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Introduction:

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Featured Speakers:

THE HONORABLE LAWRENCE SUMMERS
Harvard University, Former Treasury Secretary

THE HONORABLE CHARLES SCHUMER (D-N.Y)
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P R O C E E D I N G S

MR. ELMENDORF: Good morning, and welcome to Brookings. I'm Doug Elmendorf, a Senior Fellow here in the Economic Studies Program.

Brookings is pleased and honored today to be joined by two of the leading voices on economic policy in the United States: Larry Summers, former Secretary of the Treasury, and Chuck Schumer, the senior U.S. Senator from New York.

These distinguished guests have come here at a moment of great risk and challenge to the American economy. The housing market continues to deteriorate at a rapid pace. Both housing starts and new home sales have now fallen about 50 percent from their peak several years ago. House prices have declined a little so far, but are expected to fall more substantially in the coming years.

In addition, more and more borrowers are unable to make their mortgage payments. In the third quarter of this year, more that 16 percent of sub-prime mortgage borrowers were delinquent on their payment, up almost 4 percentage points from a year earlier. Almost 5 percent of sub-prime adjustable-rate mortgage borrowers are actually facing foreclosure proceedings -- more than double the reading of a

year earlier. And overall rates of mortgage delinquencies and foreclosures are at their highest levels in at least 20 years.

Moreover, most forecasters expect a notable slowing in overall U.S. economic activity. When Federal Reserve policy makers offered their projections this past February, they were looking for solid economic growth and stable unemployment, both this year and next.

Their expectations for this year have largely been realized. But storm clouds have clearly gathered for 2008, and some people think it's already raining.

The Blue Chip Consensus forecast from a few weeks ago shows real GDP growth barely above 2 percent in the coming year, and the unemployment rate rising. The odds of a recession have clearly gone up.

At the same time, rising oil prices have fostered worries about inflation.

These economic circumstances pose a substantial risk to the standard of living of American families.

We've seen a variety of policy responses, from the Administration, the Congress and the Federal Reserve. But there's an active debate about whether those responses are correct, are in the

right direction but insufficient, or actually, in some cases, counterproductive and might worsen our economic problems.

Our two speakers today will present their diagnoses of the nature and severity of the economic problems that we face, and will offer their own proposals for tackling those problems.

Our first speaker will be Larry Summers. He will talk for awhile and then take your questions. He'll be followed by Senator Schumer, who will also talk and then, following that, take your questions.

Neither of these speakers really needs any introduction, so I will be quite brief.

Larry Summers is the Charles W. Elliot University Professor at Harvard University. He has served previously as the President of Harvard, Chief Economist of the World Bank, and Under Secretary, Deputy Secretary and Secretary of the Treasury Department.

Larry also has several connections to Brookings. He is a Trustee of Brookings, a member of the Advisory Council of the Hamilton Project here at Brookings, and a co-editor of the Brookings Papers on Economic Activity, along with Greg Mankiw of Harvard, and myself. This is a journal that we edit that publishes policy-oriented research on current issues in macroeconomics.

During his time at Treasury, Larry was a member of what *Time* magazine dubbed “The Committee to Save the World,” when he and Bob Rubin and Alan Greenspan dealt with the international economic crisis of the late 1990s.

Like you, I’m eagerly looking forward to hearing his views about our current situation.

Please help me welcome Larry Summers.

(Applause)

MR. SUMMERS: Doug, thank you very much for that generous introduction. When I once introduced President Clinton, during the administration, I’d worked hard, I’m giving a generous introduction. The President responded by saying, “Larry, you have just demonstrated one of my first laws of political life: whenever possible, be introduced by someone who you appointed to high office.”

(Laughter)

Well, there’s a kind of academic corollary to that which is: whenever possible be introduced by one of your former students.

(Laughter)

It is good to be here at Brookings, and to have a chance to speak today about our current economic situation.

I believe that our current economic situation requires a comprehensive program of measures to contain the fallout from problems in the financial and housing sectors, and to assure sufficient policy support for economic growth over the next several years.

Perhaps because of a failure to appreciate the gravity of our current situation, and the problems our political process has in responding quickly and collaboratively to emergent threats, such a comprehensive program is not, in my view, either in place or in immediate prospect.

For the last year, the economic consensus and the policy actions that have flowed from it have been consistently behind the curve in recognizing the gravity of the problems in the housing and financial sectors, and their consequences for the overall economy.

This continues to be the case. In my view, it is almost certain that we are headed for a period of heavily constrained growth, quite likely that the economy will experience a recession as technically defined, and distinctly possible that we're headed into a period of the worst economic performance since the stagflation of the late 1970s and recessions of the early 1980s.

The late Rudi Dornbush was fond of remarking that in economics things take longer to happen than you think they will, and then they happen faster then you thought they could.

So it has been recently. The related but distinct patterns of excessive valuations in housing markets, and excessive complacency in credit markets were pointed out for years by experienced observers. The cracks took longer to appear than many expected, and have now proven to be far more structurally damaging than almost anyone supposed.

Experience suggests that downturns like the current one, driven by falling asset prices and credit problems tend to be quite protracted. Two extreme examples are the American experience after 1929, and Japan's experience in 1990, after the 1989 stock and real estate market collapse. Our last two recessions, associated respectively with the bursting of the savings and loan real estate bubble and the NASDAQ collapse revealed gaps of several years between asset price peaks and the restoration of satisfactory rates of economic growth.

Nationally, housing prices peaked less than a year ago, and credit spreads reached their minimum only about six months ago.

History has cautioned that situations like the current one are likely to surprise on the downside for a considerable time, and prove quite protracted is confirmed by forward looking indicators regarding the economy. The text you have mentions many. I will mention just a few.

The new and relatively crude futures market that predicts what will happen to housing prices nationwide suggests that before this ends, they will fall by 24 percent from their peak levels. And according to that index, the decline has only been 6.6 percent so far.

The most important driver of U.S. economic growth over the past seven years has been consumption, which has outstripped GDP growth. The combination of a near zero personal saving rate, lost housing wealth, reduced availability of credit, reduced real incomes caused by rising oil prices, falling dollar and rising food prices, as well as increased uncertainty constitute a perfect storm, depressing consumer spending.

Even looking five years out, markets suggest that the spread between safe, liquid Treasury borrowing and the rates at which major financial institutions will be able to borrow will remain well above normal levels. The debt of some of our country's largest and most prominent financial institutions is now trading at levels suggesting a

market judgment that their odds of defaulting on their debts over the next five years approach one in 10.

It is, of course, possible that the improved trade performance coming from a falling dollar, the working through of the Fed's monetary policy actions, and the remarkable resilience of the American economy will carry us through the next year robustly.

But this is not, I would suggest, where the lessons of experience and the preponderant probability lie.

Economic policy-making is about balancing risks. I've already suggested that the probably of sub-par growth substantially exceeds the chance that growth will be robust. There is an additional crucial point, as well. The adverse consequences of policy choices that fail to deal with a potential recession, and fail to stimulate the economy, or that do not allow for financial repair, far exceed, I would argue, the adverse consequences of over-insuring against economic slowdown.

Consider the costs if we experience even a milder than average recession. Losses of close to $5,000 in income for the average family of four, quite heavily concentrated among the disadvantaged, who inevitably last-hired-and-first-fired, along with cutbacks in Medicaid, child welfare, and other social safety net programs as State budgets contract.

A several hundred billion dollar increase in our national debt, and a significant reduction and cutback in investment in plant and equipment, education and R&D.

Hundreds of thousands more foreclosures, and greatly increased risks to the financial system.

Greatly complicated international relations, as our downturn slows the rest of the world economy, the American economic model is called into question, protectionist pressures rise, and the dollar's centrality to the international financial system becomes more in doubt.

