the agenda

WITH REIHAN SALAM

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Annie Lowrey on Fixing the GSEs [Reihan Salam]

Annie Lowrey of *The Washington Independent* has written a valuable post on a new proposal from Senators McCain, Gregg, and Shelby to wind down Fannie and Freddie.

> It dissolves Fannie and Freddie over a fifteen year time frame. (It is unclear whether or how the bill deals with other government-sponsored enterprises, like the Federal Home Loan Banks.) It limits taxpayer exposure to Fannie and Freddie's losses in the near term. It would substantively change the way mortgage finance works in the United States — before the crisis, even, Fannie and Freddie backed 40 or 50 percent of mortgages, and this transfers that business to the private market. And it marks a sea change from three decades of Washington policy pushing and subsidizing homeownership.

As Lowrey describes it, this sounds like an excellent proposal. Yet it does reinforce an argument that she made earlier on, namely that tackling the GSEs is an undertaking complex and controversial enough to merit separate legislation.

> Why roll all of the politicking over the trillion-dollar question of whether to shut Fannie and Freddie down — or whether the government should be in the business of subsidizing mortgages and backstopping the U.S. housing market at all — in with the question of, say, whether Goldman should keep more cash on hand? Why hold up the Dodd bill while Washington figures out how it wants to handle mortgage finance? Why let two potentially controversial bills hurt one another's chances? Moreover, why group what might be an expensive housing bill in with the slightly deficit-reducing financial regulatory reform bill?

Taken together, this is a fairly strong *political* case for separate bills. Yet later in the post, Lowrey actually makes the case for crafting a housing bill sooner rather than later.

> Finally, the Obama administration has buoyed the housing market this year, engaging in policies to keep fewer people underwater and to soften housing losses for banks. The Fannie and Freddie bill will likely change the housing market, for better or worse — the administration would not want to tackle how to do that now.

This is precisely the problem: in buoying the housing market, the Obama administration has exacerbated a number of long-term problems. Tad DeHaven of Cato has written extensively about the large amount of risk that the Federal Housing Administration has taken on. Efforts to soften housing losses for banks will have to give way to more sustainable policies eventually. It is natural, given the structural headwinds facing the economy, that we'd want to delay this reckoning. But for how long?

The percentage of housing that is owner-occupied has declined from 69.2 percent in 2004 to 67.2 percent in the first quarter of 2009. But given the large number of underwater mortgages, etc., one can easily imagine it declining far more before we reach a new equilibrium. And while this will prove a difficult adjustment, this decline could facilitate labor mobility and encourage a more efficient allocation of housing resources.

My preference would be for an aggressive series of interventions designed to withdraw or at the very least rationalize subsidies for the housing sector, from paring back if not eliminating the mortgage interest deduction to winding down Fannie and Freddie, etc. We'd then create a new regulatory structure for mortgage finance modeled closely on the Danish approach.

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