



## The Dead Shall Be Raised: The Future of Fannie and Freddie

By Peter J. Wallison

*The renewed interest in Fannie Mae and Freddie Mac is premature. They are currently the mainstays of the U.S. housing market—more important now than they were before being placed in a government conservatorship in September 2008. Many observers do not believe the two government-sponsored enterprises (GSEs) can survive the immense losses they will cause taxpayers, but this is far from true. For Fannie and Freddie to be eliminated, a new mortgage-financing system must take their place, but there is not even a hint of a replacement on the horizon. Once the housing market recovers, the GSEs will still be the only game in town, and supporting them will continue to be the course of least resistance for Congress. Moreover, it will not be easy to implement any of the alternatives to reestablishing Fannie and Freddie as GSEs. Nationalizing or reorganizing them as public utilities would both have significant drawbacks, while privatizing the GSEs—the most sensible approach—would require a major change in public attitudes about securitization. Sadly, in the absence of viable alternatives, their restoration as GSEs seems the most likely outcome.*

It has been an interesting few weeks for the small band of stalwarts who have always followed the depredations of Fannie and Freddie. The Treasury's Christmas Eve action,<sup>1</sup> which removed the cap on the financial support it would provide the two companies, awakened renewed interest in what they will ultimately cost taxpayers. Then, in a surprise move, Representative Barney Frank (D-Mass.)—the GSEs' long-time sponsor-protector—announced that the House Financial Services Committee, which he chairs, would seek to abolish them. All this interest—and certainly Barney Frank's promise—is probably premature, since the two companies, still under the control of the Obama administration's conservatorship, are the mainstays of the housing finance market in the United States today. Indeed, because they have securitized 75 percent of all mortgages originated in the United States in the first three quarters of 2009, the GSEs are playing a more prominent role in the U.S. housing market now than ever before.<sup>2</sup> It is unlikely, accordingly,

that Congress will seriously tinker with the GSEs until the housing market stabilizes or another credible source of financing for middle-class homes capable of replacing them becomes available.

### Key points in this *Outlook*:

- It is unlikely that Fannie Mae and Freddie Mac, currently in a government conservatorship, will undergo any significant structural changes before the housing market is stable.
- The future of these government-sponsored enterprises (GSEs) is not yet decided; Fannie and Freddie could be nationalized, restructured as public utilities, privatized, or simply reestablished as GSEs operating as they did before the financial crisis.
- Privatizing Fannie and Freddie is the best option as a matter of policy, but in the absence of alternatives, Congress is likely to take the path of least resistance and return the GSEs to their precrisis status quo.
- Still, once the securitization market is functioning again, Fannie and Freddie can be privatized by reducing the conforming loan limit over time.

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Still, it is not too early to review the options that will be available to policymakers when they consider the future of the GSEs. Given the sad history of these two companies, one might think they will be received as pariahs when Congress is again asked to look at them, but that is unlikely. The GSEs offer advantages to Congress that will be hard to replicate, and as policymakers weigh the alternatives, they will be under significant pressure to reestablish Fannie and Freddie as GSEs. This will be a huge policy mistake, but one that may yet be made if the public fails to understand how and why the GSEs contributed to the financial crisis and why they will do so again if they are restored to their former role in the housing finance system.

In their former lives, Fannie and Freddie were politically powerful shareholder-owned companies known as GSEs because they were established through congressional charters, had government “missions” to operate a secondary market in residential mortgages and support low- and middle-income housing, and were viewed in the financial markets as government-backed even though their debt securities and other obligations had no explicit government guarantee. Their implicit, or assumed, government backing enabled them to drive all competition out of the middle-class housing sector, permitting Fannie and Freddie to acquire over \$5 trillion in mortgages, which they either held in portfolios totaling approximately \$1.5 trillion or securitized as mortgage-backed securities (MBS). In pursuing their mission to support low- and middle-income housing—also called affordable housing—Fannie and Freddie assumed the credit risk on almost 11 million subprime and other high-risk mortgages and contributed substantially to the growth of a housing bubble. When that bubble began to deflate in 2007, they began to suffer huge losses that resulted in their apparent insolvency and a government takeover in September 2008.<sup>3</sup>