Of course, if a downturn turns into more than a historically mild recession, the risks are that much greater.

Against these risks, what do those who counsel against what they see as imprudent activism avoid? They fear stating the need for strong action will somehow undermine confidence by laying problems bare, and they worry that inflation might tick upwards, or that those who've made financial errors will somehow be insufficiently punished.

I only hope that history will see those as the main economic problems faced by whoever is elected President of the United States in 2008.

It is the great irony of financial crisis that the very measures that could have prevented crisis are counterproductive once crisis comes. Of course, it would have been better to have had more fear on the part of lenders, less rampant liquidity, and higher savings two years ago when the imbalances were building.

But that is not what we need now.

The most urgent priority for policy over the next several months is containing the incipient economic downturn. I am convinced that it is possible to do this without giving rise to either excessive complacency in the future, or accelerating inflation.

I want to briefly sketch what would seem to me, on current information, to be the appropriate evolution of policy in a number of areas. Of course, as data comes in and alternative measures are debated, any particular combination of policies might look less and less appropriate. I will have served my purpose today if I've advanced the debate by contributing an example of an ambitious policy program.

One former economist colleague, whose advice I sought in preparing these remarks, referred to recent events as "adjusting for raised expectations, the greatest failure of risk-management in financial history." This is perhaps too apocalyptic. But it is suggestive of the

extent to which major financial institutions are unsure of their own and their counter-parties' credit worthiness.

In normal times, the spread between the rate at which the Treasury borrows and the LIBOR rate at which banks lend each other money for three months is typically well under half a percentage point. Currently, it is about two percentage points.

In the United States and Europe, large and persistent spreads have also opened between the policy rates of central banks and the lending rates at which banks make credit available to each other and to firms and households.

In this environment, the dominant risk is a downward spiral, in which financial problems curtail credit and spending, thereby reducing economic activity which, in turn, exacerbates financial strains, creating a vicious spiral. Once in progress, such a spiral may prove very difficult to arrest.

It is much more important to establish credibility that policy is ahead of the credit crunch spiral than to reassure, yet again, that it is not behind the inflation curve. I say this, not because I am unconcerned about inflation. The point is, the achievement of price stability over the last generation is one of the most important factors contributing to improved economic performance. It is a matter of balancing risks.

With (inaudible) and firms as insecure as they are today, I see little chance of the kind of wage price spiral that has set off inflation in the past. Data on indexed and nominal bonds suggest that despite what has happened to oil prices and to the dollar, there has been no increase over the last year or two in the expected price level for the American economy in 2010 or 2011. Moreover, failure to contain a credit spiral could cost the economy several years of satisfactory economic performance.

In contrast, if I am wrong, and policy creates undue inflation pressures, they can be removed gradually at a moment of much less financial peril.

So far, the Federal Reserve has responded by cutting policy rates by a full percentage point, and putting forward a number of programs to make liquidity available to banks. The seriousness of the problems is suggested by the fact that liquidity provision has not yet made a large dent in the spread between bank and policy or government borrowing rates.

Reductions in policy rates have, to be sure, translated into lower lending rates. But it appears that half or more of their impact has been offset by the increase in the spread between policy and lending rates. This means that the apparent easing in monetary policy in recent

months has been much greater than the actual easing in credit conditions.

What does this suggest going forward?

First, it suggests that policy-makers should consider focusing attention, not on their tradition policy rate but, instead, on targeting some more meaningful indicator of the cost of credit to households and businesses, such as the three-month LIBOR rate.

In this way, increase in credit risks will not, as they do today, automatically translate into de facto tighter policy.

Second, assuring full transparency with respect to the valuation of assets and the recognition of losses and liabilities should be the top regulatory priority. The Japanese experience taught painful lessons about the dangers of government support and encouragement for measures that seek to rearrange balance sheets so as to avoid facing painful financial realities.

Wherever possible, assets should be marked to market, not to model, and liabilities should be explicitly recognized.

Third, regulatory policy needs to focus on assuring that financial institutions raise adequate amounts of capital to maintain their activities, even if this is painful for existing shareholders. If a bank is at the point of indifference between reducing the size of its balance sheet

and raising capital by issuing shares or cutting dividends, the broader economy is not.

Policy in recent months has devoted considerable attention to de-stigmatizing and, indeed, borrowing in what form or other from the Fed. In the months ahead, it will be equally important to de-stigmatize the raising of capital and, indeed, to insist that institutions raise enough capital to allay credit risks and permit the resumption of normal lending activities.

The success of the Clinton 1993 budget plan, in setting off a virtuous circle of growth, reduced deficits, lower interest rates, and still more growth, along with a growing sense that short-run stabilization policy is the job of the Fed, have reinforced the economics profession's growing aversion to the use of fiscal policy as a tool of economic stabilization.

Yet if economic data over the next several months come in, as I feel they will, with increasing signs of recession, several considerations suggest that the policy response should include fiscal, as well as monetary, measures.

Fiscal policy can work more rapidly than monetary policy, which has a lag of about a year between the change in the Federal funds rate and its maximum impact. Moreover, the efficacy of monetary

policy may well be diminished by capital constraints that limit the ability of banks to lend, or where credit-worthiness constraints can limit the ability of businesses to borrow.

As important, the extent to which monetary policy can prudently be used in the current environment is limited by concerns about the dollar, as well as about the bubble-creating effect of the low interest rates.

Certain problems, such as the impact of mass foreclosures on affected communities are not easily amenable to monetary policy.

Fiscal stimulus, therefore, is potentially critical. But it can be counterproductive if it is not timely, targeted and temporary.

Gene Sperling's *Bloomberg* column this week makes these points strongly. "To respond to incipient downtown, fiscal policy has to have its impact in a timely manner. It has to be targeted to ensure that increased government borrowing translates directly into increased spending and demand. And, critically, it has to be temporary so that its effects are not offset by higher long-term interest rates."

Indeed, from the point of view of stimulus, the optimal package is one that raises spending on the deficit in the short run, while reducing the deficit in the long run, therefore bringing down long-term interest rates.

Any fiscal stimulus program would have to be worked out in the context of events as they unfold, and should be walled off from longer term policy considerations, where actions to assure long-term fiscal sustainability are essential.

It is reasonable to suggest that stimulus approaching $50 to $75 billion, roughly in the range of one-half of 1 percent of GNP, is likely to be appropriate. The largest part of this stimulus should come in the form of tax cuts distributed equally among all taxpayers and recipients of tax refunds.

Other elements of a stimulus package should include extension of unemployment insurance, given that long-term unemployment is already at recession levels; temporary step-up in food stamp benefits, which can be executed and have effect very quickly; and tax measures to eliminate from taxation the so-called "income" that homeowners receive when they are foreclosed -- this last step having just been passed by Congress.

In the context of a legislative stimulus program, consideration should also be given to steps that can be taken to help contain energy and food prices. Such measures, if successful, would both raise consumers' purchasing power, and reduce inflation concerns. They might include reform of the Strategic Petroleum Reserve to assure

that the government stops the current practice of accumulating especially scare oil products at times when markets indicate that current supply is selling at a large premium to future prices -- as well as adjustments in policies promoting ethanol, to assure that they do not have an excessively adverse impact on food price inflation.

Probably the single most important thing that economic policy can do for homeowners is to minimize the risk of recession or the severity of recession if it comes. That is why the aggressive fiscal and monetary policies I have just discussed are so important.

But it is also true that problems in the housing sector are an important reason for recession fears, and need to be addressed.

