The Financial Crisis of 2008

A Clarion Call to Include Economic Policy and Financial Illiteracy on Public Administration's Intellectual Radar Screen

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My thesis is simple. The current financial crisis obligates public administration scholars and journal editors to redefine our intellectual boundaries and pay greater attention to a locus of economic issues with particular focus on the "housing obsession," pension policy, financial illiteracy, declining earnings, and "Fed" policy. Our discipline has ignored these issues for decades; continued neglect will undermine our stated commitments to social equity and relevance.

Nearly 20 years ago, I wrote that academic public administration ignored a number of topics in the broader economic environment (Frank, 1992). Among them, the steady decline of real income for most Americans (what Wallace Peterson [1995] dubbed "the Silent Depression"), our society's paucity of savings, and our broad-scale lack of financial literacy. My contention at the time was that ignoring these subjects was done at our own intellectual risk. The beginning of the "tax rebellion" and onset of strong antigovernment sentiment was coincident with steep declines in real earnings during the mid-1970s (Kirlin, 1982). Further, I noted that dependence on foreign capital, much like our dependence on foreign oil, diminished monetary policy autonomy and sent billions in interest overseas. Last, financial illiteracy resulted in less than optimum working of markets and contributed to a number of financial issues, including ignorance of how to save and invest for retirement.

In a recent piece, my colleagues and I (Frank, Christian, & Scutelnicu, 2009) analyzed content of nearly 600 articles from 1996 to 2006 in the *Journal of Public Budgeting, Accounting, & Financial Management* and *Public Budgeting & Finance*. We found no articles related to the macroeconomy or financial literacy. Central bank policy was also put on the "ignore" list, despite recognition that the Federal Reserve and its peers overseas are major drivers of economic development policy (McDonald, 2006) at all levels of government. Twenty years ago, neglect of these subjects seemed bothersome for a

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policy science. The onset of the worst financial crisis since the depression says our discipline's continued inattention to a locus of macroeconomic and personal finance issues is a huge intellectual blind spot that undermines our stated commitments to social equity and relevance.

WHAT WE NEGLECT AND WHY THAT SHOULD NOT BE THE CASE

What follows is a list of subjects that should be on our discipline's intellectual antennae. They are in no order of importance; however, they are linked in one important regard: Each relates to a society that undersaves and overconsumes, with shrinking real earnings as a backdrop.

Home Ownership as Secular Religion

Robert Samuelson argued that one of the underlying causes of our crisis is what he termed "The Homeownership Obsession" (2008, p. 37). The difficulties with the Federal National Mortgage Association (Fannie Mae) and the Federal Home Mortgage Corporation (Freddie Mac) can be traced to a coalition of realtors, homeowners, builders, and mortgage lenders who saw home ownership as an entitlement. Government agencies such as the Department of Housing and Urban Development and the Federal Housing Administration aided and abetted this effort with support of "affordable housing" initiatives that have backfired into above-average foreclosure rates for minorities. Robert Reich (1992) placed this obsession in a broader context: a tax code that puts estate investment on a pedestal relative to stocks or other asset classes, with negative consequences for economic growth. The upshot is that the current crisis requires an examination of a culture and tax structure that "incentivizes" housing as an illiquid form of savings to the possible exclusion of more productive investments.

Readying the Workforce for a Defined Contribution Pension Reality

America's traditional defined benefit pension plans were financially challenged prior to the financial crisis, but the steep downturn in stock market values has further damaged plan assets, and shrinking profits have diminished the funding capacity of many institutions (Goldstein, 2008). Meanwhile, the Pension Benefit Guarantee Corporation's capacity to backstop defined benefit plan solvency has been seriously eroded, given the spate of bankruptcies in the airline, steel, and mining industries over the past decade. Thus, the steady decline of Americans covered by any pension, much less a traditional defined benefit plan, is likely to accelerate.

