December Edition: Economic Crisis

2008 witnessed an enormous shift from one of the most thriving times in U.S. history to one of the bleakest. What began as a foreclosure crisis changed into a credit crisis and ultimately generated a recession. Americans are confused and in anguish about the financial crisis. This article is intended to provide a brief overview and explanation of America's economic situation:

The attraction of bigger houses and nicer possessions encouraged the planting of over-leveraged loans. And the new government-sponsored universal home ownership assisted trends with financing options for even the most credit-challenged. Instant gratification and free money became the norm. Disciplined prudence and hard work became part of the past. Credit card limits determined standards of living and new college graduates bought homes worth much more than their incomes could support.

In March, concern began that the country was headed for recession when high-profile voices (like Warren Buffet and Alan Greenspan) declared just that. Then, one of the world's largest investment banks, Bear Stearns, collapsed causing confirmation of America's eminent economic failure.

The national home foreclosure rate soared to between 200,000 and 250,000 per month in the spring, a 300 percent increase from the pre-crisis levels of 2005. Millions of homeowners desperately watched as their adjustable-rate mortgages ticked upward even as their property values plummeted below their loan amounts. A surplus of low-priced residential real estate flooded the market at a time when buyers were few - many of which never sold.

Immediate availability of refinancing began to smell like fraud and the no-doc loans and subprime options became nonexistent. Unlike the careless past of little to no checks and balances, lenders now must demand proof of income, a solid credit score, and true home value appraisals. Abandoned properties and foreclosure signs decorated neighborhoods nationwide, further driving down real estate values and increasing pressure on the homeowners.

Next, methods to alleviate the situation began in the summer. For example, financial crisis hotlines, free counseling services, and lender-borrower liaisons became popular. Programs to help short sales and deed-in-lieu-of-foreclosure agreements were formed by state governments. President George W. Bush signed federal legislation designed to help states buy and repair foreclosed properties. It also allows helpless homeowners to escape subprime financing in favor of low-interest government-backed loans. Further aid began when the federal foreclosure rescue bill brought new optimism that the nation might move toward recovery. Sadly, rescue efforts proved too little, too late. The nation's housing and credit imbalances required severe market correction. Meanwhile, oil and food prices and mortgage delinquency continued to increase.

By late summer, government-supported Fannie Mae and Freddie Mac faced a liquidity crisis. The massive lenders came under control of the Federal Housing Finance Agency on Sept. 7 due to danger of insolvency. It was the first major government bailout and intervention in American history. In the following weeks, more financial firms failed. Lehman Brothers filed the largest bankruptcy in U.S. history, Merrill Lynch sold to Bank of America, and Washington Mutual was subject to America's largest bank failure. Consequently, the market seized and stocks plunged.

A government bailout became eminent. Support from both major party presidential candidates combined with further Wall Street collapses generated considerable political momentum. All signs pointed to speedy passage of the bailout bill. But to the surprise of President Bush and investors, the House of Representatives rejected the first $700 billion bailout bill. Republican critics such as Rep. John Culberson claimed that the bill would protect poorly managed businesses from the consequences they deserved. "This legislation is giving us a choice between bankrupting our children and bankrupting a few of these big financial institutions on Wall Street that made bad decisions," said Congressman Culberson. Meanwhile, Democrats who opposed the bill claimed that it did not offer sufficient foreclosure relief.

Clearly, the bill's defeat sent an unnerving message to Wall Street. Shortly after the vote, the Dow Jones industrial average fell more than 700 points. Five days later, the House of Representatives made enough changes in the bill, including the addition of $100 billion in pork, to pass it. Regardless, the market did not recover.

Fiscal conservatives loudly opposed the massive expenditure and government expansion. They argued that a government bailout could have been prevented. If legislators had recognized the dangerous path the American economy was taking, perhaps this crisis could have been avoided. Five years earlier a quote from Rep. Barney Frank lent credibility to such accusations: "These two entities-Fannie Mae and Freddie Mac-are not facing any kind of financial crisis," the Massachusetts congressman told The New York Times in September 2003. "The more people exaggerate these problems, the more pressure there is on these companies, the less we will see in terms of affordable housing."

Of course, the blame game cannot fix the current crisis. However, the promise of a $700 billion market injection could not correct the sinking economy either. Despite the federal money, investors became further worried. On November 20, the Dow Jones Industrial average plummeted to a six-year low of 7,552.29.

Increasingly desperate to ease the situation, the Federal Reserve released $800 billion for mortgage, credit card, college, and auto lending. It was a decision directed at increasing availability of loans within the private sector. With a lame-duck Congress in session, legislators considered yet another bailout, this time for Ford, Chrysler, and General Motors - the country's Big Three automakers.

But again, government action could not preclude the inevitable. In December, the National Bureau of Economic Research declared the country in recession.

The road to recovery will be slow and long. But, the United States will remain strong and steadfast. The recession will not last forever. Without doubt, Americans will survive this tumultuous economic journey.