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Cato on Housing Finance Reform: Nothing to See Here — Part II

By Robert Feinberg

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On July 18, the Cato Institute held a briefing for Capitol Hill staff titled "Housing Finance Reform: Past, Present and Future" and featuring Mark Calabria, director of financial regulatory studies at Cato, and Kevin Villani, a consultant who is a former chief economist and CFO at Freddie Mac, deputy assistant secretary and chief economist at the Department of Housing and Urban Development and vice president of Imperial Credit Commercial Mortgage Investment Corp. The **first article** discussed Villani's presentation, while this article will discuss Calabria's.

Calabria began with the threshold question of whether homeownership should be subsidized and the caveat that just because homeownership is correlated with a lot of positive outcomes in society doesn't mean that homeownership caused those outcomes. He advised the staffers to be especially skeptical of arguments made to them that homeownership creates jobs. Since everyone has to live somewhere, it doesn't create more jobs when the dwelling is owned than when it is rented.

Calabria repeated Villani's point that maximum homeownership had already been achieved before the expansion of Fannie Mae and Freddie Mac and that most Americans owned their homes free of mortgage debt. In other words, the owners owned their homes rather than the banks owning them. He credited mortgage finance policy with pushing up house prices and household debt without increasing the homeownership rates.

In seeking to determine what about the current mortgage finance system should be saved, Calabria found that the system of mortgage securitization often ends up recycling mortgages originated by "too big to fail" banks like Bank of America after packaging them as mortgage securities that are purchased by Fannie and Freddie, then sold back to BofA having shifted the risk to the federal government and cut the required capital charge in half.

Calabria also pointed out that at the height of the mortgage crisis, the basic business was leveraged 60:1, and the guarantee business of Fannie Mae and Freddie Mac was leveraged 200:1, conditions that invite massive failures whenever conditions in financial markets turn unfavorable. His idea is to go back to a locally based financial system grounded in deposit taking, where the banker making a mortgage loan would be close enough to the local economy to understand firsthand the likelihood that the borrower would repay.

One of the most profound observations anyone has made in the debate is that not only has regulation substituted for the discipline of the market, which a lot of people have said, but Calabria fingered the Federal Reserve Bank of New York as the worst culprit, and he noted that the president of New York Fed at the time of the financial crisis, Tim Geithner, was not fired but rather promoted to Secretary of the Treasury. It would have been an even more powerful point if he had added that Geithner's predecessor at the Treasury, Goldman Sachs CEO Henry Paulson, was also promoted to Treasury Secretary from the failing investment bank, which placed him in a position to bail out Goldman and his cronies at the other zombie banks.

Calabria stated explicitly that regardless of what the proponents say, the insistence by the industry on a federal guarantee is all about allowing them to make loans to subprime borrowers at no risk. He concluded with a list of principles that would bar capital subsidies, credit allocation, hidden liabilities and income redistribution — probably all conditions that the industry will reject, either immediately or down the road.

To this writer, the policy for housing finance seems always to be the same: Semper Fannie and Freddie. Now that the Ominstration has installed as director of the Federal Housing Finance Agency the friendly regulator of the government-sponsored enterprises, Mel Watt, the able former congressman who was a zealous supporter of Freddie Mac and Fannie Mae throughout his long service, the way is freshly paved to the recreation of a mortgage market dominated by government agencies through which mortgage bankers can move product with little or no capital to support the enterprise.

This is truly the American Dream. Is this a great country, or what?