The recent "teaser-freezer," which freezes the initial teaser rate of some sub-prime mortgages, is a useful step that addresses that very small minority of sub-prime mortgage holders who, on the one hand, are unable to get new mortgages with any real prospect, but on the other hand can be confidently relied on to remain credit worthy with respect to their existing mortgages. It is a constructive step, but I know of no credible estimate suggesting that it will reduce annual mortgage payments by more than about $5 billion.

It is a perhaps appropriate component of a much broader strategy that recognizes the core problems posed by the sharp decline

in housing prices. While the issue of re-sets is an important one, there is a more fundamental problem that needs to be addressed.

Consider a homeowner who purchased a home for $250,000, putting nothing or next to nothing down, implicitly relying on appreciation of the house to service the mortgage. That homeowner finds himself today with a home worth perhaps $220,000, and with the capacity to service perhaps $200,000 worth of mortgage, even before any rate re-set. Yet if the house is foreclosed, its value will probably decline to $150,000, and adversely affect the neighbors, as well.

The best outcome for the borrower, the lender and the economy is a write-down in the value of the mortgage that allows it to be service and, at the same time, prevents a mutually costly foreclosure. This is the same idea of Chapter 11 of the Bankruptcy Code that prevents the liquidation and enables the continued operation of overly-indebted but viable companies.

It is deals of this kind -- not just in the sub-prime space, but in the Alt-A mortgage space and in the prime mortgage space, where foreclosures are reaching levels that were typical of sub-prime mortgages just a couple of years ago -- that we are going to need to make if families are to be saved the agony of foreclosures, and lenders are to maximize their resources.

The answer may lie in Bankruptcy reform, it may lie in standard templates for mortgage restructuring, or there may be other ways.

Certainly, various tax and regulatory obstacles to shared-appreciation mortgages -- the mortgage equivalent of what on Wall Street are known as “pick bonds,” in which lenders reduce lump payment in kind -- bonds in which lenders reduce monthly payments in return for a share (inaudible) appreciation when it is sold should be removed.

Until there is a recognition that many individuals who cannot meet their original mortgage obligations are nonetheless the highest value occupants of their homes, we are not going to fully respond to problems in the housing sector.

Additional steps that should be taken in the next several months to ensure an adequate flow of credit to housing should include the provision of Federal assistance to those who are foreclosed as they locate new rental housing, and to communities that wish to purchase foreclosed homes and convert them into rental properties.

Support for an adequate supply of mortgage credit; proposed increases in the availability of FHA guarantees are a positive

development, though they are manifestly insufficient to assure an adequate flow of mortgage capital across the entire housing spectrum.

The government sponsored enterprises, Fannie Mae and Freddie Mac, should be granted significant temporary increases in their portfolio limit so that they can perform their market-stabilizing function at the time it has been most needed in two generations. They should also be freed, on a temporary basis, from punitive capital requirements, and the conforming loan limit should be increased to about $600,000.

It is, of course, possible that developments in housing sector will prove less serious than I fear, and that not all of these measures will have been necessary.

How serious a problem would that be?

A substantial fraction of the originators of sub-prime mortgages have already gone bankrupt. If I read the political winds correctly, those who remain will face greatly enhanced regulation.

The concern that too many homeowners will learn from the events of the last year that it is a good idea to excessively lever-up their homes seems less than paramount at this point.

On the other hand, if policy remains behind the curve, families and communities across the country will bear the brunt of the errors.

While it has not been my topic this morning, I trust that extensive efforts will be made to learn from recent painful experience. Most obviously and visibly, there is the need to protect vulnerable people from the kind of predatory lending practices that have been all too common in recent years.

Recent experience also suggests that the need for evaluation of traditional approaches to monetary policy, the regulation and provision of liquidity to different types of financial institutions, the role of the rating agencies, and much else.

It has always seemed to me that those of us involved with finance bear great responsibility. There is the importance of well-functioning capital markets and the credibility of the currency.

Much more important is the reality that when the economy is successfully managed people's fortunes are determined by their own choices and efforts. When the wrong economic policy choices are made, people's lives can be wrenched apart, as they lose their jobs or their homes or their ability to provide for their family because of complex forces entirely beyond their control.

The economy is at as crucial a juncture as it has been in many years. Policy must balance risks at an uncertain moment. The lives of millions of people who will never think about counter-cyclical

policy, moral hazard, lending facilities, or the Federal funds rate will be profoundly affected by the policy choices made in this city in the next few months.

I hope and trust that they will be made both urgently and wisely.

Thank you very much.

(Applause)

I am happy to respond, until Doug gives me the hook, to any questions.

Yes?

SPEAKER: So --

MR. SUMMERS: Why don't you identify yourself?

MS. BRANNON: Oh, I'm Rachel Brannon with the EIM.

We have this age-old phrase: the bigger they are, the harder they fall. And it appears as though the idea of putting more credit into the system is simply going to prolong the collapse and actually make it bigger.

So I find it interesting that you bring up this rental proposal, of attempting to freeze the collapse that's going on in the financial system. But I don't think it can be done without an increase of

the productivity of the physical economy as well -- this -- the policies of Franklin Roosevelt, not the policies of Felix Rohatyn.

So I wanted to see what you had to say about that.

MR. SUMMERS: I'm confident that Felix Rohatyn regards his policies as being in the tradition of Franklin Roosevelt. And I'm not in the position to distinguish between Felix's views and Franklin Roosevelt's views. So I'll only speak to mine.

It is, I think, a great lesson -- you may raise it as the central lesson of John Maynard Keynes that when there is a shortage of demand in an economy, that shortage undermines the productivity of that economy -- as plants that could be producing sit empty, as workers who could be producing output are idle, and that whatever is necessary, what is (inaudible) for everyone is to put them back to work, and that the capacity to put them back to work lies with policy tools that are at government's disposal: the use of prudent fiscal policy, the use of prudent monetary policy, the assurance of financial stability.

And so in arguing for a macroeconomic policy response, I am very much oriented to supporting the productivity of the economy, and maximizing the capacity to produce goods and services for the benefit of all citizens.

Yes?

MR. PALLEY: Good morning. I'm Tom Palley. I'm an economist here in Washington, D.C.

You began your comments with some references to the fact that a lot of people, for quite a while now, have made observations about the economy potentially running into the type of storm it's now run into. And I'd like to probe the implications of that a little bit.

I think we all know that we need a really good containment strategy now, and that's how I interpret your own remarks.

But the fact that we got into this mess suggests there's some deeper structural problems, which suggests we might need something of a deeper reform strategy. And the things that come to mind, sort of monetary policy, and targeting asset-price bubbles. I think trade policy's been a big part of this. The deficit has been a factor driving policy and creating some of the excesses. And some of the financial deregulation that, in fact, took place under the Clinton Administration.

I'm wondering sort of, along those sort of lines -- this is a time, I know, that containment is needed, a containment policy. But I think it's also a time when we should be thinking about reform policies, as well.

And I'd like to hear your thoughts on that, please.

MR. SUMMERS: I think the penultimate paragraph of my speech, and the conclusion, made essentially that point -- namely, that there was a great deal that had to be evaluated in terms of the failures of regulation issues as a provision of liquidity, what can be done to respond to asset bubbles, the role of the rating agencies and so forth.

And I don't presume to know what the right answers are to those questions.

I think my own instincts would run towards focus on financial regulation, on issues of transparency about risks, on finding ways of containing the pro-cyclicality that financial regulation tends to give rise to -- when things are good capital goes up and so people are strongly encouraged to lend more; when things go bad, capital goes down, and people are strongly discouraged from lending. And both kinds of reactions are counterproductive.

So finding ways to address that pro-cyclicality seems to me to be very much the essence of the question, as well as addressing a variety of kinds of non-transparency and information problems. I think that reliance on the rating agencies as a filter in evaluating risks appears much more problematic today than it did a year or two ago.

