Effect of Government Takeover of Home Mortgage Market

The Washington Post reported September 7 that the federal government is now guaranteeing 86 percent of all new home mortgages, as default rates continue to increase and threaten to require a bailout of federal loan guarantors such as the Federal Housing Administration.

"Only one lender of consequence remains," the *Post* reported, "the federal government, which undertook one of its earliest and most dramatic rescues of the financial crisis by seizing control a year ago of the two largest mortgage finance companies in the world, Fannie Mae and Freddie Mac." Citing *Inside Mortgage Finance*, the *Post* noted that the federal government and its chartered corporations only guaranteed 30 percent of mortgages four years ago.

The *Post* stressed that "taxpayers are on the hook for most of the loans that are still being made if they go bad. And they are also on the line for any losses in the massive portfolios of old loans at Fannie Mae and Freddie Mac, which own or back more than $5 trillion in mortgages."

This isn't some theoretical but unlikely risk to taxpayers. The *Post* story explained that the Federal Housing Administration, which guarantees many loans to first-time home-owners, is getting into financial trouble as homeowner defaults have continued to increase. "FHA has been exhausting much of its loss reserves," the *Post* wrote, "which are funded by premiums paid by borrowers. The reserves currently stand at an estimated 3 percent of all outstanding loans, half of what they were just a year ago. If the reserves fall below the 2 percent threshold set by Congress, they could require a taxpayer bailout."

This is precisely what free market economists — led by the Austrian School — predicted would happen. Private lenders, who would never make such risky loans if their own capital were on the line, are happy to make loans if someone else (i.e., the taxpayers) will pick up their losses. The result is that taxpayers are the losers in this transaction. The only winners are the statist corporations (who can socialize their losses and privatize the profits) and the politicians who can claim that they've "rescued" the mortgage market … until the next crash and bailout.