Public workers are not immune to this erosion. Changes in governmental accounting rules obligate state and local governments to carry pension and other postemployment benefits as current liabilities. The concomitant steep increases in payroll costs are making headlines across the nation and raising fundamental questions about the public's willingness and ability to pay for these benefits when so many citizens outside of government are losing pension coverage (Lowenstein, 2008).

Mainstream public administration has viewed this problem in narrow-gauged terms, examining how a change in accounting rules will impact balance sheets or bond ratings (Frank, 1997; Marlowe, 2007). A more fruitful research agenda with spillovers for the private and nonprofit sectors would examine financial literacy education that prepares Americans for understanding defined contribution plans that dominate the pension landscape. The Pension Protection Act (PPA) of 2006 and the behavioral economics that drove it suggest a substantial nest egg can be created through mandatory employee payroll deductions and investment in qualified default investment alternatives, generally a target or "life cycle" mutual fund. But this approach is not without its drawbacks, not the least of which is a more volatile portfolio over a 30- to 50-year saving cycle (Armstrong, 2007; Wherry, 2006). Increasing numbers of public employees (the PPA covers 403(b)s and 457s) will need guidance on how they can better manage their retirement portfolios throughout the life cycle.

Although some in the workforce have at least a rudimentary knowledge of investments, many, particularly women and minorities, are seriously deficient (Armone, 2006; Frank, Condon, Dunlop, & Rothman, 2000). Public administration research that pinpoints and overcomes those deficiencies would be a major contribution to the financial well-being of all Americans.

WIDESPREAD FINANCIAL ILLITERACY AND A CULTURE OF DEBT THREATEN AMERICA'S FINANCIAL WELL-BEING

Wachovia Bank's insolvency and subsequent takeover by Wells Fargo in 2008 are largely attributable to a corporate purchase Wachovia made in 2006—the $26 billion takeover of the California-based Golden West Financial (Boye, 2008; "Golden West Financial," 2009). Golden West's signature product was the "Pick-a-Pay" mortgage plan, a loan type that might be viewed as a poster child for all that was wrong with mortgage lending in the run-up to the current crisis—"teaser" interest rates as low as 1%, poor borrower creditworthiness, limited income verification, and borrower ability to forgo principal payments—hence, the "Pick-a-Pay" moniker.

Many would rightfully argue that better regulation would not have allowed "Pick-a-Pay" mortgages or their analogs to be underwritten in the first place.

But regulatory failure is not the sole culprit in the horrific financial dynamics at play with many subprime mortgages. Financial illiteracy and a broader cultural tolerance of excessive indebtedness play critical roles in the torrent of mortgage defaults and foreclosures. On the face of it, a more financially literate, savings-oriented clientele would have forgone many subprime or exotic mortgages. Why might that be the case?

A financially literate public would understand that interest "bumps" of 2% or more on five- and six-figure loans could wreak havoc on a family's budget. Consumers with rudimentary knowledge of personal finance would have avoided mortgages with four- and five-figure prepayment fees. Federal Reserve chairman Ben Bernanke's (2006) congressional testimony foreshadowed the financial pain many would suffer at the hands of unscrupulous lenders. As Bernanke observed, government regulators cannot be in every car dealership or loan office to protect consumers from their inability to discriminate between sound and unsound loans. Sadly, too few borrowers knew enough about personal finance to ask lenders and themselves if a prospective loan made sense given their financial circumstances.[1]

Financial literacy aside, "Pick-a-Pay's" self-determined amortization schedule underscores Barbara Dafoe Whitehead's (2008, p. 8) contention that the United States has turned from a "culture of thrift" to a nation of debtors. Seen in this light, "Pick-a-Pay" and its siblings were cultural artifacts that absolved mortgage holders from steadily paying down principal while encouraging further consumption. These products' regulatory shortcomings played into our society's insatiable demand for debt.