Today, Fannie and Freddie are wards of the government, held in conservatorships established under the Housing and Economic Recovery Act of 2008 (HERA). Placing the GSEs in conservatorships rather than receiverships was an error.<sup>4</sup> A conservatorship is generally created for the purpose of restoring a failed company to health, while a receivership would have given the government the clear authority to close the GSEs when that became the appropriate course. The conservator exercises the powers of a board of directors and, thus, cannot terminate unfavorable

contracts or wind up the firm’s business; however, a receiver, like a trustee in bankruptcy, has the powers necessary to liquidate failed companies, pay off their creditors, and terminate their existence. Under HERA, the Treasury had a choice between a conservator and a receiver for the two GSEs. Choosing a receiver would have signaled that the GSEs were on their way out, although the receivership could have lasted for years while Congress debated and adopted an alternative means of financing mortgages. In contrast, a conservatorship is, at best, a temporizing mechanism; it has effectively put off the decision of what will actually be done with Fannie and Freddie, and it gives Congress a role in making that decision. Congressional involvement in this situation will not produce a good policy result; GSEs offer Congress great advantages—particularly opportunities to direct spending on housing without appropriations and to use the GSEs for political benefit.

This *Outlook* will outline and analyze the four possible outcomes for Fannie and Freddie—nationalization, reorganization as a public utility, restoration to GSE status, and privatization. Liquidation is another possible outcome, but its policy implications are not substantially different from privatization, so it will not be treated as a separate option in this *Outlook*.

## Nationalization

One option available to Congress is to nationalize the GSEs. This would entail merging Fannie and Freddie into a single government agency responsible for maintaining a secondary mortgage market. The new agency, like the GSEs themselves, would buy mortgages from banks and other originators, package them into MBS, and sell them to investors. Costs would, presumably, be kept low by the government’s explicit backing of the agency’s MBS and of its debt, as well as by the absence of any requirement for capital or profit. For this analysis, let us leave aside the usual concerns about government agencies as operating units—their inefficiency, resistance to change, and difficulty in recruiting high-quality staffs—because one overriding issue seems to disqualify nationalization as a realistic option for Congress. As a nationalized activity, the new combined agency would have to be included in the federal budget, which is already in serious deficit. In 1970, Congress “privatized” Fannie Mae—that is, sold it off to public

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shareholders—as a way of reducing Fannie Mae’s budgetary impact. It may also be that the GSEs were given an affordable housing mission in 1992 because the Federal Credit Reform Act of 1990 (FCRA),<sup>5</sup> impaired the usefulness of the Federal Housing Administration (FHA) for this purpose. Even assuming the new agency did nothing more than securitize mortgages, maintaining a secondary mortgage market would have a significant budgetary effect. In a growing housing market, its outlays to acquire mortgages would always be larger than the revenues it would recoup by selling MBS, and there is always the chance the GSEs will suffer losses on the mortgages the government would then guarantee.

In addition, under the FCRA the subsidy value of explicit government guarantees of private debt must be recorded in the budget. The subsidy value associated with the guarantees of a nationalized entity performing a secondary market function could be quite high, especially because it is likely that Congress will require any such entity to accept loans for securitization that private insurers or securitizers could reject as too risky. For example, consider the loans requiring low down payments and loans to borrowers with blemished credit that Congress and the Clinton and Bush administrations wanted Fannie and Freddie to accept. Further, a nationalized agency would be subject to periodic spurts of congressional generosity with the taxpayers’ money. For example, Congress periodically directed the FHA to reduce the down payments required from borrowers. Under these congressional demands, mortgages with loan-to-value ratios of more than 90 percent went from less than 1 percent of FHA mortgages in 1956 to more than 85 percent of its guaranteed loans in 2008. As loan-to-value ratios rose, the FHA’s financial condition deteriorated; today the agency is probably in need of a congressional bailout. In short, if nationalization is what Frank has in mind as his replacement for Fannie and Freddie, he will have a fight on his hands if budget projections remain as dire in the near future as they are today.

### A Public-Utility Structure

Proposals to reorganize Fannie and Freddie as one or more public utilities rely on a model in which the GSEs would be privately owned by banks or other private shareholders but would function like public utilities under federal

regulation. As Fannie and Freddie did when they were GSEs, the public-utility version would buy mortgages from originators and securitize them; the main difference is that as public utilities Fannie and Freddie would probably be prohibited from holding mortgage portfolios. In this model, their guarantee fee rates and costs would be limited so they would pay a steady dividend to their shareholders, allowing them to raise capital, and regulation would limit their risk taking. Any borrowing would presumably not be backed by the government, but as discussed below it seems likely they would still require some government support to function effectively.

