

## Economic Issues

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### Competitive Private Mortgage Markets Are the Solution, Not the Problem

The United States' market-government hybrid mortgage system nurtured the excessively risky loans, financed with too much leverage, which fueled the U.S. housing bubble of the last decade and resulted in the systemic collapse of the global financial system, say Kevin Villani, former chief economist of Freddie Mac, and Patric Hendershott, a part-time chair in real estate economics and finance at the University of Aberdeen, Scotland.

The responsibility for the massive failures of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac falls directly on regulators and indirectly on their political overseers.

Private and GSE prudential regulators were given politically determined social lending goals that ultimately trumped prudential regulation, forcing the GSEs to fund subprime lending in competition with private label securitizers.

The result was the extension of lower and lower quality loans, creating a race-to-the-bottom between the GSEs and private mortgage providers, all while regulators and politicians looked on approvingly.

The financial crisis resulted when many of those loans turned sour in the latter part of the last decade.

There is no evidence that the U.S. housing market has unique characteristics requiring a hybrid GSE system, thus Villani and Hendershott conclude that the system and the political risks it is subject to are unnecessary. Any U.S. housing finance policy that does not safeguard prudential regulation from political influence by separating housing subsidy from finance and eliminating government-induced distortions will result in another systemic failure, say Villani and Hendershott.

Source: Kevin Villani and Patric H. Hendershott, "The Subprime Lending Debacle: Competitive Private Markets Are the Solution, Not the Problem," Cato Institute, June 20, 2011.

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