



The Daily Dish

The Administration Weighs in on GSE Reform

DOUGLAS HOLTZ-EAKIN | JUNE 28, 2018

Eakinomics: The Administration Weighs in on GSE Reform

Last week the Trump Administration released its [plan](#) for a massive reorganization of the federal government. Most of the headlines were grabbed by large-scale proposals like merging the Departments of Education and Labor. But [as noted](#) by AAF's new Director of Financial Services Policy [Tom Wade](#), quietly tucked away on pages 75 to 77 are some important hints regarding where the administration is headed on the future of Fannie Mae, Freddie Mac, and housing finance more generally.

Recall that the housing government-sponsored enterprises (GSEs) are private entities that benefited from a wide variety of special government treatment (e.g., a line of credit at the Treasury, exemption from normal securities' registration laws). Markets viewed them as implicitly backed by the federal government, which allowed them to be thinly capitalized and borrow cheaply to fund their two lines of business: (a) a guarantee for investors in their mortgage-backed securities (MBS), and (b) large monoline hedge funds that invested in their MBS and other housing assets. When the financial crisis hit in 2008, the two entities were placed in conservatorship. They remain there to this day.

The essence of the White House proposal is to privatize the GSEs by ending both the conservatorship and their federal charter. It also intends to "reduce [the GSEs'] role in the housing market" by opening up the secondary mortgage market to additional competition from new entrants. Those competing in this market would have access to an explicit federal guarantee for their MBS, but they would have to pay for it to compensate the taxpayers for the budgetary risk. The secondary mortgage market would be regulated by a new federal entity, and responsibility for affordable housing would be largely transferred to the Department of Housing and Urban Development (HUD).

The bare bones of this proposal look quite promising. Affordable housing is important but it should be done on-budget and through the relevant federal agency (HUD). That ensures a fair fight for budgetary resources and ongoing congressional oversight of the programs. Better competition in the secondary mortgage market is also a "must have" policy item. But for that to develop effectively, care must be taken to strip Fannie Mae and Freddie Mac of every unfair advantage that has accrued due to their privileged status and ensure that they compete on the basis of what they really are: large, systemically important (and dangerous) financial institutions that should be subject to an enhanced prudential regulatory regime.

The White House plan is a good first step. Now comes the part that has been a bridge too far for 10 years: follow through and real reform.