Special support from the government would be necessary because a utility model would have to be shareholder owned to keep it off-budget, but its rates would be regulated. Allowing it to set its own rates, or

to function as an unregulated cooperative owned by banks or others, would amount to a privatization, which is not what the supporters of the utility model have in mind. Unlike an electric utility, however, mortgage securitization involves significant risk, and dealing with risk requires differential pricing. A utility subject to government rate regulation will generally not be permitted to charge differential rates on any but the most formulaic terms. Thus, a rate-regulated securitizer, the public-utility version of Fannie and Freddie, might be allowed to charge a higher rate for a low FICO score or a mortgage with a high loan-to-value ratio, but not for a mortgage that is subject to high risk because of the area in which it originated. Risk-based pricing is very difficult for the government to do. The Federal Deposit Insurance Corporation has never been successful, for example, with risk-based pricing for bank deposit insurance premiums. The likelihood, therefore, is that regulated rates will tend to be blended: higher-quality mortgages will subsidize the lower-quality ones that the entity is required to take on. Under these circumstances, an unregulated competitor could skim the cream of the best mortgages in the market and always charge a lower rate than its government-regulated competitor for the highest-quality mortgages. Over time, this would lead to the regulated utility holding a portfolio of securitized mortgages seriously skewed toward the risky end of the curve. The solution will be to give the utility some special advantage—guaranteeing its MBS or conferring a monopoly over a special section of the market, or both. The former would

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create automatic market acceptance of its MBS as against those of its competitors, while the latter would simply exclude competitors. Safety-and-soundness regulation would be relied on, in the absence of market discipline or competition, to prevent excessive risk taking.

But these government-conferred advantages have their own problems. The most serious concern is the budgetary effect of such a measure, since the MBS guarantee would have to be scored under the FCRA. Again, the subsidy level would need to be high because a government-regulated utility would be expected to accept risky mortgages other securitizers would shun. In addition, unlike public utilities such as local electric or water companies, Fannie and Freddie as regulated utilities would be taking major risks with the taxpayers' credit card. They will need to set rates for their guarantee fees that will provide a safe return to the shareholders while at the same time covering the potential for losses, and this will be extremely difficult, especially when—as is true for all regulated entities—Congress will have a strong influence on the rates prescribed or approved by their regulator. As in the case of the FHA, political forces will suppress guarantee fees, thereby preventing the utilities from being compensated appropriately for the risks Congress will require them to take. Without a profit incentive, and under pressure from Congress, there would be little incentive on the part of management or creditors to raise guarantee fees to fully compensatory levels. With these fees too low for the risk involved, regulated utilities will eventually become insolvent, and, ultimately, the taxpayers will pick up the losses.

In other words, there are strong arguments against reorganizing Fannie and Freddie based on a public-utility model. Not only would doing so have an undesirable budgetary effect, but it would also likely be costly for taxpayers in the long run.

## **Restoration as Government Sponsored Enterprises**

GSEs have always been popular in Congress because they appear to provide free money for purposes for which Congress would normally have to appropriate funds. Because GSEs can borrow with the implicit backing of the federal government and can be directed to spend their funds on policies and programs favored by Congress, lawmakers perceive them as an improvement over the well-known and much-vilified earmark. For GSEs to spend money for congressionally desired purposes, members of

Congress do not need the agreement of other lawmakers as they do with appropriations, and GSEs can spend without the hassle of troublesome public reporting. Because of the power Congress has over GSEs—the continuing ability to affect the scope and value of the GSEs' franchise—GSEs are always willing to do favors for important members. In Fannie and Freddie's case, favors included absorbing the cost of unprofitable housing or other projects in states or districts of important lawmakers, raising campaign funds from industries dependent on a flow of funds from the GSEs (such as realtors and home builders), and even hiring the relatives of important congressional supporters for Fannie Mae's local offices. It was a form of corruption, certainly, but for many years it was impossible for anyone to do anything about it. Fannie and Freddie were too powerful in Congress, and Congress enjoyed the benefits of controlling GSEs too much. Restoring Fannie and Freddie as GSEs opens the door again to many of these same problems.

