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# Greg Feldberg, Notes on John Gordon Steele Interview

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**Notes from John Steele Gordon Interview**

- The heart of this beast was basically FNM and FRE. They were the economic equivalent of a chimera – half-bull, half-lion. Whenever a chimera showed up in mythology it was very bad news. Johnson administration spun off FNM in 1969. It had been there to help provide liquidity to mortgages, a terrific idea. Theoretically it was a corporation. In 197X, they created FRE to theoretically give FNM competition.
- But in many ways they remained government agencies.
  - Everyone knew that if push came to shove, the government would still stand behind it.
  - Both of them remained in Washington, DC. With all respect, Washington is the largest company town in the world. The largest financial organizations aren't in Washington.
  - It was permeated with politics. FNM and FRE were very generous with contributions.
  - 2006 fines for FRE for improper political activities.
- They became the engine behind the housing bubble.
- Also
  - The Federal Reserve did not tighten interest rates soon enough.
  - Wall Street was in the Greed phase; they felt if FNM and FRE could make money in mortgages, so could they.
  - CRAs completely failed.
- Homeownership was a good thing; one aspirin will help you, 20 aspirins will kill you.
  - It's awfully hard in politics to say, this is enough.
- [Landon: Paradigm of how the financial sector interfaces with the nonfinancial sector?]
  - Nowadays we're turning corners every 20 minutes. We're in unprecedented change thanks to the microprocessor.
  - The modern financial world came into being in the early part of the 20$^{th}$ century, when CP became important, limiting the power of the banks. No bank has ever been as powerful as JP Morgan was at the turn of the century.
- [Regulation?]
  - Regulation in a free market is always going to lag behind innovation. People are always free to innovate. Governments are always slower to act than are free markets.
  - I wrote an article June 2009: one of the problems is that the government is hemmed in by laws… the President can't spend a dime without going through Congress. A CEO can just order it done. This is why so many regulations come out of disasters.
- [Shadow banking run?]
  - I'm not much of an expert on that.
- This was much bigger than 1987… it pales in comparison to the Great Depression. A lot of people think the stock market crash caused the Great Depression. At the time the Fed did nothing except raise interest rates; then Congress raised taxes in 1932 to balance

government books. <u>This time the government acted very forcefully, very quickly, and that's what kept this from snowballing into a bigger disaster.</u>

- Financial crises had come along every 20 years; then there was this big hiatus of almost 60 years. Part of that was improved regulation. It was also partly the welfare state. Social Security and other financial program acted as pump primers.
- [Matt: Complexity?] Some of these financial instruments make my head ache. It would appear they made them ache over at S&P and Moodys and Fitch. I would hope you wouldn't put this in the hands of the government, the bureaucrats, they would be inclined to say no. The rule should be, if you can't explain it on a sheet of paper, maybe you don't understand it either.
- [Other countries, other eras?] We never repeat the same disaster. We learn from our mistakes. It's always some new idea… we live in utterly new times. The world 25 years from now is going to be unimaginably different from what it is today. In 1970, if every computer in the world stopped working, you wouldn't notice until the end of the month. Today, nothing would work any more. The microprocessor made everything cheaper and faster, and we ain't seen nothing yet. It will be hard to regulate things that people haven't thought of now. It will be a bumpy flight.
- [What are we at risk of missing?] This is getting a lot of scrutiny as well it should. You guys are the scrutinizers.
- [Is it just inevitable that there will be bubbles?] I expect it is. In 1927, Lindbergh flew the Atlantic and caused a worldwide uproar. This proved you could actually fly across the Atlantic. It caused a sudden bubble on airline stocks on Wall Street. Anything that had airline in it went up. One of those was Seaborn Air Lines, which was just a poetically named railroad. This is enthusiasm getting carried away.
- [Are you worried about over-regulation?] I worry about under-regulation and over-regulation. Both of those are very bad news. I don't want bureaucrats to stifle innovation.
- [TBTF?] I'm not sure an ordinary company can get too big to fail. The assets are still there. The banking system is completely different because it's like the arteries. A bank that is TBTF needs to be regulated or broken up, otherwise there is a huge moral hazard. The guys at Lehman Brothers thought [they would be bailed out].
- [Financial complexity? Symptom of financial markets?] Yes. The average man on the street today [most owns some securities]. Probably in 1932 only 4% of people owned securities. I'm disturbed by all of these ads for buying gold.
- [Worst?] No. 1837 started the longest recession in US history, until 1843. The Great Depression actually ended in March 1933.
- [A lot more federal debt]. I think, when you have an economic crisis like this, the government and the Federal Reserve should be shoveling money out the door. That's why 1987 was a blip. Big job getting money back into Federal Reserve. We are *not* at that point now, but CBO is estimating the federal debt is going to double in next 10 years. 1780s France was spending 80% of its revenues on the debt, which may explain why it didn't end well for the French government. I have a revised history of the national debt coming out tomorrow. We used to run up the national debt for wars or depressions, but for the last 30 years we've been running it up so nobody in Washington has to say no to any constituents. One way would be to force the government to honestly show their books. They display outrageous games for the short-term gain of getting reelected. In

the 1890s, Wall Street realized CEOs couldn't be trusted to keep their own books. The same is true of municipalities and governments today.

- [What would you want to know if you had the resources of this commission?] I'd be more interested in reading emails in the public sector than the private sector. I'd sure like to look at FNM and FRE. They played the game of Washington politics, they were the New York Yankees of Washington politics.
- [Hypothetical if government had not stepped in? September, March 2008.] I think it would have been an unmitigated disaster. The banking system would have collapsed. We came awfully close in 1933 to seeing the entire banking system collapse. That possibility certainly would have been there.
- [Was this the perfect storm, or are there some very key themes here?] It's not a perfect storm. Was the blizzard of 1988 the perfect blizzard? We've had worse since. This was one incident. We can have others from other causes.
- The thing you can't do anything about are human nature. The exact causes of this one we can certainly [know]. Keep the power of the books away from the politicians: an independent board, Federal Accounting Board, they would ask the questions. That's what CBO can't do.