The Daily Dish

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Yesterday, House and Senate negotiators reached an agreement on a $305 billion, five-year highway bill just days before current highway funding expires. If passed, this will be the first U.S. highway bill in over a decade to last longer than two years. The legislation also reauthorizes the Ex-Im Bank, limiting Ex-Im's lending limit by $5 billion. The bill is partially paid for by using $19 billion from the Federal Reserve's surplus funds.

The House voted to overturn the president's controversial climate rules for power plants, which would cost up to $45 billion more each year by 2025. President Obama, who is currently at a conference with world leaders on climate change, has said he would veto these measures.

Eakinomics: De-Risking the Housing GSEs

In the aftermath of the financial crisis, the news was filled with Fannie Mae and Freddie Mac, the housing Government Sponsored Enterprises (GSEs).

The financial crisis was in part (but not wholly) the result of bad mortgage lending. Those bad mortgages were at the heart of the business models of Fannie and Freddie, which lowered the credit quality standards of the mortgages they securitized. A mortgage-backed security was therefore "worse" during the crisis than in preceding years because the underlying mortgages were generally of poorer quality. This turned a bad mortgage into a worse security. And it turned the undercapitalized Fannie Mae and Freddie Mac into such dangers to the financial system that they had to be taken over by the taxpayers and put into conservatorship.

Now, housing markets have recovered to some extent; indeed Denver, Dallas, Boston and Portland are above their pre-crisis peaks. But Fannie and Freddie remain frozen in time; financial behemoths pretending to "guarantee" the return on mortgage-backed securities when, in fact, they hold little capital and are on track to hold even less in the future. For that reason, they are not only classic "SIFIs" (Systemically Important Financial Institutions), they are actively dangerous SIFIs. But, in the absence of GSE reform legislation, how can they be made safer?

One possibility highlighted by the Mortgage Bankers Association letter to Mel Watt, the Director of the Federal Housing Finance Agency (their chief regulator), is to use private mortgage insurance (PMI) more extensively. PMI has traditionally been used to reduce the potential losses on low downpayment mortgages to the same level as a 20 percent downpayment mortgage. The idea is to have PMI absorb even more of the losses so that Fannie and Freddie face less than the potential of having to cover losses up to 80 percent of the mortgage. In effect, this would put more private capital behind these mortgages, up-front limit the GSE exposure to losses, and "de-risk" Fannie and Freddie to a greater degree.

One goal of GSE reform has been to get private capital back into housing finance. Up-front de-risking using PMI does exactly that and represents a step toward finally resolving the structural flaws that contributed to the crisis.

From the Forum

Health Policy Follies By Douglas Holtz-Eakin, AAF President

U.S.- Japan Missile Defense Cooperation: Increasing Security and Cutting Costs by Rachel Hoff, AAF Director of Defense Analysis

Fact of the Day

The number of ER visits caused by problems or complications from using drugs reached nearly 5.1 million in 2011, an increase of 88 percent from 2004.