Given this history, what—other than nationalization—could Barney Frank have had in mind when he said his committee would seek to abolish Fannie and Freddie? One need not be particularly cynical to see this is not a sudden confession of error. Before the two GSEs can be eliminated, Frank said, Congress will have to come up with “a whole new system of housing finance.”<sup>6</sup> Currently, Congress is not considering a new system of housing finance, nor does it appear to have conceived of one. Even if a new system were under consideration, it would take years to implement. Frank knows this as well as anyone; in all likelihood, his “new system” will turn out to be the same old system, but he can express regret as it happens. Schadenfreude perhaps. The administration promised to say something about its plans for Fannie and Freddie in the budget document it delivered February 1, but once again it had apparently overpromised: the budget document was silent on the future of the GSEs.

Under these circumstances—although I would like to be proven wrong—the restoration of Fannie and Freddie as GSEs seems the most likely direction Congress will take once the housing-finance market stabilizes. It has the benefit of being the course of least resistance—everything else will look like a leap into the unknown—and the lack of a prospective system to replace Fannie and Freddie will further buttress the arguments of the GSEs' supporters in and out of Congress. The advocates of restoration will have to overcome several obstacles, of course, such as the fact that the GSEs will have recently cost the taxpayers as much as \$400 billion (and perhaps even more) before their losses were entirely taken into account. But it is likely that

the GSEs' insolvency will be attributed to weak regulation before the adoption of HERA, and perhaps to the fact that their regulation was divided between the Department of Housing and Urban Development, which was their "mission regulator," and the Office of Federal Housing Enterprise Oversight, which was their safety-and-soundness regulator. Under HERA, it will be argued, a new agency, the Federal Housing Finance Agency, will have both responsibilities and will thus be able to assure that they do not take too many risks while pursuing their affordable housing mission.

Despite these modified arrangements, it is difficult to say anything has fundamentally changed. Congress will still be influential with both the GSEs and their regulator, insisting that underwriting standards be relaxed so their constituents will find it easier to get mortgages. These diminished standards will eventually result in losses. The example of the FHA, discussed above, is relevant here. Moreover, regulation itself is a weak reed. Considering how often it has failed, it is remarkable that regulation is still considered a protection for the taxpayers. After the savings and loan crisis in the late 1980s and early 1990s—when almost 1,600 commercial banks also failed—Congress adopted the Federal Deposit Insurance Corporation Improvement Act, which contained every tough provision Congress and the bank regulators could think of to prevent bank crises in the future. Yet, we have just come through the worst banking crisis since the Great Depression. Furthermore, the GSEs are far more difficult to control with regulation than banks. Because of their centrality to the housing system and the ability of Congress to affect their franchise directly, Congress is acutely interested in what they are doing and the GSEs are equally interested in retaining Congress's approval. This is not a healthy mix. Requests directly from Congress will trump the restrictions imposed by their regulator, or the regulator itself will get congressional signals to relax restrictions that might be impairing the ability of their constituents to buy homes.

From all indications, the Obama administration is not likely to include the revenues and expenses of the GSEs in the federal budget now or in the foreseeable future, and this will also increase their attractiveness to Congress. The Congressional Budget Office recently added \$291 billion to its baseline 2009 deficit to account for Fannie and Freddie's operations, arguing that they were being used as

instruments of federal policy and that the administration had promised to extend unlimited funds to support them.<sup>7</sup> However, the Office of Management and Budget controls the standards for what is included in the president's budget

and continues to follow a policy of treating privately owned companies as outside the federal budget process. Thus, while the market will continue to perceive Fannie and Freddie as entities at least implicitly backed by the government—demonstrated most recently by the conservatorship and the Treasury's unlimited financial support—their activities will have no effect on the federal budget. If this policy holds, and it is certainly likely to continue when the housing market has stabilized and some federal support has been withdrawn, Fannie and Freddie and their congressional supporters will have the best of both worlds—

the assurance of government backing and the freedom to operate without affecting the deficit.

But it is important to remember that GSEs are founded on a false premise: that private companies can perform a government mission. This cannot be true. Private shareholder-owned companies must seek profit, while a public mission assumes complete devotion to that public objective. Given a choice between the two, the public mission is inevitably slighted. The requirement that the GSEs support affordable housing certainly accelerated their demise, but even without that spur the GSEs had plenty of incentives to increase risk taking. As long as the private capital markets were persuaded that creditors would be rescued if they ran into financial trouble, there was no effective check on the GSEs' risk taking. Although they had a weak regulator, the GSEs would have evaded even a strong regulator. Much of the call for a stronger regulator was based on the idea that the new regulator of the GSEs should have bank-like regulatory authority; now we know, as noted above, that not even bank-like regulatory power *over the banks* could prevent banks from taking excessive risks. To be successful, regulation needs the assistance of effective market discipline. Where moral hazard has eroded market discipline, regulation will not be able to prevent excessive risk taking. As Professor Dwight Jaffee has observed:

