Congress Needs to Find a Productive Role in Restoring Confidence to Our Financial System

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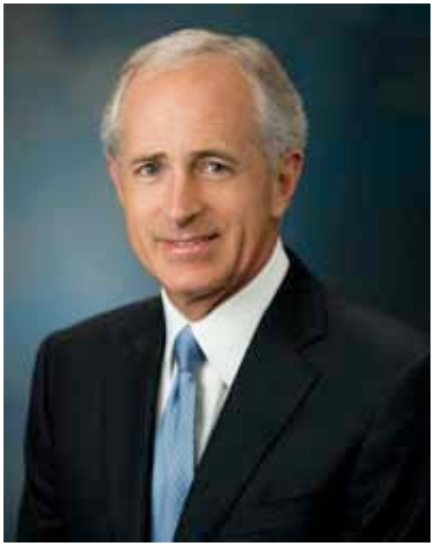

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by Bob Corker

Since coming to Washington from Chattanooga, I have learned two important lessons. The first is that there is absolutely no construct for fiscal discipline at the federal level. And the second is that there are many things that Congress, as a body, doesn't do very well. Where we have historically proven to be least effective is legislating in a crisis, particularly in an unprecedented 21st century financial challenge like the one we are facing now. What the Senate has done thus far has missed the mark with attempts at both economic and housing market stimulus. I am hopeful that the Senate can begin to take a fresh approach, learn lessons from this time of financial transition, and apply appropriate additional Congressional assistance. There certainly may be suitable types of fiscal stimulus in economic downturns that should be well-timed and aptly focused. Unfortunately, we have not yet hit that target. This week and perhaps into next week, we are debating a housing package that includes reform of the Federal Housing Administration, a new oversight regulator with stringent controls and appropriate tools to oversee the housing government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, and a tax credit for first-time homebuyers that is designed to incentivize buyers to enter the market so that we can begin to clear surplus housing inventory from the markets. If Congress is going to provide some federal intervention, I am hopeful that we can do it quickly so that markets can begin some sort of return to normal behavior.

In our first attempt to stimulate consumer growth and spending in the economy, Congress voted to send rebate checks to Americans at certain income levels. My heart goes out to people who find themselves in financial situations that are beyond their control, and I am happy for the Tennesseans who will be able to put this money to good use, but I find something extremely inappropriate about a deficit-ridden federal government borrowing more than half a trillion dollars from foreign countries and sprinkling it across the country for a short-term fix that will do little, if anything, to jump-start our troubled economy. None of us in Congress will ever pay a dime of the debt created by this action. Instead, we'll be sending the bill, compounded many times over, to our grandchildren and their children to pay. I think most citizens join me in recognizing this so-called "economic stimulus" for what it is: a political stimulus designed to generate election-year public favor.

When Congress attempted to address challenges in the housing markets, we also failed to get it right. While there were some well-intentioned provisions like Federal Housing Administration modernization, increases in tax exempt mortgage revenue bonds for state governments, and renewable energy tax incentives, the overall bill was ineffective and perhaps harmful. An earlier version of the Senate bill included an important tax credit designed to incentivize more buyers to enter the market, but instead of providing the benefit to all home buyers, that provision was changed and became a targeted tax credit for individuals who purchased foreclosed homes. This would put homeowners trying to sell their homes at a competitive disadvantage, along with homebuilders bringing new products to the market, which would in turn cause market distortions and do little to incentivize lenders to renegotiate the terms of a mortgage with the homeowner.

Given the magnitude of the disruptions in our housing market, as policymakers we cannot assume that the market will be entirely self-correcting. In many ways, this has been the "perfect storm" of lax economic policy, market irresponsibility, consumer overspending, global transformation, poor regulation, and politicization of important issues facing the competitiveness of the United States. While it may be tempting to legislate and manufacture a solution, we must be certain that we balance the strength and resilience of the free market with the need for government intervention.

Our regulators have been largely innovative and swift in their actions to help spur the stall in credit markets. Their actions have been helpful in attempting to inject some life into our capital markets. However, mistakes were made, and we need to take the time to understand them before we act clumsily again. It is now time for our markets, our economy, and our financial institutions to start getting back to the business of doing business. To be clear, it is likely that more distress in the markets lies ahead. and we are in, if not a full-fledged recession, certainly an economic downturn. In certain regions of the country, house prices are more than likely to fall again, and more homeowners may be under water, faced with negative equity and significant pressure on their ability to repay. Consumer spending is down, small business owners are faced with challenges in obtaining credit and capital, and our capital markets remain very fragile. We may see additional bank failures and more tension before we begin the recovery.

But the news from Wall Street to Washington to Tennessee is not all bad. If you separate out the financial companies from the rest of the economy, we have actually seen modest growth. Some forecasters believe that economic output expanded at 0.5 percent in the first quarter, and many nonfinancials have proven to be more resilient than most would have expected. Our regulatory system for financial services firms has long been due for an overhaul to bring it in line with the global marketplace. This might be the impetus for Congress to begin that process. Additionally, the turmoil has given markets the opportunity to rein in some of the more egregious practices that introduced more risk than our companies and their shareholders were prepared to bear.

I am honored to be serving on the Senate Banking Committee at a time when our country is facing some of our most unique economic circumstances in 70 years. Markets tend to create differing opportunities and problems as we move through cycles like this one. Sometimes we in the Senate and House try to focus on the problem instead of the opportunity, but in essence, the fact that housing prices are declining is actually a good thing for those people who were unable to afford homes at the height of this bubble. I am hesitant to put additional taxpayer money at risk to bail out speculators, irresponsible borrowers, and careless lenders in certain areas of the country where the market overheated in an unproductive way.

I have said before that we cannot assume these markets will be entirely self-correcting, and a case may be made for federal support of certain programs to put a floor into the market and begin the process of stabilization. The Federal Housing Administration *must* be modernized before we expand its role and exposure to more risky borrowers. The GSEs, Fannie and Freddie, need to play a critical role in absorbing certain mortgage securities and restoring confidence to the marketplace. These entities were created to provide liquidity and stability to the conventional conforming loan mortgage market, and they are needed now more than ever. Yet there are dangers to our financial system and housing markets in encouraging further expansion of the GSEs without putting a strong regulator in place to oversee their activities. We must also require them to raise substantial capital for prudential reasons, to support their increased activity in the market, particularly because of the implied government backing of the GSEs. Timing of any relief will be key as will the duration of its application. The current legislation we are debating in the Senate does all of these things.

As our very resilient economy begins the long road to recovery, we will need to evaluate the lessons learned from the financial market turmoil. Financial institutions were transformed by abundant liquidity in the markets and created inherently risky products without truly understanding the risk of their exposure to their trading relationships with other companies and investors and the direct relationship between confidence and liquidity. Incentives for lenders and consumers to participate in the seemingly infallible housing boom were careless and costly not only to those who participated but to all taxpayers, who are now left paying the bill.

I am hopeful that Congress will find a productive role in restoring confidence to our financial system, and perhaps Congress itself will learn a valuable lesson in responsible fiscal behavior and the need for checks and balances in that system. Only time will tell. In the process, it is essential to recognize that the longer we allow election-year politics to invade our policymaking, the message that we send is one that ultimately delays inevitable adjustments in the market and the significance of lessons learned at a crucial time in our nation’s financial history.

Bob Corker, elected in 2006 to represent Tennessee in the U.S. Senate, is the newest member of the Senate Banking, Housing, and Urban Affairs Committee. Prior to his election to the Senate, Corker had a successful career as a businessman and served as Tennessee Commissioner of Finance and Administration and mayor of Chattanooga.