Bringing Sanity to the Home Mortgage Market

FRIDAY, 13 AUGUST 2010 09:00 - WRITTEN BY MICHAEL TENNANT

Most people — except possibly the American political class — know that one of the prime causes of the current economic crisis was government policies that resulted in countless people taking out mortgages that they couldn't possibly pay back. Then financial firms who had made the bad mortgages issued securities backed by these shaky loans. When the borrowers defaulted, the whole house of cards came tumbling down — or at least it would have come tumbling down if the federal government hadn't bailed out so many firms, delaying the day of reckoning.

Among the biggest offenders in this whole shell game were the government-sponsored enterprises Fannie Mae and Freddie Mac. These companies, established to help Americans obtain mortgages at terms they couldn't get on the free market, knew they could get away with such shenanigans because Uncle Sam had their backs. The companies' employees and political action committees contributed heavily to Washington power players such as Sen. Christopher Dodd (D-Conn.), current chairman and longstanding member of the Senate Banking Committee, who in turn fought federal oversight of the companies. Then, when they were about to go belly up, the federal government took control of the companies, which have thus far cost taxpayers a cool $150 billion.

On August 17 the Obama administration is holding a conference in part to discuss what do to about Fannie Mae and Freddie Mac. Cato Institute senior fellow William Poole has a simple suggestion for the administration: Put Fannie and Freddie out of our misery.

In an August 11 op-ed for the *New York Times*, Poole explains why the companies were able to get away with their dangerous practices for so long:

> Fannie and Freddie had a license to print money. They could borrow at an interest rate only a bit over the Treasury rate and then accumulate large portfolios of mortgages and mortgage-backed securities earning the market rate. What a deal — borrow at the low rate, invest at a higher one, hold little capital and let the federal government bear the risk! Investors enjoyed high returns, and management enjoyed high salaries. Incidentally, politicians also got a steady flow of campaign contributions from the companies' executives.

Poole doesn't go so far as to say the companies should be shuttered because they're unconstitutional (which they are); perhaps his 10 years spent as president of the St. Louis branch of another unconstitutional, disastrous financial institution, the Federal Reserve, explain that.

He does, however, say that the companies “were poorly structured” from the very beginning and that whatever successes they have enjoyed are dwarfed by the liabilities they have created for taxpayers. He also points out that the companies not only participated in the subprime mortgage fiasco that led to the financial crisis but also “in some respects led it.” Therefore, he concludes, “it would be an inexcusable mistake to reconstitute them as private companies in anything close to their prior form.”

In fact, Poole says, “they should not be preserved in any form” but should be “gracefully retired.” He suggests preventing them from buying any new mortgages and issuing securities against them. Poole estimates that within 10 to 15 years the mortgages would be paid off and the companies could go out of business, while the private sector took up the securitization business.

Poole also expressed his disdain for federal housing subsidies in general, saying “I hope there are not” any more of them. Clearly he is a sane man.

An insane man, it has been said, keeps doing the same thing over and over again, expecting different results. Nothing better explains the ways of Washington than a collective insanity that seems to overtake nearly everyone who ventures inside the Beltway, where the prevailing attitude is, “If a government program fails, don’t kill it; pour more money into it!”

Thus, while any reasonable person should agree with Poole that federal housing subsidies ought to be terminated for a host of reasons, the Obama administration is instead almost certain to keep Fannie Mae and Freddie Mac around and has just announced what Joe Weisenthal of *Business Insider* terms another “homeowner bailout.”

The Treasury Department is sinking an additional $2 billion (on top of the $1.5 billion already spent) into the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets. The money from the fund goes to states with an unemployment rate at or above the national average over the past year for assistance to unemployed persons who are having trouble making their mortgage payments.

At the same time, the Department of Housing and Urban Development is creating a new Emergency Homeowners Loan Program “to provide assistance — for up to 24 months — to homeowners who are at risk of foreclosure and have experienced a substantial reduction in income due to involuntary unemployment, underemployment, or a medical condition.” HUD is mulcting taxpayers for another $1 billion for this program.

Like Fannie and Freddie, these programs have no constitutional basis for their existence. Furthermore, they represent transfer payments — legalized theft —

from the employed to the unemployed and will only stave off a bit longer the necessary corrections to the housing market. In principle, they are no different from the bailouts of Fannie and Freddie and various private financial firms, and they should be opposed for the same reasons.

And so the collective insanity of Washington continues apace. Federal programs to permit people to purchase homes they otherwise couldn't afford got us into this mess, so the government's plan to get us out of it is to create more programs to permit people to remain in homes they otherwise can't afford.

Sanity needs to prevail in Washington. Poole's warnings, plus his advice that the home finance market ought to be "fully private," should be heeded, while the typical Beltway approach of doing the same thing repeatedly but expecting different results should be abandoned. The sane lane leads to liberty and prosperity; the insane one leads to tyranny and penury. It's time for voters to lay in a supply of straitjackets.