Negative: Fannie Mae & Freddie Mac

By “Coach Vance” Trefethen

***Resolved: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy***

Summary: Fannie Mae and Freddie Mac are slang terms for two entities created by the federal government to facilitate the home mortgage industry. They do this by buying up mortgages from private lenders and re-selling them as mortgage-backed securities. They are supposed to improve the housing market by 1) lowering mortgage interest rates (because they borrow money at interest rates below-market, since they are associated with the federal government) and 2) spreading risk across the entire country by combining mortgages from the country at large, meaning that a housing downturn in one area won’t bankrupt the mortgage lenders in that area (which works until the entire country goes into a housing crash, as in 2008) and 3) when banks and private lenders can off-load their mortgages to Fannie Mae and Freddie Mac (they sell the mortgages not long after the house is bought) they have more money to make new mortgages and don’t have to worry about repayment risk (if the borrower can’t repay, it doesn’t matter to the bank because they no longer own the mortgage).   
Understanding the history is important: When Fannie Mae (“Federal National Mortgage Association” FNMA) was created during the Depression, it was owned and operated by the federal government. In the 1960s, Pres. Lyndon Johnson privatized it (but everyone knew or believed that the federal government would back it up or bail it out). Freddie Mac (“Federal Home Loan Mortgage Corporation”) was created in 1970 and operated the same way (privatized but still “kinda” affiliated with the federal government). When the housing market crashed in 2008, both were bailed out and brought back into the federal fold, in order to keep the home mortgage market afloat. AFF plan will probably try to privatize them again.

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Negative: Fannie Mae & Freddie Mac

HARMS / SIGNIFICANCE

1. No financial harm in Status Quo

Fannie and Freddie are profitable and have paid back their entire bailout

Associated Press 2019 (journalist Marcy Gordon) 5 Sept 2019 “Trump administration unveils plan to privatize Fannie Mae, Freddie Mac” <https://www.usatoday.com/story/money/2019/09/05/fannie-mae-freddie-mac-overhaul-plan-privatize-mortgage-companies/2226608001/>

While not prominently in the public eye, the two companies perform a critical role in the housing market. Together they guarantee roughly half of the $10 trillion U.S. home loan market. Fannie and Freddie, operating under so-called government conservatorships, have become profitable again in the years since the 2008 rescue and have repaid their bailouts in full to the Treasury.

2. No link to the ’08 housing crash

Fannie and Freddie didn’t cause the ’08 crash. Turn: It was Wall Street BYPASSING Fannie and Freddie that crashed everything

John Griffith 2012 (*Policy Analyst with the Housing team at the Center for American Progress*) 7 Things You Need to Know About Fannie Mae and Freddie Mac 6 Sept 2012 <https://www.americanprogress.org/issues/economy/reports/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/>

What role did Fannie and Freddie play in inflating the housing bubble of the mid- to late-2000s? Contrary to conservative talking points, the answer is very little. During the bubble, loan originators backed by Wall Street capital began operating beyond the Fannie and Freddie system that had been working for decades by peddling large quantities of high-risk subprime mortgages with terms and features that drastically increased the chance of default. Many of those loans were predatory products such as hybrid adjustable-rate mortgages with balloon payments that required serial refinancing, or negative amortization, mortgages that increased the unpaid balance over time. Wall Street firms such as Lehman Brothers and Bear Stearns packaged these high-risk loans into securities, got the credit-rating agencies to bless them, and then passed them along to investors, who were often unaware or misinformed of the underlying risks. It was the poor performance of the loans in these “private-label” securities—those not owned or guaranteed by Fannie and Freddie—that led to the financial meltdown, according to the bipartisan Financial Crisis Inquiry Commission, among other independent researchers.

3. Harm of “bailouts” doesn’t justify Plan

Even if bailouts are bad, it doesn’t mean privatization is better. Federal government still needs to play a role in the housing market

John Griffith 2012 (*Policy Analyst with the Housing team at the Center for American Progress*) 7 Things You Need to Know About Fannie Mae and Freddie Mac 6 Sept 2012 <https://www.americanprogress.org/issues/economy/reports/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/>

To be sure, Fannie Mae and Freddie Mac were flawed companies that made several bad business decisions, and taxpayers should never again have to foot the bill for any financial institution’s greed. But as policymakers look to the future of U.S. housing finance, they must seek smart reforms that focus on what was broken in the previous system, while maintaining what worked for decades. The federal government must continue to play a key role in the housing market, regardless of whether it works through Fannie and Freddie, a new agency, or purely private firms.

4. No housing problem in Status Quo

No housing bubble / threat to the economy exists today

Dean Baker 2018 (Senior Economist at Center for Economic and Policy Research) “The Housing Bubble and the Great Recession: Ten Years Later” Sept 2018 <https://cepr.net/images/stories/reports/housing-bubble-2018-09.pdf>

First, given the size of the bubble and the extent to which it was driving the economy in the years prior to the downturn, a severe recession was virtually inevitable following its collapse. Second, the bubble should have been easy to recognize for anyone who was closely monitoring the economy. For the Federal Reserve Board and top economic advisers in the Bush administration to miss the bubble required an extraordinary degree of negligence. And finally, there is no imminent crisis that is at all comparable. Dangerous bubbles like the housing bubble don’t slide by under the radar. If bubbles are big enough for their collapse to severely damage the economy, they are big enough to be seen.