Whether the current frameworks of monetary policy that don't focus on asset prices at all are appropriate seems to me to be an important area for debate.

And then maybe linkages between financial deregulation and what has taken place -- although my current instinct would be that that's a harder argument to make.

Yes?

MS. McGARRY: Thank you, Mr. Summers. My name is Leila McGarry, and I'm from the Mortgage Bankers Association.

My question is: some advocates have said a good solution to the sub-prime problem is to change bankruptcy law to eliminate preference to first home mortgages.

Industry thinks that this will raise the rates for buyers by 1-1/2 to 2 points. What do you think?

MR. SUMMERS: I'm sorry -- was the business about 1-1/2 to 2 percentage points, was that your view? I didn't hear the source on that.

Ms. McGARRY: I believe that's coming from our association -- the research center in our association.

MR. SUMMERS: I'm confident that -- I think the appropriate -- I don't think the record of the mortgage industry in its

lending over the last several years has suggested that it is entirely in strong position to evaluate the consequences of policy actions.

It's predictive powers have not been well demonstrated.

(Laughter)

Or perhaps its predictive powers have been demonstrated negatively -- as Senator Schumer suggests -- by events.

You know, there are two kinds of moral hazard concerns here that people are very worried about. And I guess policy has to balance them. And I think the set of measures I'm proposing would.

On the one hand, there is the concern that lending has created an enormous bubble, has been substantially underpriced, and that that enormous bubble has given rise to great economic instability.

The prospect that when there is hugely imprudent lending it will prove difficult to fully recover from that hugely imprudent lending will discourage such lending in the future.

The principal policy concern of those who are worried about prevention -- in the future, such as, I suspect, Senator Schumer and many on the Hill as they responded to the Defense proposals, is precisely to assure that you do not see this kind of large-scale imprudent lending that at time has a predatory aspect that we've seen over the last -- over the last several years.

On the other hand, the concern that you raised, which is that one wants to maintain a viable flow of capital and that lenders will only lend if they have reasonable assurance of repayment, and if they lack reasonable assurance of repayment, they will lend at higher prices is also a valid one. And those tradeoffs are always present in shaping and structuring the bankruptcy law, that it seems to me that at a pond when we're in entirely unprecedented and uncharted territory with respect to a class of loans, and when current arrangements are locking in enormous inefficiency with extra modalities through excessive foreclosure, that is appropriate to be opened to revisioning institutions and rules that were designed in an entirely different context.

Then I think if you read my speech carefully, you'll see that I was very clear in describing the kinds of restructurings that I thought needed to take place and rather agnostic about what the right way to pursue them is. And it would seem to me that it would be very valuable for the Mortgage Bankers Association with all their experience in this area and all that they've learned from the events of the last 18 months not just to respond to the proposals of others but to put forth constructive proposals of their own that would be judged by the standard of the scale of their impact on affecting of the large numbers of homeowners who are affected by current difficulties.

Yes, please?

MR. PRICE: Lee Price from House Corporations. I agree with your point about the limits of the monetary policy, given the financial system situation, and therefore we need to consider fiscal policy. But you also say it needs to be timely. We had fairly -- you didn't talk about it -- we had fairly timely response movement on fiscal policy in 2001-2003, but we had the same party controlling the White House and the Congress. We don't have that now, so I'm interested in what you think is -- how timely is "timely"? We've all got cloudy crystal balls on how things are going to evolve, and when it's going to be needed or too late, but what is your sense of how quickly it needs to happen?

SPEAKER: I can't hear you.

MR. PRICE: The question -- and how did you arrive at one-half of one percent of GDP for what's the appropriate fiscal stimulus?

HONORABLE MR. SUMMERS: The question -- the questions were about fiscal stimulus, what's timely and how do you get timely when the President's of one political party and Congress is of the other. And besides that, where did you get the number a half a percent of GNP -- GDP.

I'd say we, at fiscal stimulus 2001, gets a good grade for timely, but gets a failing grade for temporary and a failing grade for targeted in the sense that it proved permanent, at least quasi-permanent,

and most of it went to the groups in society that had the lowest marginal propensity to spend.

What would "timely" be? It depends on the flow of data. If, as I hope is not the case but feel maybe --the case a recession starts to look like a very high likelihood as we move into the mid Waymes through in early spring, then I think it's essential that it be legislated and intermented (?) within a small number of months. Whether that's possible in this historical environment, we're not, or others in this room who are, in a better position to judge what is the right level of fiscal stimulus, half a percent of GNP with a multiplier combined with monetary policy action, combined with measures that respond to housing seem to me to represent a firm response to downwards pressures.

If the need for stimulus was a great deal less than that, I'm not sure the political efforts involved in launching a stimulus program would be warranted. If the situation deteriorated further, I could imagine the need for greater levels of stimulus, but as the magnitude increased, my concerns about the ability of the political process to keep it temporary would increase as well.

Yes?

MS. KENNEDY: Judy Kennedy, National Association of Affordable Housing Lenders. Thanks for all that you did to support community reinvestment in 1999.

We did predict this crisis in reports in 2001 and 2005 with the help of Nick Gramlich, and so it saddens us, frankly, to be in this situation. But now where you were agnostic in terms of a lot of very sensible recommendations involved Fannie and Freddie Mac. And I think -- I think the facts don't support those recommendations, and let me just tell you about a regulatory failure.

Somewhere in 2004 Freddie Mac and SEMNI persuaded HUD to give them credit for affordable housing when they invested in Triple A-rated tronches of securities backed by subprime mortgages. So they bought about half of those in 2004, more than a third in 2005, and the L.A. Times says they were the chief fit in fears of subprime excess.

They have continued to get HUD-Golds credit and presumably will through 2007. So I want to come back to whether or not eliminating capital requirements that some people think they're going to burn through very quickly makes sense, and also why recommend increasing portfolio limits when they're well under their portfolio limits, and they can do more with mortgage-backed securities? Mortgage=backed securities require less capital; they involve less risk to the government; they allow lender to do more; they allow home buyers to get more. But, in fact, you know, they're actually increasing their prices right now, they're not helping the market.

HONORABLE MR. SUMMERS: Thank you for those -- thank you for the compliments and thank you, also, for those -- those thoughtful -- thoughtful comments. I hope it's clear from my track record that I am not without concerns about the government-sponsored enterprises. And, certainly, from looks of the long sweep of history, the major policy problem is not that the government has asked too much of the government-sponsored enterprises. and I am not knowledgeable what, but am not surprised by this -- by your suggestion that the regulations regarding low-cost housing goals could be defined and enforced in much more satisfactorily ways. Though that's not my subject today, that seems entirely reasonable to me.

I think that it is a matter of no one prudence; there are a whole set of issues about GSE capital and bout the scale of the GSEs that are appropriate to regulate. It does seem to me that one of their mandates was to provide a counter-cyclical element in the housing market. We are in the midst of what is probably the biggest crisis in housing finance since the Second World War. They are a major policy tool that has been put in place towards that objective. It seems to me that it would be a shame if the pressure from policy was for their contraction rather than for their expansion at such a juncture. If the particular set of measures that I spoke about are not the right ones to enable them to expand and respond at a moment when there is a shortage of credit, I am

far more committed to the end than I am to the particular means that I suggested.

Thank you very much.

(Applause)

MR. ELMENDORF: We will move to the second participant in this morning's program, Senator Chuck Schumer. Senator Schumer represents the great state of New York, and I say "great" with feeling because I was born and grew up in New York state. I left too many years ago to be a constituent of the senator's, but I followed events there much more closely, I am confident, than the average Marylander, and as an economist and from a New Yorker, I have been very pleased to see New York represented by someone who takes so seriously the opportunity and the responsibility of the U.S. Senate in guiding American economic policy.

