# Is Obama Planning to Keep Fannie and Freddie Alive?


Most sound observers of the mortgage crisis say that to maintain the status quo would be incredibly foolish. They have concluded that federal guarantees of subprime mortgages via “government-sponsored enterprises” Fannie Mae and Freddie Mac, along with other federal policies encouraging banks to issue loans to less-than-creditworthy borrowers, were one of the major causes — if not *the* major cause — of the mortgage meltdown. Fannie and Freddie, since taken over fully by the government, have thus far cost taxpayers over $150 billion in bailouts, an amount that is expected to reach [$259 billion](#) by the time all is said and done. Who in his right mind, analysts ask, would want to continue down such a disastrous path?

Obama would, according to the *Post*. On the advice of Housing and Urban Development Secretary Shaun Donovan and Treasury Secretary Timothy Geithner, aided by his own proclivity for big government, the President has agreed on a plan that “could even preserve Fannie Mae and Freddie Mac … although under different names and with significant new constraints,” the paper reports. In other words, critics note, it’s just sleight-of-hand designed to make it appear that Obama is looking out for taxpayers when in fact he is far more concerned with the large financial institutions that have his ear.

The *Post* says the two main options for accomplishing Obama’s goal are (1) “restructuring Fannie and Freddie as public utilities overseen by a government regulator” and (2) shutting down and replacing Fannie and Freddie “with several successors.” Under both options the government, either directly or indirectly, would guarantee the firms’ mortgages. Writes the newspaper: “A federal guarantee, by reducing the risk to investors, can make it cheaper for firms to raise money for making home loans, in turn reducing mortgage rates.” Of course, the guarantee also creates a moral hazard: The companies will be far less cautious in issuing mortgages when they know taxpayers can always be forced to bail them out, as clearly happened in the years leading up to the 2008 crisis.

Should Fannie and Freddie be retained in any form, the administration plans to impose some conditions on them that will give the appearance of protecting taxpayers while more or less allowing business as usual to proceed. For instance, the companies would have to hold a higher percentage of their cash in reserve and relieve themselves of many of the mortgages they currently hold. In addition, writes the *Post*, they “would charge a fee to mortgage lenders and banks and use the money to create an insurance pool to cover losses on mortgage securities caused by defaults on the underlying loans.”

What happens if that pool turns out to be too shallow? “The government,” explains the *Post*, “would be the last line of defense in case of another housing market meltdown, using taxpayer money to cover losses only if the insurance pool ran dry.” This would, naturally, give the new companies little more incentive to make wise loans than their predecessors had. As American Enterprise Institute fellow Peter

Wallison told the paper, “The long-term consequence is that the taxpayers ultimately have to bail out the government’s losses.”

According to the *Post*, Obama’s preferred approach is one of three options that were presented in a publicly released white paper in February. The other two options “called for greatly reducing the federal role in the mortgage market,” the newspaper explains, though “all of the options preserved the Federal Housing Administration, a government agency that helps low- and middle-income and minority home buyers.” (Even Wallison, the supposed conservative, agreed that this is a “legitimate role for government.”)

Both Austan Goolsbee, the former chairman of Obama’s Council of Economic Advisers, and Lawrence Summers, former director of Obama’s National Economic Council (and Treasury Secretary under President Bill Clinton), argued against maintaining a large federal role in the housing market. Goolsbee, the *Post* writes, “argued that the federal role in housing distorts the free market. By subsidizing mortgage investments, he argued, the government drives capital away from other types of investments…. He also warned that the government is putting enormous sums of taxpayer money on the line while conveying little actual benefit to home buyers.” Summers agreed that the dangers inherent in government guarantees are too great to allow Fannie and Freddie (or something similar) to continue, although he thought the government’s role in the mortgage market would have to be phased out a decade or more down the line.

However, Donovan, Geithner, and Gene Sperling, the successor of Summers at the National Economic Council who “agreed that a continued government guarantee made sense,” carried the day, at least according to the *Post*’s sources.

The administration, however, maintains that the President is still considering all the options — all, that is, except the constitutional option of ending all federal involvement in housing, including Fannie, Freddie, FHA, and HUD.

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