Introduction

By Peter Wallison
AEI Conference on
The Future of Fannie Mae and Freddie Mac
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This is the third conference we have sponsored on Fannie Mae and Freddie Mac, and much has occurred since this series began. For one thing, there is good deal more interest in the subject than was true at the time of the first conference in March 1999. Recent articles and editorials in the *Wall Street Journal, the Economist* and the *National Journal* reflect a recognition that the problems presented by Fannie and Freddie are more than simply a food fight in the mortgage industry.

Congressman Richard Baker's legislation, Treasury's response, and the evident skittishness of the financial markets, are all indications that the settled world that Fannie and Freddie enjoyed only a few years ago is starting to show wear and tear. Yesterday, Chairman Alan Greenspan sent a letter to Richard Baker, criticizing continued implicit government support of Fannie and Freddie.

The flood of advertising by Fannie and Freddie—full page ads in the major newspapers and news magazines, and radio and television spots boasting about their being in "the American dream business"—attest to the seriousness with which these companies are taking the challenge.

Recently, the press has reported that Fannie Mae hired a phone bank company to make calls into the districts of key lawmakers on behalf of what appears to be a phony organization called "The Coalition for Home Ownership"—soliciting opposition to H.R. 3703. The desperation this suggests seems a bit unwarranted, but subtlety has never been one of Fannie's strong points. And arguably, attacking fleas with hand grenades has always worked in the past.

In any event, today's conference seems quite timely, because something will have to be done relatively soon. I don't say this because I believe there is a financial disaster looming before us. On the contrary, Fannie and Freddie are healthy companies that will continue to be financially sound as long as the economy maintains its current stability.

But Fannie and Freddie's future is cloudy for another reason: as Bert Ely and I pointed out in our recent monograph, *Nationalizing Mortgage Risk* (AEI, 2000), these two companies are growing at about 11.5 percent per year, but the mortgage markets are growing at about 6 percent.

By the end of 2003, Fannie and Freddie will have assumed the credit risk of almost half of all residential mortgages in the United States. It will not be long thereafter that they have acquired all the mortgages available.

What then? As many have pointed out, passing legislation that Fannie and Freddie oppose is very difficult—maybe impossible in the short run. But that is not to say that Fannie and Freddie have the political support to pass legislation they *favor*—and without new legislation, no matter how generously they interpret their charters, some time after 2003 they are going to run out of assets they are permitted to buy.

Quite apart from any slowdown in the economy, this will cause a slowdown in their growth, and that in turn will cause a serious decline in their stock prices. Now, many of you may believe that Fannie Mae is in the "American dream business," but I can assure you that when their stock price begins to fall because they can no longer grow at double digit rates, the interests of American homeowners won't be uppermost in the minds of Fannie's management.

The question then will be how to get out from under the government's thumb so that they can continue to grow. As we have pointed out again and again, the GSEs managements have duties to their shareholders that they are obligated to carry out. The experience of Sallie Mae is instructive here—not only the reasons that they sought privatization, but the way it was done and their subsequent success.

So this conference is about Fannie and Freddie's future, and the alternatives available to policy makers—and to them.

Some of these ideas involve steps that will precipitate moves on their part for privatization. Guarantee fees that compensate the government for its risk are an example of this. But other ideas we'll discuss today—if implemented—might reduce the value of privatization or foreclose it entirely. Offering free GSE charters is an example of the former.

Making Fannie and Freddie securities full faith and credit, and eligible for purchase by the Social Security and Medicare trust funds, is an example of the latter. In other words—unless they believe that they are going to be able to get favorable legislation that will allow them to enter other businesses with their current government backing—Fannie and Freddie would be well advised to think seriously today about how they are going to maintain their growth and profitability when, in effect, they have outgrown their market.