Senator Schumer is a member of the Senate Finance Committee and the Senate Committee on Banking, Housing, and Urban Affairs. He's also currently the chairman of the Joint Economic Committee. Under his leadership, the AEC has produced a number of very insightful reports on a wide range of topics, including the subprime mortgage meltdown. The senator has been one of the most active voices in recent months in exploring, advocating policies to address economic problems and to help American households. Please help me welcoming Senator Chuck Schumer.

(Applause)

SENATOR SCHUMER: I always ask where, when you're from New York, where you went to high school. That's some part of New York, it's what parish are you from, and in every part of New York it's what high school you went to. And, Mr. Elmendorf went up in Poughkeepsie to a very fine high school.

I went to Madison High School. I was a basketball player there. Our team's motto was: We may be small, but we're slow. But Madison has great distinction because we are probably the only high school to have three senators in the United States Senate and probably the only ever to have one, a Democrat -- me. one a Republican, Norm Coleman, and one an Independent, Bernie Sanders. So I doubt any other high school has that, but anyway it's good to be introduced by a New Yorker.

I'm honored to be here with my friend, Larry Summers. He's done an amazing job on issue after issue. When I have a problem or need some explanation, I call Larry and his explanations are practical, incisive, deep
-- I mean, he's just great on issue over and over again, and not always conventional either. So I very much appreciate his staying active in the policy area even though he's no longer Treasury Secretary.

I also want to thank Brookings just for being the great institution that it is, and I want to thank Doug and so many of the scholars and residents at the Institute.

Now, Larry has done a great job letting out some of the serious problems facing our economy and steps we need to take to stave off the dreaded R word, recession. I want t talk a little more in depth about the subprime mortgage crisis, which I believe is at the center of all of our problems. It's not the only cause and maybe the largest cause, but it's there.

The subprime crisis has become a symbol of the Bush administration's serious mishandling of so many economic and domestic policy priorities. Just as Katrina sort of became the metaphor for the administration's inability to manage government with the ham-handed efforts of FEMA, the housing mess, which has hit homeowners and neighborhoods with too many foreclosures, credit markets with mountains of debt, and the economy with meek job in economic growth is further evidence that this administration all too often is ideologically handcuffed and cannot step up to the plate to solve major problems.

As our country teeters on the edge of recession for the first time since 1990, the administration's almost powerless to really roll up its sleeves and involve itself in the problem, and you ask yourself the question why. There are very talented people there -- Secretary Polson,

Deputy Secretary Steele -- and it's my belief that, as I said, they've had ideological handcuffs imposed on them. Keep the government out of any solution. Do whatever you can but keep the government out of any solution.

And the administration ends up tying itself in a pretzel to come up with solutions that are not direct, that don't really hit the bull's-eye in terms of solving the problem, and make the crisis worse, and they're always a step behind for the same reason.

Now, the administration seems to be unable to get the government moving quickly, decisively, and competently to address the most serious economic crisis we've had in the last decade. It is this irresponsibility in action, attributable, in my judgment, to their ideological opposition to government action that has exacerbated the housing and economic lows we are facing.

And our housing problems have rippled through the economy. The fact is that economic contagions are difficult to contain. It's not like a bottle of water; it's much more like a pond where the ripples move outward, but in this case sometimes get larger. The initial ripple is the foreclosure problem, the very serious problem of foreclosures. But it doesn't stop at foreclosing.

The statistics show that every time there's a foreclosure in a community housing prices decline. And so you've had a decline in

housing prices, not all of which caused -- is caused by the subprime foreclosure crisis, but certainly been exacerbated by it and probably is a leading, if not the leading cause.

The ripple goes outward further. Housing prices decline and the consumer buys less, and here we are, and we're getting reports that this Christmas season isn't a very good one, and again, there are other reasons as well: There is high fuel prices, for instance, but one of the main things that this study shows, when housing prices go down, the consumer feels less flush and spends less.

And then, finally, there's probably the most outward ripple which could have the greatest effect, which is the credit crunch. If people aren't lending, if lenders aren't lending to businesses and to individuals, the economy really has a crimp put in it. And so the crisis, the problem -- call it what you will -- just moves outward and gets larger and larger, and the administration seems unable to aim at the bull's-eye, to aim at the problem and help ameliorate it, help mitigate it, and thereby lessen the severity of the ripples that move outward`.

Now, I believe that we could have avoided a lot of this. There is no doubt that an economic slowdown would have occurred, but the administration's inaction could well spell the difference between an economic slowdown and recession. Now, first, I want to focus on four myths surrounding the subprime crisis, and particularly the

administration's limited response. And then I want to take time talking about seven steps we need to take to handle this crisis and lead the rest of the time for your questions.

The first myth is, oh, all this new subprime lending created a huge number of new homeowners, homeowners that could never get homes before now do it through subprime. Not so. There are some, but guess what percentage of subprime loans went to first-time home buyers: 11. One out of 10, okay?

Guess where most of it went. Guess where the plurality went: Not to new homes at all, to refinancings. Forty-seven percent of the people who borrowed did not buy a new home, whether it's their first home or second, and were not even speculators who were buying homes and not living in them; 47 percent were just getting cash sort of like a home equity loan. They needed it for one reason or another. Nine percent went to investors and speculators, and the remainder went to people who bought and lived in homes, but it wasn't their first home; they were signed up. That's the first myth.

The second myth, the unqualified buyer one. The second myth is, well, this is all the free market dogma. I believe in the free market, believe me, but it isn't perfect. And a clinging to the belief that it's perfect and that's all you should rely upon helped create the crisis and helps prevent us from getting out of the crisis.

So the second one is, well, none of these people could have gotten loans if there weren't a subprime market because they couldn't get prime loans. Wrong. Fifty-five percent -- I always talk by the rating -- this is frustrating to me. I've been involved in talking about this crisis. I wasn't as early as Mr. Gramlich or someone like that, but I've been talking about it for about a year. And starting in the spring I mentioned this, that 55 percent of subprime borrowers would qualify for prime loans. They had both the credit scores and the income to do it. Fifty-five percent. More than half. No one paid attention.

Finally, I don't know if anyone's here from The Wall Street Journal, but God bless you, they write a story on the front page about two weeks ago, three weeks ago, and now people are talking about it. Fifty-five percent in the Journal's analysis, this confirms with Martin Eakes and others at the Center for Responsible Lending have been saying for a long time -- so have I -- had credit scores worthy of prime conventional mortgage in 2005, and by last year it was 61 percent.

So this idea that, well, the subprime market, it's gotten all these people who never could have gotten money -- it could get some, no question about it, but not most.

Third, the myth is that there's perfect knowledge. This is always where the free -- the free market falls down the analysis. If you don't take into account lack of perfect knowledge and externalities, you fun

into trouble, and yet our doctrinaire people, too many of whom are governing the administration, that's what they do. So perfect knowledge, that's the problem here.

Everyone assumes, well, all these borrowers knew exactly what they were getting into. This is part of the dogma. They knew exactly what they were getting into, and they made a mistake and they should pay the price. But they didn't. It's been about 20 years after Adam Smith came out that people realized that there was not going to be perfect knowledge, and we had to compensate for that. And yet we still have that myth going on now.

How many of you read your entire mortgage document? How many of you? I didn't. I'm a Harvard lawyer. Now, probably many of you in this audience hired a lawyer to do it. Do most homeowners hire a lawyer before they buy a home? They can't afford it. Of course not. And so people don't have knowledge of what they were getting into. They're responsible, they signed the statement, the 35-page document, but to assume they knew it and now they should pay the price?

