive analysis of how they sought to influence policy through lobbying, courts, and political parties will yield a much more fine grained look at the development of American credit programs and markets over time.

What Happened Next?

The decisions firms made about securitization in the 1970s and the 1980s have had profound global consequences. As money poured through American firms and into American homes at previously unheard of levels the unchecked largesse eventually had a devastating effect. But in the aftermath of these events it is easy to forget that until the 1980s many financial companies were unwilling to buy mortgages under any circumstance, believing that securitization was overly complicated and risky. Firms had to learn to stop worrying and love securitization. How did this happen? How exactly did the structure of these instruments change? How did companies decide to enter the securitization market? How did securitization help change the structure of global financial markets, even before the global credit bubble? How did the role of the government change during this time?

These are all pressing questions in view of the current economic crisis. I believe that it is important that bring the sociological perspective to bear on them. Even the most complex, sophisticated, mathematical financial markets are social systems subject to human interpretation and error. Financial tools are designed and used by people trying to solve economic problems in environments thick with political machinations, social pressures, and cultural meanings. Technologies like securitization direct more than the flow of dollars and cents – they also direct obstacles and relations, and flows of obligations and opportunities. Sociology's expertise about the social world will help us understand finance more fully, and we must understand finance to understand how the social world is changing.

This project shows that American securitization was a breakthrough in accounting treatments. One of the implications of my findings is changing accounting rules have tremendous social importance and deserve greater scrutiny. We know that in the middle of the recent bubble Mark-to-Market (MTM) accounting was used to inflate the value of

securitized bonds on balance sheets. But while we are well aware of the terrible consequences of that coupling, we have only partial and fragmented knowledge of how securitization and MTM accounting converged in American firms. This suggests that securitization may be emblematic of a larger set of accountancy changes in American finance. An investigation of how changes in corporate accounting in the late twentieth century relate to the securitization market would contribute to our understanding of the transformation of economic practice at the close of the twentieth century.

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Appendix A: Archival Research

Primary data for this study was gathered in the summer and fall of 2008 at the Lyndon Baines Johnson Library (LBJ Library) in Austin, Texas, the National Archives I, Washington, D.C., and the National Archives II, in College Park, Maryland. This was supplemented with recordings of telephone conversations of Lyndon B. Johnson, publicly available online through the Presidential Recording Program at the Miller Center of Public Affairs, University of Virginia. I also accessed government reports on credit programs and legislation through Lexis-Nexis Congressional. Finally, I drew from papers provided by former Federal Reserve Member Sherman Maisel.

The bulk of the analysis of primary materials for this project has been based on an analysis of the Maisel Papers and materials from the LBJ Library, so it is those sources that I focus on in this Appendix. The Maisel Papers contained memos from the Interagency Committee on Housing Credit (1967), the Mortgage Finance Task Force (1967), and government reports and memos (some final, some drafts) on topics that included secondary mortgage market operations, the housing market, and options for mortgage finance reform. The papers also contain minutes from meetings among government officials, and between government officials and representatives of the housing industry. There are copies of speeches from Sherman Maisel and Robert Weaver, and letters and proposals submitted by representatives of S&Ls and banks.