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of a private firm with a public mission. We have learned from first-hand experience that the incentive of a GSE with a government guarantee, implicit or explicit, is to expand its size and risk-taking as much as possible, and that these incentives ultimately dominate any public mission. I believe that the reestablishment of new GSEs will inevitably end with a new government bailout.<sup>8</sup>

As an example, if we assume that the GSEs will no longer be able to hold portfolios—one of the sources of their risks—and will be functioning solely through securitization, what risks could they take? First, we have to assume they will operate by placing a guarantee on the MBS they issue and that this guarantee will be deemed in the market to be roughly the equivalent of a federal-government guarantee. As noted above, the market is likely to slip back into the habit of believing that Fannie and Freddie are backed by the government. After all, in bailing out Fannie and Freddie's creditors, the government did exactly what those who thought the GSEs were government-backed expected the government to do. The government did the same thing in 1987 when it bailed out the Farm Credit System,<sup>9</sup> and it is useful to note that the Farm Credit System is now a fully functioning set of GSEs again and is still off-budget. We can expect, then, that Fannie and Freddie will be able to function as they have in the past: by placing their guarantee on a pool of mortgages. The credit risks they take, unless compensated by high rates, will eventually result in insolvency and another government rescue.

To be sure, Fannie and Freddie as GSEs could be compensated for their risk taking and losses through their guarantee fees. If these fees are high enough, they could operate in a safe and sound manner. But as regulated entities, they are not likely to be able to exploit their franchise without some congressionally extracted cost. The choice Fannie and Freddie made the first time around was to increase market share by cross-subsidizing their subprime and Alt-A loans with the high profits thrown off by their portfolios. This pleased their congressional supporters and protected their franchise. The same strategy will seem appropriate if they are restored as GSEs. Even if they do not have the authority to hold mortgage portfolios, the dynamic is unlikely to change. Risk taking through expanding their market share and reducing their lending standards will enable them to earn substantial profits while increasing their congressional support. This strategy, however, will eventually result in unmanageable losses. In the end, as always, the taxpayers will be handed the bill.

Congress should face the fact that the profit mission of a shareholder-owned company is simply incompatible with a government mission of any kind. Although restoring Fannie and Freddie to their former status may appear to be an attractive option, doing so will be like rolling a live grenade into the future.

## A Sensible Approach to Privatization

Although it is the most sensible approach to take, privatizing Fannie and Freddie is an unlikely choice for Congress at this point. The principal reason for pessimism in this respect is that the deficiencies of securitization have received much of the blame for the current financial crisis, and privatizing Fannie and Freddie would add two more players to a market many lawmakers already think should be supplanted by something else. However, the negative view of securitization—also known, tellingly, as the originate-to-distribute system—is undeserved. In reality, securitization is a financial technology that has consistently produced low-cost credit for consumers.

Although originators sell their mortgages to those higher up the chain, it is not true—as many observers seem to believe—that they have no further risks. The standard agreements in the securitization market allow buyers to put back to originators—or anyone lower in the chain than themselves—any mortgages not performing as promised. As a result of these arrangements, many banks tried to return faulty mortgages to their originators, only to find that the originators had gone out of business. Recently, there were reports in the press that Fannie and Freddie were trying to return some deficient mortgages to the banks from which they were purchased. Of course, banks and investment banks could have done many things to protect themselves from faulty mortgages—why they failed to do so in time is something of a mystery—but it is not true that the securitization system is inherently faulty because originators do not bear any responsibility once they sell the loans.

There is as yet no substitute for the securitization system, and the banks—without a secondary mortgage market into which to sell their loans—cannot likely produce enough lendable funds to keep the mortgage markets functioning at the level required for continued growth. The private securitization market will have to be restored before the housing markets can return to normal, but that will probably take several years. During that period, Fannie and Freddie and the implicit government guarantees they offer will be necessary to keep the housing market functioning. That is one of the reasons the markets

will again become accustomed to dealing with Fannie and Freddie as restored GSEs, and why keeping them in existence will be the course of least resistance.

