Moneynews

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

By Robert Feinberg
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The Cato Institute held a briefing July 18 for Capitol Hill staff titled "Housing Finance Reform: Past, Present and Future" on the perennial subject of the status of housing finance reform.

Presenters were 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., and Mark Calabria, director of financial regulatory studies at Cato, a former staffer for the Senate Banking Committee and Sen. Richard Shelby, R-Ala. The panel was moderated by John Maniscalco, director of congressional affairs at Cato.

The event offers an opportunity for readers to eavesdrop on one of the innumerable briefings that take place constantly in Congress, and for that it probably deserves 2 gavels as political theater.

In his introduction, Maniscalco noted that the prevalent view expressed in Congress and fostered by the industry is that any reform of the mortgage markets must be based on a government guarantee. The purpose of the briefing would be to examine how housing finance could work without such a guarantee.

Villani said he left Washington 30 years ago and found it to be a "Disneyland East, a Fantasyland where myths are born and they grow." He recalled that 30 years ago Mikhail Gorbachev was trying to save the Soviet system, but he was unable to do it through Perestroika, and this reminds him of the current state of the housing finance system in the United States. He described it as "a crony capitalist system pretending to be a market system," and attributed the series of financial crisis episodes that date back to the savings and loan crisis to moral hazard arising from social insurance, which reduces the incentives to work and to save.

In his slide show, Villani cited the new book by Charles Calomiris and Stephen Haber, Fragile by Design, that explains the sources of built-in flaws in the U.S. banking system. He explained that the wealth for which the financial industry now takes credit, including a high rate of home ownership, was built successfully by private savings, then corrupted when the industry established a model of funding long-term mortgages with short-term savings backed by no more than 5 percent capital.

Villani's biggest contribution was to finger the government's guarantee of liquidity to this duration mismatch of assets and their funding for the series of systemic financial crises. He then jumped the tracks completely when he endorsed the banker line that banks have been unduly punished by the legal system when they were charged $100 billion or so for the enormous risk and fraud they perpetrated with the connivance of politicians and captured regulators.

It's unfortunate that Villani doesn't understand how the legal system was manipulated to enable the "too big to fail" banks to get off with token fines that were funded by backdoor government subsidies. Otherwise, his analysis is remarkably accurate, as is his conclusion that there is no way to rebuild the mortgage finance system, because the capital to do it is gone.