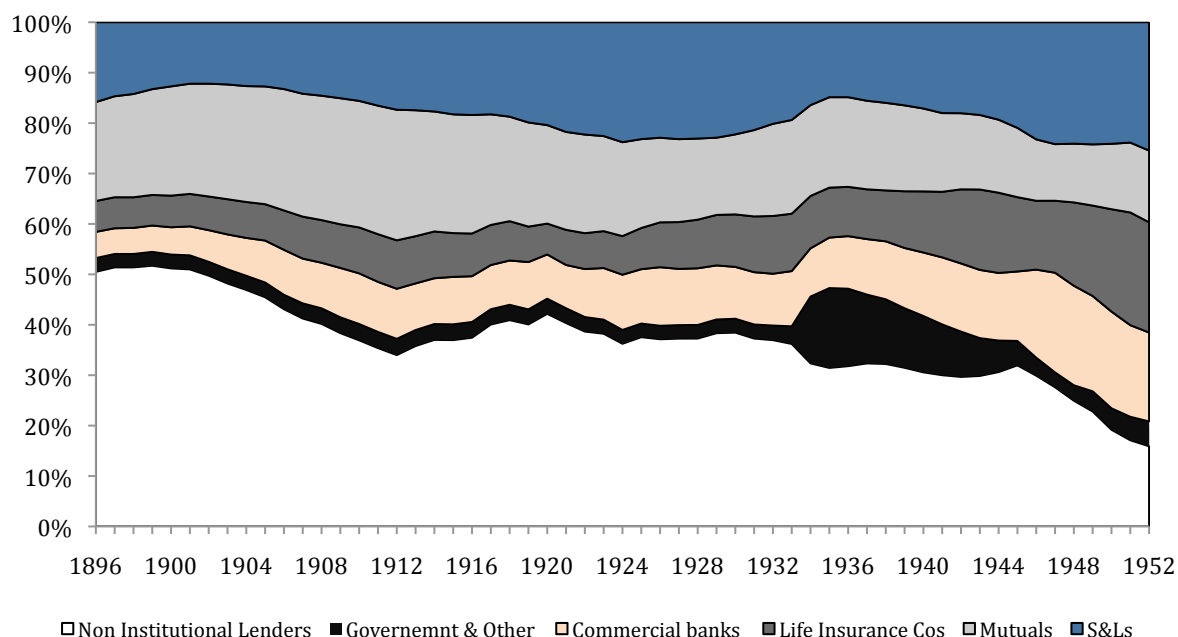
At the Lyndon Baines Johnson Presidential Library, in Austin, TX, my focus was on identifying the reasons for privatizing Fannie Mae, and on understanding the roots of the mortgage-backed security. To that end, I reviewed boxes from the White House Central Files on the Department of Housing and Urban Development (Federal Government (FG) 170) and the Housing and Home Finance Agency (FG 245). Other relevant files were found in the files of the Commission on the Budget (FG 785). Additionally, I reviewed selected boxes from the Finance Files (FI, included selection from FI 1-2 on disbursements and expenditures, FI 4-2 on loans and funds, FI 5 on credit loans), with a special focus on the housing finance files (FI 5-4). I also reviewed selections from the White House Central Files, Confidential Files, with a special focus on housing (HS), housing finance (FI 5-4), and Fannie Mae (FG 170-6). When reviewing the White House Central Files on Legislation, my focus was on housing finance legislation (LE/FI 5). Presidential Files on Enrolled Legislation (EL) files on the Housing Act of 1964 (PL 88-560, S 304) and the Participation Sales Act of 1964 (PL 89-429, S 3283) were especially useful. Files of the White House Aides pulled included those of Fred Bohlen, Larry Levinson, Joseph Califano, and James Gaither. The Administrative histories of the Bureau of the Budget, Council of Economic Advisors, Department of Housing and Urban Development, and the Department of the Treasury were particularly useful. I also consulted the Task Force Reports on Mortgage Finance Task Force. For Audio files, I reviewed those that referenced participation certificates: there were three recorded telephone conversations of President Johnson speaking with Henry “Joe” Fowler (dated 9/10/1966, 1/11/1966, and 1/25/1967, citation numbers 10734, 11340, and 11403), and single conversations with Alan Boyd (1/18/1967, citation number 11367), John Carlock (1/19/1967, citation number 11376) and Gerald Ford (2/7/1967, citation number 11520).

I supplemented these findings with additional research from the National Archives. I first visited the National Archives II, in College Park Maryland in June 2008. The most important thing to note about this is that I was unable to review the files of Fannie Mae in the years before its reorganization in 1968. Unfortunately, there is no record of the Fannie Mae files from 1954 to 1968 listed in the National Archives system. The archivists instructed me that those files may remain hidden in other files, or may not be in the National Archives at all. In hopes of tracking down the files, I contacted the offices of Fannie Mae and the Department of Housing and Urban Development. Neither reported having the materials. However, since Fannie Mae submitted reports to other government agencies, I was able to gain some insight into the agency through files in the Departments of Housing and Urban Development (RG 207), and the Treasury Files on Fannie Mae meetings (RG 56, General Records of the Department of the Treasury, Undersecretary for Monetary Affairs, Federal National Mortgage Association Meeting Files). For later years, files included those in the subject files of Housing and Urban Development Secretary Robert Weaver (in RG 207, General Records of the Department of Housing and Urban Development, Secretary Weaver's subject files). I visited Archives II in College Park, Maryland again in November of 2008. Among the materials reviewed during that visit, the files of the Office of Management and Budget (RG51), particularly those of the Budget Methods Branch, were especially useful.

My visit to the National Archives Building in Washington, D.C. did not yield much revealing material on the dissertation topic, but while there I had the great pleasure of going back into the stacks, which was a revelation of a different sort.