PUBLIC ADMINISTRATION SHOULD PAY ATTENTION TO PROLONGED "EASY MONEY" ON THE PART OF THE FED

Nearly a decade ago, Bob Woodward dubbed Alan Greenspan the "Maestro" (Woodward, 2000) for orchestrating the sustained economic recovery after the 1987 stock market crash and subsequent shocks such as Mexico's currency crisis of 1994. Nobel Laureate Paul Krugman's (2009) reassessment is less sanguine, suggesting that Greenspan's persistent low interest policies fostered the stock market crash of 2001 and the housing crash of 2007.

Interest rates are a shorthand expression for a culture's time preferences regarding savings-consumption tradeoffs (Smith, 1989). Perhaps unwittingly, the Federal Reserve (the Fed) has conditioned Americans to borrow too cheaply, at rates that do not account for inflation, in much the same way that automakers and airlines have become hyperreliant on rebate programs and "fare wars." Academic public administration has an obligation to cry "foul" if artificially low interest rates eventually lead to painful boom–bust cycles. This is particularly true in the broader context of an overleveraged society that neglects current health, education, and infrastructure needs while foisting increasingly large debt burdens on itself and future generations (Walker, 2007).

THE "SILENT DEPRESSION" REQUIRES A REDEFINITION OF SOCIAL EQUITY IN OUR DISCIPLINE

While academic public administration was debating the meaning of social equity (National Academy of Public Administration, 2006), real earnings in this country continued to decline. Between 2000 and 2008, family income fell $2,000 (Bernstein, 2008). This is a painful continuation of a trend that started in the late 1970s (Thurow, 1980) and has remained largely unabated. Worse still, the wage decline has been accompanied by increased earnings concentration in the top fifth of the workforce (Levy, 2007; Ryscavage, 1999). Reiterating what was said at the onset, the "tax rebellion" commenced with the onset of the Silent Depression (Kirlin, 1982). This is unsurprising. Can we expect citizens to willingly embrace collective provision when 80% are having increasing difficulty making ends meet?

The National Academy of Public Administration's (2006) definition of social equity is largely based on public organization inputs, outputs, and outcomes. This narrow definition is an intellectual dereliction of duty carrying the implicit message that antigovernment sentiment is simply the result of bureaucrat bashing and bungled (perceived or actual) service delivery. America's income dynamics over the past 30 years suggest otherwise. It behooves scholars in the discipline to broaden the meaning of social equity and to explore the causes of our shrinking, skewing incomes and to offer remediation.

CONCLUDING THOUGHTS

Some would argue that public administration researchers do not have the bona fides to comment on economic policy or its execution. Others might dismiss issues related to financial illiteracy and investments as topics best left to personal finance "gurus" such as Suze Orman. My response is twofold. First, those with the presumptive financial expertise (including Ph.D.s in mathematics and economics) designed many of the economic policies and financial instruments that led to this crisis, and their subsequent Troubled Asset Relief Program and mortgage modification efforts have done little in mitigation. Hence, we should feel no compunction about offering our diagnoses or solutions. Second, this crisis shows that personal and public finance are inextricably linked; individuals who are unable to make informed decisions regarding savings, investments, and debt will cause significant financial harm to themselves, their neighbors, and society as a whole.[2] Hopefully this crisis will serve as a wake-up call to public administration scholars (and journal editors) that they cannot claim relevance while ignoring major macroeconomic trends.

NOTES

1. There is widespread agreement that most American high school graduates have limited understanding of personal finance basics such as balancing a checkbook, comparing insurance policy or bank loan terms, establishing ongoing savings, or planning for retirement. Most employers do little to overcome this educational legacy (Credit Union National Association, 2002; Volpe, Chen, & Liu, 2006). This leads to lower savings and higher spending for financial services over a lifetime.

2. Other academic disciplines, most notably psychology, economics, and accounting, explore this issue. Research findings were incorporated into provisions of the Pension Protection Act of 2006, most notably automatic enrollment of employees into 401(k) plans and automatic annual escalation of contributions.

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