That's ideology straight out of the 1890s. It reminds me of the people who, you know -- I get people who tell me this all the time. At a Christmas party Saturday night, two people came over to me and said, "Look, they got into their trouble, they should pay for it."

I said, "Well, do you believe that we should not regulate medicine? You should take a quack medicine and die, and everyone else will learn from your experiences?" That's how the perfect free market would work. But we don't do that anymore. We haven't done that since the 1890s but somehow that kind of thinking, that kind of myth has gotten us into this.

And the fourth one is the most important and relevant one of all, that the free market alone will solve these problems. The administration is wedded to the philosophy government should take a hands-off approach to governing and dealing with these crises. And that myth, left to its own device, the myth that left to their own devices, free market forces will correct these disruptions caused by the subprime crisis has cost us perhaps the most economic pain, because it's allowed the subprime crisis to grow and grow and wreak havoc in the other areas of the economy.

It is true, left to its own devices, the free market will solve the problem, negatively. We'll maximize the number of foreclosures, and the economy will eventually dig out of a hole. But the bottom line is there are externalities so that, for instance, when you're -- when I have paid my mortgage completely, but the homeowner next to me hasn't and is allowed to go into foreclosure, my home values go down. The studies show it. But

the cost of my home going down isn't calculated for whether you should foreclose or not. It's an external cost.

Our economy, being complicated, is rated with external costs, and yet these ideologues don't do it, and that's -- so in other words, the cost of foreclosure in the costs of the outer ripples is not captured. So the declining housing prices is not captured, and the freeze in the credit market is not captured, and the overall downturn of the economy is not captured, and so the free market alone can't fix this, and that's what we've seen in terms of the rippling out.

And you can see this by the administration and what they've done. They just -- they're a step behind all the time because they keep thinking the free market is going to solve this, and the reason they think that is because they don't take extra announce (?), a simple easy theory, but the world is complicated.

Okay, and I'm not going to get into all those details, but in summing this up I want to give you one little example of somebody who is a victim of this crisis. I've met lots of these folks. That's how I knew about this before a lot of other people did. But, Frank (inaudible) that -- he passed already a month ago, but his death isn't relevant to the story -- Frank is your typical subprime buyer.

Frank is a subway-- was a subway motorman, retired, who lived in Ozone Park Queens, in Nativity Parish. I don't know what high

school he went to. And he had a good pension of about $28,000 a year and his Social Security was $11,000, so there was Frank with $40,000 a year, and he had a home that had a 30-year mortgage that had decent value, and he had paid 16 years on the mortgage. And Frank was a prime borrower. His FICO score was about 700. He always paid his bills, okay?

But Frank got diabetes and somehow his health care plan didn't pay for the treatment that he thought was the right treatment. And so he read in the newspaper that he could refinance his home and get quick cash. And he called up the mortgage broker, who visited him, and the mortgage broker was unregulated. If there's ever a justification for regulating, it's if you look at where almost all of the problems in the subprime market occurred at currently unregulated sector which was nonbanking, as opposed to the regulated sector which was banking, and if a guy came in -- and Frank's no dummy, he's not genius, but he's no dummy -- was -- asked him a question.

He said, "How much more?"

He says, "I need fifty thousand."

"We'll get you the fifty thousand, we'll just do a new mortgage at thirty thousand, you know, 30 years."

And so Frank says, "How much more am I going to pay?"

And the guy didn't lie, he said, "In January you'll pay," -- he was paying about a thousand a month, which is about a third of his

income, a little less, so that's just fine. He said, "You'll go up to about $1,100 a month in January.

Frank said, "I can afford that. Great, let's sign and so it." And he signs the document and he didn't read it. And sure enough, on page 23, that the next January his mortgage was going up to $3,300 dollars a month, which is more than his income. Should we hold Frank accountable for that so we can learn the lessons of the free market?

Second. As I said, Frank was a prime borrower -- third, listen to this, this is not related to the four myths but it's probably the most galling of all, and it shows the need for regulation. Of the $50,000, do you know how much Frank got? Fifty-seven hundred dollars. The mortgage broker, unregulated, got $22,000 of the fifth because he got commissioned for how high the interest rate was, if it was a no doc loan, if there was no prepayment allowed if there was a prepayment penalty.

The mortgage company, which is a company like Country Wide, one of the other ones that went bankrupt, got $11,000 of the fifty, and then between the appraiser, and this one and that one, they took the rest. Frank got fifty-seven hundred and, of course, he lost his home. And he was a prime borrower. Had he walked into a bank, they would have given him a prime loan, he would have gotten his extra money, et cetera. But he didn't know he could do any of that.

So those are the myths all put together. Frank is far more typical than your poor, struggling inner city family that finally gets manna from heaven in the subprime loan and lives happily ever after. And most of it, much of it, in terms of the foreclosures were people who were being ripped off -- maybe legally ripped off. We have to change for being ripped off.

Okay,. so those are the myths. The administration plan just doesn't make much -- doesn't do much. As I said, they've twisted in a pretzel to avoid government involvement, and as a result it only covers about 10 percent of all the borrowers is the new plan that Secretary Polson announced. And I met with his folk and Steele beforehand and, you know, I just get the feeling this is me talking. But these guys are too smart to know that this is the right way to go [sic], but they're marching within the confines that they were given: no government aid, no government involvement.

And it covers only 10 percent. It doesn't help buyers who have had their rates reset and have missed a payment already; it doesn't help owners like Mrs. Ada Diaz, who I met in Staten Island, another civil servant -- actually, she worked in a private hospital -- another person who was losing her home even though she had enough money to pay, because she was put in the loaned -- she's not going into the problem, she has the problem already. It doesn't help homeowners who were duped on

their loans outside of the plan's arbitrary start and end dates. And 'cause it's voluntary, each servicer sets their own eligibility criteria. So some buyers will get help and other buyers in exactly the same position won't.

And I don't believe you can take this chance. Leave it up to the -- to each situation, leave it up to each of the mortgage servicers to decide what to do, because it's fraught with difficulty, and then you have a final problem which is, if one of the 30 lenders, one of the 30 investors decides to sue, they can hold this thing up for a long time.

So it just doesn't work. So what is the solution? And, by the way, it's been widely discredited. The markets didn't react well to it, the experts didn't react well to it, and they're going to have to come out with another plan just like the SIV plan before. All of these things that don't aim help directly at the bull's-eye, the person who's in foreclosure needs help, are bound not to work. So what is the solution?

Here as the seven things that I think we have to do, and they do involve some degree of government action:

First, the world's changed. I'm all for the second ready market. It creates, makes things much more efficient. But you're missing that good old bank loan officer. The bank doesn't make the loan, there's no one supervising the mortgagor, okay? And so if Frank, if someone came to Frank even after he starting paying $3,800 and was ready to be

foreclosed and said, "You're a prime buyer, or you have a good income, I can do a workout for you," it would be great.

And if Frank's lender was a bank that still had the mortgage like in 1985, that's what would have happened. It's very easy to train these people, and we should -- the federal government should put in -- and this is not a bail-out, this is people on the ground to help those 55, 60 percent of those in foreclosure who are prime borrowers to do a workout. That's all it is. And it'll end up costing five or six thousand dollars rather than $200,000, which is what a foreclosure can cost at the end of the day, if you add up all the other costs, external and internal.

And we should simply take them, because no one else would. I tried to get some of the major banks and the major nonbanks to put up money to do this, and, yeah, someone will give a couple of million here and one will give a couple of million there, but that's why we have a government, because it's not up to the private sector to do this. So that's the first thing we should do. For about a billion dollars, every person who could refinance will have someone help them refinance.

You could even train college graduates to do this It's not that hard, and groups like the scent if there's responsible lending and others are ready to do it.