Appendix B: The Housing Market, 1869-1952

Figure B.1: Proportion of Residential NonFarm Mortgage Debt Held by Type of Debtor, 1896-1952 (excludes mortgage bonds)¹¹⁰



About this Chart

Until the early 1900s, non-institutional investors (like friends, neighbors, or wealthy individuals) were the primary source of funds for mortgage lenders (Weiss 1987). However, in the early 1900s, and at an accelerated pace after the New Deal, institutional lenders displaced individuals as the primary holders of the nation's mortgage debt. For the Government/Other category, please note that before 1925 this includes certain insurance companies and mortgage brokers, and after that time, mostly represents government holdings. The large increase in the "Government/Other" category in the 1930s represents the New Deal era mortgage purchase programs, and owes mainly to the HOLC.

¹¹⁰ **Source:** Carter, Susan B., Scott Sigmund Gartner, Michael R. Haines, Alan L. Olmstead, Richard Sutch, and Gavin Wright. 2006b. "Series Dc903-928: Debt on nonfarm structures, by type of debt, property, and holder: 1896-1952." in *Historical Statistics of the United States Millennial Edition Online*, edited by Michael R. Haines. New York: Cambridge University Press.

Note about the Data

The data reported in this section are derived from the Historical Statistics of the United States (HSUS). The HSUS primarily drew this data from Grebler, Winnick, and Blank (1956) who in turn primarily drew from other reports and the Department of Commerce.

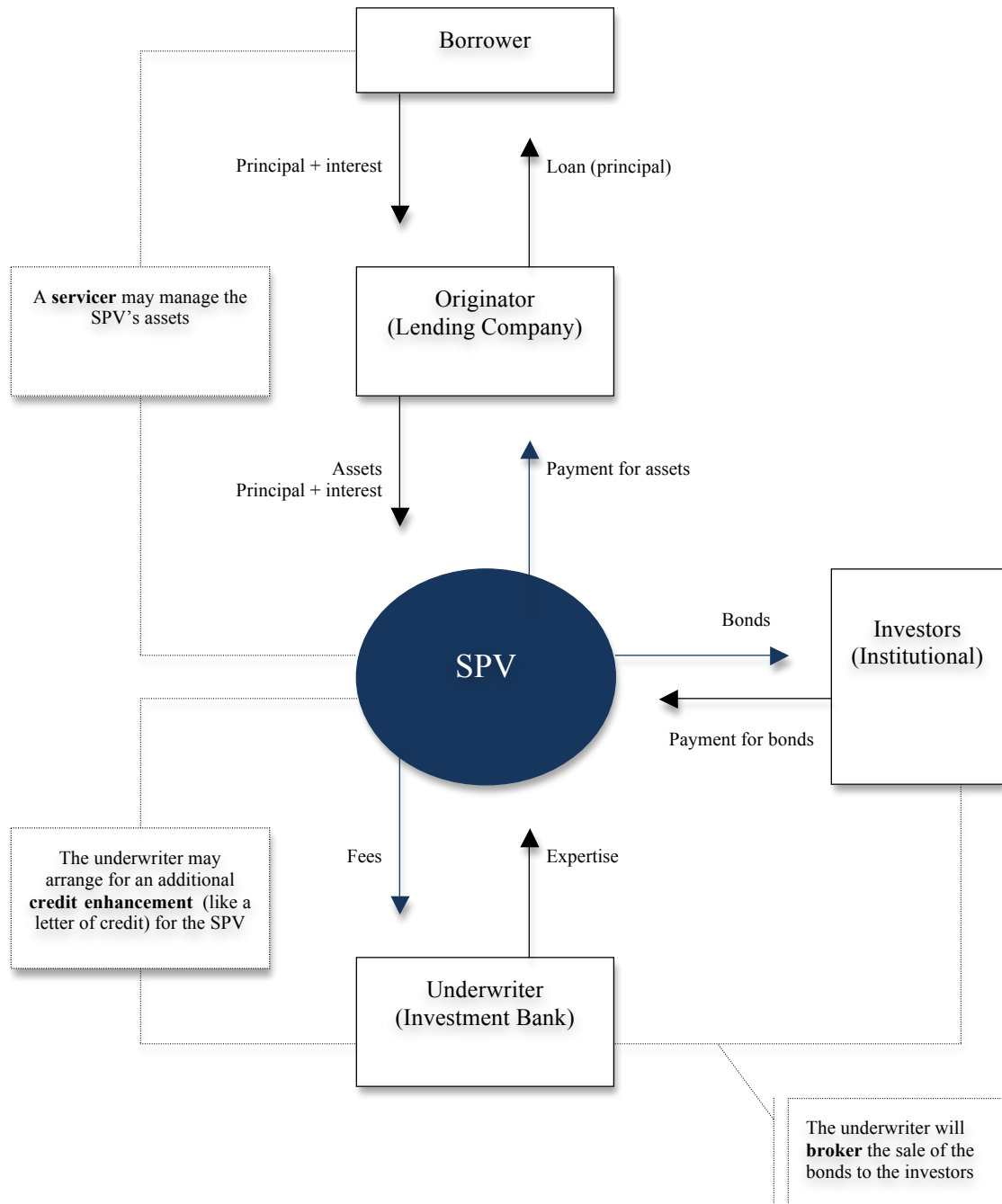
Both the HSUS and Grebler stress that that the numbers for the years 1896 to 1925 are better thought of as estimates rather than perfectly accurate amounts: “the residential mortgage debt series is especially weak for the pre-1925 period, based as it is on the two widely separated mortgage censuses of 1890 and 1920 and on the movement of total non-farm mortgage debt, itself an inadequate series.... For the earlier decades the series reflects approximate levels and underlying trends rather than accurate annual movements” (Grebler, Blank, and Winnick 1956, p. 442, quoted in Carter et al. (2006a), see the full documentation for Series Dc905-906.) Nevertheless, the authors of the HSUS conclude that “[d]espite problems and caveats, therefore, the Grebler, Blank, and Winnick estimates remain the best and most comprehensive view of the size and structure of the American mortgage market before 1950.”¹¹¹

