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

by

Sarah Lehman Quinn

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Committee in charge:

Professor Neil Fligstein, Chair
Professor Marion Fourcade
Professor Heather Haveman
Professor Dwight Jaffee

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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 state is 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.

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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, 1989[1]

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, 1968[2]

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

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[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 USHCBC. 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.

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[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 is 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 a 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

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[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.

<u>A Sprawling Structure</u>. 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 American's 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

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[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 pursing 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; Stinchombe 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 then 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.