Now, we did put $200 million in the new omnibus bill for some of this, so we've made -- it's progress, and they didn't veto the

omnibus bill yet, so they're not gonna. So there'll be a start, but we have to do more. That's the one thing you need.

The second thing you need is money. Where is the money going to come from to refinance these mortgages. Someone on the ground knows how to do it, has the expertise, and there, to me, the place is Fannie and Freddie. They can provide liquidity. If you raise their portfolio caps 10 percent, you'll provide $150 billion. You'll acquire that money just for one year -- don't raise them permanently -- you'll acquire that money to go to refinance these foreclosures. Fannie and Freddie don't really want to do this. They don't make enough money on these loans.

Well, Fannie and Freddie, you're not just a private sector company, and you can't keep putting your hat on and taking your hat off when you, one, say private/public, private/public. You want to be public, say private sector only; and if you're only mission is to increase your shareholders' price, then don't take the government guarantee.

But I don't believe that's right. That's really what the administration and even Alan Greenspan wanted. They didn't want a Fannie and Freddie. I voted this should be a robust Fannie and Freddie, but I believe that Fannie and Freddie's responsibilities to the public sector are at times like this, and so Fannie and Freddie, they should raise their portfolio, no caps required, the money to go into this.

And, you know, some of us who have helped Fannie and Freddie in the past ought to jawbone them to do it, because legislation that I've introduced along with Barney Frank to do this, we've also introduced legislation to raise the confirming loan limits for the GSEs. This one does have the support of the administration and Mr. Bernanke. And they would raise the limits of the so-called jumbo loans from the low four hundred thousands into the mid six hundred thousands, so more and more bridges would be covered. Jumbos are having big trouble even though they are larger homes with richer people. And you give them a Fannie and Freddie guarantee, and it makes sense.

Third. I will be introducing new legislation to provide additional liquidity into the markets. This would allow states and localities to use single-family tax exempt bonds, the mortgage revenue bonds, MRBs, to refinance subprime loans at the risk of foreclosure. Probably, mortgage refinancing is not permitted under the MRB program; fixing that's a good idea.

The administration has proposed we provide a temporary three-year increase in the volume cap that limits the state issuance of MRBs. Treasury officials tell us that five billion a year in mind, that doesn't go far enough, obviously, and ignores one key fact: The reduced homeownership that's a result of the subprime crisis means we also need more money to go to multifamily rental housing, an the insistence that all

of the volume cap go to single-family is not ideal for cities that have been hardest hit by the subprime crisis, places like Buffalo and Cleveland and Detroit.

So I'll be introducing legislation shortly that expands on the administration proposal by doubling the amount of the increased bond cap they're proposing making a portion of the increased cap permanent and giving states and localities the flexibility to respond to a wider range of mounting housing needs.

Fourth. My fourth proposal addresses the many subprime buyers who won't qualify for refinancing. They have damaged credit, have lost income, have loans greater than the value of their homes. These people need judicial loan modifications through bankruptcy, and that could be a highly effective tool helping families recover from this situation. Today's bankruptcy code prevents courts from modifying -- this has all been talked about, so I'll go through it briefly -- the modifying the terms of a primary mortgage loan, the less singles out home mortgage loans is the one debt courts are not permitted to modify.

Senator Durbin, my colleague and roommate, has proposed -- and I cosponsored -- legislation to amend the bankruptcy code to make primary home loans eligible for the same remedies that are available on other less important debts. So if you did these four things, you wouldn't eliminate foreclosures, but you could greatly reduce them.

And what would happen is the markets would say: Someone's in charge, and this isn't going to get worse. And then the outward ripples, whether it be home prices, consumer spending, credit crunch, would feel some degree -- I couldn't specify how much degree -- of relief, but it's a lot better than what's being done now. So those four proposals deal with the problem we face now.

Next, how do you prevent it in the future, happening in the future? First, and obviously, mortgage brokers should all have some degree of regulation and responsibility. The guy who went and saw Frank should not just be a freelancer, the guy in the wild west, who can do whatever he wants. He's happy, by the way. He has his twenty-two thousand, who knows where he is?

And so we should regulate these people, plain and simple, and the mortgage brokers would say, well, there are a lot of grid responsible mortgage brokers wherever, and they won't mind the regulation. We don't regulate for the good responsibility; we regulate for the rogues who hurt everybody.

I'm sure if you're a good mortgage broker who never did these things, your reputation's suffering right now, and you don't like it. Regulation would prevent the bad apples from doing the kinds of things they did. They were encouraged. I don't have much faith in the country-wides. They encourage these bad people by giving them bonuses and

giving them everything else. But that's very different, that's very different day.

So we have that regulation. I put in legislation four months ago that did this, basically the same degree of regulation that we have on bank, bank lenders. We do give the first mortgage -- the first lender some degree of responsibility. I think it's hard to say the people who buy a little piece of one bond should be responsible that the mortgage broker did the right job, that the initial lender should be, and so we give them some degree of responsibility and liability.

And Senator Dodd just introduced legislation that is pretty close to mine. I cosponsored it, and, hopefully, we will pass that early next year. It's a little stronger than the House legislation. So that's the first -- that's to deal with the crisis in the future to prevent these mortgage brokers from coming in.

Next, we have to look at the role of credit agencies. How did all these people get triple-A ratings? I've called in the head of Standard & Poore's and Moodys and then New York companies -- I like to defend New York companies -- but they didn't have any good answers. And it may be the whole system. One of the reasons that there's a credit crunch is that people now don't trust the credit rating agencies on anything except maybe U.S. government's where they're not needed.

And how do you -- how do you deal with that? Well, you may have to change the whole structure of how the credit agencies work, or at least encourage alternative structures. You know how it works now: The issuer pays the credit rating agency after they give the rating. So first there's a basic conflict of interest that your rater is being paid by the ratee. And, secondary, even paid for after they give you a rating.

Back in the '70s investors paid the credit-rating agencies, and so there was a lean to being tougher as opposed to a lean to being more lenient, and each one has a lean, obviously. One of the problems there is it was all private. If I'm a potential investor, and I want to know what this investment is worth, and I pay the credit-rating agency, I don't want to let my competitors know what they found out. But this is something that we have to explore.

And so those are my basic proposals. Oh, I left out one, I knew there was one I left out. Simple disclosure. This one everyone can agree on, free market or not. Put in legislation but there should be -- I was the author of something called the Schumer Box, which created for credit cards they had to state what the interest rate was and the penalty in big letters right on each application, right on each advertisement. It will put the Fed on this, it brought down credit card interest rates. Before that, again, we had the free market tax. Well, it's on page 22 of the agreement that they signed knowing what the rate was.

Now, they did -- rates came down. We should have a one-page front cover of every mortgage document, and it should say on it what you're going to pay now and what you're going to pay a year from now, and what you're going to pay two years from now and three years from now. And I understand that, you know, in variable rate world, it'll need some degree of clarity. But you can do that based on today's interest rates and put a caveat. Something that Frank would understand.

And you do these seven things, the first four go to ameliorating the present crisis; the next three go to preventing a future crisis; all of them do involve some degree -- God forbid -- of government involvement or regulation, but it's the only way to solve it. And so I would hope that before the crisis gets much worse this administration will realize that the reality of the situation will force them to take off t his ideological -- these ideological handcuffs, roll up their sleeves, and work with the Congress and people like myself to solve the problem.

Thank you.

(Applause)

Okay, ready for your questions. Yes, sir?

SPEAKER: Senator Schumer, I have a question about -- oh, I'm sorry, my name is Kim Tim I'm a policy analyst in town. Your four policy interventions would seem very reasonable and thoughtful. All have

a theme which is to get the borrower to refi-out a mortgage now that is not particularly good for the borrower.