Following the HSUS, I exclude bonds from the Non-Farm numbers because they are unable to disaggregate, for reasons of data collection, the portion of those bonds that represent residential and commercial debt, and residential debt is where we have a window into the breakdown of market share.

¹¹¹ See “Documentation and Definitions” for Series Dc905–906, available online at: <http://hsus.cambridge.org/HSUSWeb/toc/tableToc.do?id=Dc903-928>).

Appendix C: Securitization

Figure C.1: Example of a Securitization Structure¹¹²



Description of a Typical Securitization Structure by the 2000s

¹¹² Adapted from Leon T. Kendall's (1996) "Securitization: A New Era in American Finance." In *A Primer on Securitization*, Leon T. Kendall and Michael J. Fishman, eds. Cambridge: The MIT Press, p 3.

A typical securitization structure starts with an investment bank that works with a lending company to create a securitization deal. Let's take an imaginary mortgage securitization deal in the private sector as an example (see Figure D.1 for an illustration). The company that initially lent the mortgages – often referred to as the “originator” – sells off a group of its mortgages to a company called a Special Purpose Vehicle (SPV) or a Special Purpose Entity (SPE). The point of this SPV is to warehouse the pool of assets and be a conduit through which payments flow. The SPV also protects the assets from any problems faced by the originating company. If the lender falls on hard times and want those assets back, or if it goes bankrupt and its other debtors want to reclaim these assets for themselves, the assets in the SPV are protected.

An investment bank will arrange and *underwrite* a securitization deal. That is, it will help create and manage the SPV, it will figure out when payments on these mortgages are expected, and it will determine how they will be divided up to create bonds that distribute these profits (a process that can require a great deal of mathematical expertise). Most importantly, the underwriter will sell the bonds and agree to take responsibility for any leftover ones. In addition to this, the investment bank may also help figure out who collects the money on the mortgages from homeowners (in industry terms, who “services” the loans). Sometimes the originator continues to do this, but sometimes another company will be hired for the job. Finally, the underwriter will help arrange for credit enhancements, like an insurance policy or a letter of credit. Please note that this is a simplified version of a simple MBS. In practice these deals are often much more complicated in structure.

Appendix D: Glossary

Asset: In *The Dictionary of Finance and Investment Terms*, Downes and Goodman (1985: 20) define an asset as “anything having commercial or exchange value that is owned by a business, institution, or individual.”

Asset-Backed Securities (ABS): Securities collateralized by a pool of assets. This generally refers to securities backed by short term or consumer debt like credit cards and auto-loans. It is less typical for this term to be used refer to securities collateralized by mortgages (see *Mortgage-Backed Securities*).

Bond: In financial terms, a contract that gives the owner right to the payment of principle and interest at pre-determined intervals.

Collateral: Property or securities pledged to guarantee a debt.

Conventional Mortgages: Mortgages that are not guaranteed or insured by an agency of the U.S. federal government.

Conforming Mortgages: Mortgages that are guaranteed or insured by an agency of the U.S. federal government.

Credit Enhancement: A technique used to lessen or eliminate credit risk, such as a letter of credit, guarantee of debt, or over-collateralization.

Credit Risk: Risk resulting from the possibility that a debtor could fail to repay an obligation, as with a default.