Ultimately, the best policy is still to privatize or liquidate Fannie and Freddie and leave the secondary mortgage market to a large number of competing private participants. A private competitive market would not require a taxpayer bailout, would price mortgages according to risk, and would display the innovation and efficiencies characteristic of private markets. While Fannie and Freddie existed, these private market characteristics were suppressed and the secondary markets were distorted. Because of their low-cost, government-backed financing, Fannie and Freddie were able to drive all competition from the secondary market for middle-class prime mortgages. Private participants were relegated to a relatively small jumbo market or the risky subprime market. Without Fannie and Freddie, a vigorously competitive secondary market for middle-class prime mortgages probably would have developed.

For this reason, once the securitization market has returned to normal, privatizing Fannie and Freddie should be considered while they remain in the conservatorship.

As it happens, the current conservatorship offers unique opportunities for privatization that would not exist if the GSEs were operating normally. There are three key obstacles. The first is what to do about their portfolios of mortgages and MBS, which probably total about \$1.5 trillion at this point. The second is how to deal with about \$4 trillion in MBS that they have previously guaranteed. The third obstacle is how to privatize giant companies that—because of their centrality to the mortgage market—will immediately become too big to fail. In many ways, the third problem is the toughest.

First, addressing the GSEs' portfolios should not be a significant obstacle to privatizing or liquidating them. Their mortgages and MBS will have a continuous depressive effect on housing prices until they are put in private hands. For this reason, the conservator should begin selling them slowly over the next few years as the securitization market struggles to recover. As with the Resolution Trust's sale of the savings and loans' assets, the prices the government receives are not as important as removing the overhang of unsold assets.

The second problem is more complicated. If Fannie and Freddie are not to be GSEs anymore, how can the

guarantees they have made continue to protect the holders of their MBS? Substituting a direct government guarantee will be a windfall, but removing the guarantee entirely will cause the MBS to plunge in value. This obstacle can also be overcome; it can be handled through a process known as defeasement, a structure commonly used in the private sector. At some point, the Treasury will have to absorb the losses associated with Fannie and Freddie; this will occur

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whether Congress decides to restore them to health as GSEs or to liquidate or privatize them. These losses could exceed \$400 billion. Part of the recognition of these losses will be defrayed by the gain on the sale of the GSEs' portfolios, but the balance must be borne by the taxpayers. When the Treasury decides to recognize this loss, it should defease the continuing obligation on the GSEs' guarantees by placing them in a trust with a sufficient amount of risk-free Treasury securities to assure the holders of the MBS that there are funds available to compensate them for any losses they might suffer on the MBS previously guaranteed by Fannie and Freddie.

Finally, privatizing or liquidating Fannie and Freddie can be easily done under the conservatorship. Currently, the GSEs operate under a conforming loan limit that prescribes the maximum size of mortgages they are permitted to buy. The limit is currently \$730,000 for a single-family home in an expensive area and substantially lower in lower-cost areas. To decrease the size of the GSEs so they will no longer be too big to fail, the Federal Housing Finance Agency can gradually reduce the conforming loan limit, thereby slowly exposing a larger proportion of the housing-finance market to private-sector securitization, including a private sector affiliate of Fannie and Freddie. If the private market seizes these opportunities, and if the market is functioning satisfactorily, the conforming loan limit eventually can be reduced to a very small number, even zero. If it reaches zero, they will have been privatized. At that point, all further securitization by Fannie and Freddie must be done through an ordinary corporation, and the government-chartered GSEs will become subsidiaries, operating until the last MBS has been redeemed.

## Conclusion

Of the four methods for dealing with Fannie and Freddie, only privatization assures the existence of a competitive, innovative, low-cost market, without the danger of an eventual

taxpayer bailout. Nationalization falls apart as an option because of its budgetary effects, and a public-utility model will not work because rates could not be regulated in a manner that would enable Fannie and Freddie to compete effectively with private-sector firms. In the absence of alternatives—and there are none currently on the horizon—the GSE form is likely to be the one Congress will turn to. However, if the securitization market returns to normal while the GSEs are still in the current conservatorship, they can easily be privatized by reducing the conforming loan limit over time.

## Notes

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2. Dwight M. Jaffee, “The Future Role of Fannie Mae and Freddie Mac in the U.S. Mortgage Market” (paper presented at AEA/AREUEA session “The Future of the GSEs,” Atlanta, GA, January 3, 2010), 2, available at [www.aeaweb.org/aea/conference/program/retrieve.php?pdfid=299](http://www.aeaweb.org/aea/conference/program/retrieve.php?pdfid=299) (accessed February 4, 2010).
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