SENATOR SCHUMER: I can't hear you.

SPEAKER: I'm sorry, the four proposals -- these are the things to get a refi-in, get a better loan to replace the one that is likely to move to foreclosure or already has led to foreclosure.

SENATOR SCHUMER: Right.

SPEAKER: My question is this: Since so many of these subprime loans have been securitized, are there constraints within the bond documents that prevent the loans to be refied-out. Some of these bonds don't allow more than a very small percentage of the loans to be replaced. (inaudible) and Down, for example.

SENATOR SCHUMER: Right.

SPEAKER: How does -- how does that -- how do you address that constraint (inaudible) to refi loans?

SENATOR SCHUMER: Okay, a couple of things here. Most of the servicing documents do say that if they're on the brink of foreclosure there can be refinancing. They don't say there can be a credit freeze, so that makes the administration's proposal less susceptible But they do say this, it's sort of standard language, and it is up to the servicer to make that determination.

Second, I think that most of the borrowers, almost all of them -- you see, again you do a credit freeze, you have to worry about who, which pieces of the loan get paid and which don't, and who comes first. You do a refinancing, everyone's going to get repaid. It just stretches it out.

Yes, sir, way in the back? Yes?

MR. JONES: Yeah, hi. My name is Creighton Jones. It does seem as you're pretty well intentioned with your plan. It doesn't really address the fundamental crisis, which is that -- because it seemed a lot like what the Fed is now doing, pumping in more money --

SENATOR SCHUMER: No.

MR. JONES: -- to try to bail out the value either of the homes or the securities, et cetera.

Now, I work with the economist, you know, Lyndon LaRouche, and he's called for a total freeze on foreclosures, end foreclosures, keep people in their homes, go for a revaluing of the price of the homes because they are hyperinflated, and then free the banks, the local and regional banks from the creditors, from the secure ties that obligation --

SENATOR SCHUMER: Let me just say to you, sir, I think you'd have one problem with just a freeze on all foreclosures: It's called

the Constitution. You know, there are various contracts between people that --

MR. JONES: Roosevelt used it.

SENATOR SCHUMER: Hmm?

MR. JONES: Roosevelt did it, and he was a follower of the Constitution.

SENATOR SCHUMER: Well, I think it would take -- yeah, it took about four years to sort it out.

MR. JONES: It's going to take that, but this is general welfare.

SENATOR SCHUMER: My view is this is a --

MR. JONES: It's people first.

SENATOR SCHUMER: -- this is a quicker way to help get to the same problems that you're talking about.

Let me call on the next person. Yes, ma'am?

MS. HARRISON: Hello. My name's Torrie Harrison with American Assistance Applications.

SENATOR SCHUMER: You'd have to speak up, ma'am.

MS. HARRISON: Okay. I was curious that Larry Summers and yourself proposing solutions that are somewhat temporary and in kind of heat of the moment. I was wondering what you think about creating a capital budget for long-term infrastructure projects to reinvest into the

economy. And the reason why I mention that is right now the real estate market is about 50 percent or more of the United States economy, whether it be your plumbers, your electricians, people in Wall Street, which is not productive, building houses and then making money in revaluing those houses.

So what are your thoughts on the long-term capital budget --

SENATOR SCHUMER: Okay.

MS. HARRISON: -- to restimulate the economy for 25, 50 years?

SENATOR SCHUMER: Well, look, I think there have been a number of interesting proposals. Felix Wellaton made a proposal along those lines. I think Bernard Schwarz and some of the others did, too. I think it's something to look at. I think it doesn't deal -- I think we'd first have to deal with this issue because it's more immediate and creating more problems.

But I will say this -- and I'm not sure the best way to get there -- that we have huge infrastructure needs over the next 25 or 30 years, because most of our fundamental infrastructure -- road, sewer, water -- was done 50 to 100 years ago and has to be redone. And when I go around New York state, the number one in suburban smaller cities and rural areas, number one, two, or three on the list of the local governments

is, how are you going to help us with our need -- not for roads, which is more federally and state-oriented -- but for water and sewer?

So this is a serious problem, I agree with you. School buildings, everywhere. How we deal with it, I don't know. I mean, I greatly worry overall that since 1980 that government, the federal government, has had a much more restricted role, and the next 25 years we're going to pay a price, and we better figure out how to adapt to that in terms of infrastructure and in terms of education, and in terms of many, many other areas.

You know, we have a great system. I don't want people to think I don't think it is. I think our system is the best in the world. I think it has the right blend of entrepreneurialness and regulation. I think we're the only country in the world where anybody -- you're sitting next to the head of Bulcher Bank, a very nice fellow, and he said, "You're the only country in the world where somebody comes here and can really aspire to the top." And we energize people no matter what their background and what their economic level -- the way China doesn't, India doesn't, Europe doesn't. It's great.

So we have all of this going for us, and the anxiety I have as somebody who loves this country, I think we have let things lag rather significantly over the last 25 years but particularly over the last six or

seven, and we better figure out ways to deal with it, and infrastructure is one of them.

Yes, sir -- although the number one thing I worry about is our education system. It is declining rapidly, it doesn't get the attention that the health care system does -- obviously, if you have someone who's sick, that's your first concern -- but our education system has declined so that if we don't change it in a very significant way, we're not going to be the leading economic power of the world 25 years from now. And I don't want that to happen. Sorry.

MR. MITCHELL: Senator, thanks. Barry Mitchell from The Mitchell Report, although probably not the one that you might be thinking about this --

SENATOR SCHUMER: Yes.

MR. MITCHELL: I'm interested in -- I'm interested in the politics of both the quick fix and the longer-term fix. In your comments, as I recall, you mentioned both Senator Durbin and Senator Dodd, and I'm interested to know to what extent there's an appetite for this on the other side of the aisle, and whether you've got any prospects for the partnership under a leadership there?

SENATOR SCHUMER: No, this is -- you know, this would be a more general comment, but I do believe that too many on the other side of the aisle are simply following the administration position, and we

used to see more independence from at least a certain core of those folks, and it's hurting us. It's hurting us in a lot of different ways.

As the crisis gets worse, that may change. And, look, even the administration's position has changed some. It's just they are so bound by their ideology that they'll always -- you know, a day too late and a dime too short. So I think we will see some changes as this gets worse, but we could be ahead of the curve.

Yes, I'll take the last question from you, ma'am.

SPEAKER: Hey. Felix or Hayden's proposal which you cited for infrastructure --

SENATOR SCHUMER: I'm sorry -- yeah, go ahead.

SPEAKER: Felix Wellaton's proposal for infrastructure which you cited uses private financing, the federal government is actually indebted to private companies. And I know the ATM reference you made that this Homeowners Bank of Atlanta is bailing out Country Wide --

SENATOR SCHUMER: Yes.

SPEAKER: -- well, these proposals right now are simply to bail out the financial interest. If we don't actually put a freeze on foreclosures and mortgages as a whole, as a piece of an overall policy package, as Roosevelt did, that also increases the physical production of this economy, then we are dead as a nation.

SENATOR SCHUMER: Okay, what --

SPEAKER: And as being from New York, you should really think about the tradition of Roosevelt in this way.

SENATOR SCHUMER: Well, I think of his tradition every so often, but -- (Laughter) -- but I guess I would say this: I think that, generally, you know, there are certain activities that are best left completely to the private sector with maybe a light degree of regulation. There are some activities that belong in the government, and then there are many in between. And I think I'm actually less worried about the structure of how to refinance infrastructure and more worried about the resources that are going to be needed to do it.

Thank you, everybody.

(Applause)

MR. ELMENDORF: Thank you, Senator Schumer, and I'll assume that finishes our program for today. Thank you all very much for coming.

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