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Georgia on My Mind

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As we look for ways to prevent future financial crises, many questions should be asked. Here's one you may not have heard: What's the matter with Georgia?

I'm not sure how many people know that Georgia leads the nation in bank failures, accounting for 37 of the 206 banks seized by the Federal Deposit Insurance Corporation since the beginning of 2008. These bank failures are a symptom of deeper problems: arguably, no other state has suffered as badly from banks gone wild.

To appreciate Georgia's specialness, you need to realize that the housing bubble was a geographically uneven affair. Basically, prices rose sharply only where zoning restrictions and other factors limited the construction of new houses. In the rest of the country — what I once dubbed Flatland — permissive zoning and abundant land make it easy to increase the housing supply, a situation that prevented big price increases and therefore prevented a serious bubble.

Most of the post-bubble hangover is concentrated in states where home prices soared, then fell back to earth, leaving many homeowners with negative equity — houses worth less than their mortgages. It's no accident that Florida, Nevada and Arizona lead the nation in both negative equity and mortgage delinquencies; prices more than doubled in Miami, Las Vegas and Phoenix, and have subsequently suffered some of the biggest declines.

But not all of Flatland has gotten off lightly. In particular, there's a sharp contrast between the two biggest Flatland states, Texas — which avoided the worst — and Georgia, which didn't.

This contrast can't be explained by the geography of the two states' major cities. Like Dallas or Houston, Atlanta is a sprawling metropolis facing few limits on expansion. And like other Flatland cities, Atlanta never saw much of a housing price surge.

Yet Texas has managed to avoid severe stress to either its housing market or its banking system, while Georgia is suffering severe post-bubble trauma. The share of mortgages with delinquent payments is higher in Georgia than in California; the percentage of Georgia homeowners with negative equity is well above the national average. And Georgia leads the nation in bank failures.

So what's the matter with Georgia? As I said, banks went wild, in a scene strongly reminiscent of the savings-and-loan excesses of the 1980s. High-flying bank executives aggressively expanded lending — and paid themselves lavishly — while relying heavily on "hot money" raised from outside investors rather than on their own depositors.

It was fun while it lasted. Then the music stopped.

Why didn't the same thing happen in Texas? The most likely answer, surprisingly, is that Texas had strong consumer-protection regulation. In particular, Texas law made it difficult for homeowners to treat their homes as piggybanks, extracting cash by increasing the size of their mortgages. Georgia lacked any similar protections (and the Bush administration blocked the state's efforts to restrict subprime lending directly). And Georgia suffered from the difference.

What's striking about the contrast between the Texas story and Georgia's debacle is that it doesn't seem to have anything to do with the issues that have dominated debates about banking reform. For example, many observers have blamed complex financial derivatives for the crisis. But Georgia banks blew themselves up with old-fashioned loans gone bad.

And for all the concern about banks that are too big to fail, Georgia suffered, if anything, from a proliferation of small banks. Actually, the worst offenders in the lending spree tended to be relatively small start-ups that attracted customers by playing to a specific community. Thus Georgian Bank, founded in 2001, catered to the state's elite, some of whom were entertained on the C.E.O.'s yacht and private jet. Meanwhile, Integrity Bank, founded in 2000, played up its "faith based" business model — it was featured in a 2005 Time magazine article titled "Praying for Profits." Both banks have now gone bust.

So what's the moral of this story? As I see it, it's a caution against silver-bullet views of reform, the idea that cracking down on just one thing — in particular, breaking up big banks — will solve our problems. The case of Georgia shows that bad behavior by many small banks can do as much damage as misbehavior by a few financial giants.

And the contrast between Texas and Georgia suggests that consumer protection is an essential element of reform. By all means, let's limit the power of the big banks. But if we don't also protect consumers from predatory lending, there are plenty of smaller players — both small banks and the nonbank "mortgage originators" responsible for many of the worst subprime abuses — that will step in and fill the gap.