Department of Housing and Urban Development (HUD): Created in 1965 under the *Housing and Development Act*, HUD regulates Fannie Mae and Freddie Mac through the Office of Federal Housing Enterprise Oversight (OFHEO).

Fannie Mae: The Federal National Mortgage Association (FNMA) is an entity created in the 1936 to support the housing market after the depression. Fannie Mae did so by buying mortgages and later reselling some of them with a guarantee of payment. In 1954 parts of Fannie were reorganized under private ownership, and in 1968 Fannie Mae was transformed into a *Government Sponsored Entity* (GSE). In 2008 it was placed into governmental conservatorship.

Federal Housing Administration (FHA): A governmental agency created as part of the National Housing Act of 1934 to stabilize the housing market after the Depression by providing mortgage insurance. The FHA was absorbed into the U.S. Department of Housing and Urban Development in 1965.

Federal Land Banks: Twelve banks created in by the Federal Farm Loan Act of 1916 to lend money to farmers through a network of farm cooperatives called National Associations.

Freddie Mac: Federal Home Loan Mortgage Corporation (FHLMC). This is a *Government Sponsored Entity* created in 1970 that is modeled after and competes with *Fannie Mae*. Freddie Mac entered governmental conservatorship in 2008 (FHLMC).

Ginnie Mae: The Government National Mortgage Association (GNMA). This is a federal agency created under HUD in 1968 to take over certain duties of *Fannie Mae*.

Government Sponsored Entity (GSE): A term used to describe corporations that are privately owned but follow a government charter. The U.S. government does not back debt and obligations of these corporations, but these firms benefit from government lines of credit, special privileges, and tax exemptions.

Land Bank: see *Federal Land Bank*.

Liquidity: The extent to which something can be commonly and easily traded on the market. Something that is easily traded is considered liquid. For example, US dollars are extremely liquid, while individual life insurance policies are less so.

Loan Originator: see *Originator*

Mortgage-backed Bonds (MBB): Bonds with payments that derive from a pool of pass-throughs and mortgages.

Mortgage-backed Securities (MBS): A security collateralized by a group of mortgages. This is an umbrella term that is often used to refer too all kinds of securities backed by mortgages, including but not limited to Pass-Throughs, Mortgage Participation Certificates, and Mortgage-Backed Bonds.

Originator: A company that brokers loans, or lends money to borrowers and then sells the rights to the future payments of principal and interest on these loans to third parties via securitization (also called a sponsoring organization).

Participation Certificates (PCs): A type of debt security whose value drives from an asset or pool of assets held in a trust.

Pass-Throughs: A type of mortgage-backed security in which both the payments and ownership rights of collateralizing assets are transferred directly to the purchaser.

Prepayment Risk: The likelihood that mortgages, typically through refinancing or home sales, will be paid before their agreed-upon term. Prepayment risk is a concern for investors because it makes it difficult to predict payment schedules and profits.

Rating Agency: A firm that judges the credit worthiness of other corporations and corporate debt, usually for a fee. The three major credit ratings agencies in the U.S. are Moody's, S&P, and FitchIBCA. They each determine credit ratings, letter grades that indicate credit strength.

Receivables: Rights to future cash flows resulting from some kind of loan, insurance policy or investment. Future payments of principal and interest on loans, credit card debt and mortgages are examples of receivables.

Savings and Loans: Community based organizations where savings are deposited, and where deposits are reinvested in mortgages. These organizations dominated the residential housing market in the US through the 1970s. In the fields of securitization and housing finance the phrase is sometimes used interchangeably with "thrifts."

Securities and Exchange Commission (SEC): Government agency created in 1934 to regulate the securities industry and stock market.

Securitization: A diverse set of financial practices that convert various assets into securities. In a typical securitization deal, receivables are pooled into a trust or corporation, which then issues bonds against that debt. Put differently, this refers to the creation of a security that is collateralized by a pool of assets.

Security: In financial markets, a security is a financial contract that gives the holder the right to own a portion of the profits accrued by a corporation or government, as with stocks and bonds. A security can also be used to collateralize a debt.

Special Purpose Vehicle (SPV): A trust or corporation created for the purposes of transferring or holding assets that will be or have been securitized.

Thrifts: These are community-based, cooperative organizations where savings are deposited. The most common of these are *Savings and Loans Associations*. Building societies and some cooperative banks are also types of thrifts.

Underwriter: In a securitization deal, this is a company (or group of companies), typically an investment bank, that prices and markets securitized bonds.

Veterans Administration (VA): Government agency established in 1930 to support War Veterans (VA 2010). In 1948 it started guaranteeing the mortgages of war veterans.