SOLVENCY

1. Privatizing would have zero benefit

No new advantages, just some additional complications and unanswered questions

Matthew Yglesias 2019 (journalist) “The Trump administration’s new plan to privatize Fannie Mae and Freddie Mac, explained” 9 Sept 2019 <https://www.vox.com/policy-and-politics/2019/9/9/20852075/fannie-mae-freddie-mac-trump-privatize>

The new Treasury plan completely punts on this question of what happens to the existing Fannie and Freddie shareholders. Instead, it just says they should be privatized through some unspecified mechanism. But rather than going back to the old system of a wink-nudge implicit guarantee, Mnuchin’s plan calls for an explicit government guarantee that will be structured like a kind of insurance policy. Fannie Mae and Freddie Mac will both pay an annual fee to the government, and in exchange their loans will be guaranteed by the federal government. That in turn is supposed to be paired with regulatory efforts to prevent them from abusing their guarantee. Conceptually, this seems to provide what many politicians imply they want — the affordable 30-year mortgages that only government action can provide, but without the embarrassing socialism of having the federal government at the commanding heights of the housing finance system. On the other hand, it’s hard to say what advantage exists to this system over having these companies be public entities. Making the putatively “private” system work will depend entirely on the government setting the price of the insurance guarantee correctly and doing a good job of supervising Fannie and Freddie as regulators. They would be completely dependent on the federal government for their business model to be viable. All this plan does is introduce a bunch of questions about how exactly to launch the new system.

2. Won’t prevent bailouts

If another crash happens, the government would bail out a privatized Fannie or Freddie just like they did General Motors

NEW YORK TIMES 2013 (journalist Lisa Prevost) 5 Sept 2013 “Life Without Fannie Mae and Freddie Mac” <https://www.nytimes.com/2013/09/08/realestate/life-without-fannie-mae-and-freddie-mac.html>

Despite widespread negative perceptions of Fannie and Freddie, the conversations about reform have, in a “refreshing twist,” drawn attention to the positive role the agencies play, noted Alex Matjanec, a founder of MyBankTracker.com, a personal finance Web site. A central argument for eliminating Fannie and Freddie is to get taxpayers off the hook for any further bailouts. But Mr. Matjanec thinks that professed taxpayer protection may be false assurance. “If a major bank fails,” he said, “I think the government will treat them like a General Motors and bail them out anyway.”

DISADVANTAGES

1. Speeding up is bad #1: Assignment of responsibilities takes time

Link: AFF immediately privatizes

That’s their plan.

Link: Status Quo is already privatizing

The Economist 2019 (respected British news journal that does not identify the names of its individual authors) 6 Sept 2019 “The Treasury plans to privatise Fannie Mae and Freddie Mac” <https://www.economist.com/finance-and-economics/2019/09/06/the-treasury-plans-to-privatise-fannie-mae-and-freddie-mac>

In 2008, having suffered heavy losses amid the wreckage of America’s housing market, Fannie Mae and Freddie Mac, the two “government-sponsored enterprises” (GSEs) that support much of the country’s mortgage finance, were bailed out by the federal government to the tune of $188bn. They were placed in “conservatorship”, a form of government control. That was supposed to be temporary. It has lasted for more than a decade. On September 5th the treasury secretary, Steven Mnuchin, published a long-awaited plan to privatise Fannie and Freddie.

Link: Could repeat the ’08 crisis if we don’t complete the preparation underway now to correctly assign responsibilities to Fannie, Freddie and FHA

Jacob Passy 2019 (financial journalist) 2 Nov 2019 (URL says 10/29/19 but the article says it was published on 11/2/19) “Borrowers won’t be left behind as Fannie and Freddie privatize, regulator says” MARKET WATCH <https://www.marketwatch.com/story/borrowers-wont-be-left-behind-as-fannie-and-freddie-privatize-regulator-says-2019-10-29> (brackets added)

In 2020, the FHFA [Federal Housing Finance Agency] will require Fannie and Freddie to assist regulators in determining what overlaps exist between the two enterprises and the FHA. “Thoughtfully addressing these overlaps makes sense for both the Enterprises and FHA because they were created to perform different roles in our housing finance system,” FHFA Director Mark Calabria said. “In order to prepare to responsibly exit conservatorship, Fannie and Freddie must not repeat the mistakes of the crisis by stretching to serve borrowers who are better served by FHA.”

Impact: Economic recession.

Dean Baker 2018 (Senior Economist at Center for Economic and Policy Research) “The Housing Bubble and the Great Recession: Ten Years Later” Sept 2018 <https://cepr.net/images/stories/reports/housing-bubble-2018-09.pdf>

As argued above, the main cause of the Great Recession was the bursting of the housing bubble that was driving the economy. The bubble had pushed both residential construction and consumption to unusually high levels. It was very directly driving the economy. When it burst, it was inevitable that the demand it had been generating would disappear. Furthermore, in the case of housing, because the bubble led to substantial overbuilding, it was reasonable to expect that residential construction would fall to lower than normal levels for a period of time. While the financial crisis undoubtedly made the downturn worse, first and foremost the problem was the loss of bubble-driven demand.

2. Speeding up is bad #2: Big financial risk must be resolved first

Link: AFF speeds up privatization

As we all know.

Link & Brink: Fannie and Freddie are on the brink of insolvency and could fail if we rush the timing

Jacob Passy 2019 (financial journalist) 2 Nov 2019 (URL says 10/29/19 but the article says it was published on 11/2/19) “Borrowers won’t be left behind as Fannie and Freddie privatize, regulator says” MARKET WATCH <https://www.marketwatch.com/story/borrowers-wont-be-left-behind-as-fannie-and-freddie-privatize-regulator-says-2019-10-29> (brackets added)

Separately, [Federal Housing Finance Agency Director, Mark] Calabria once again raised the alarm regarding the risk that Fannie and Freddie could fail again. Currently, the dollar amount in loans that the two enterprises own or guarantee is roughly 500 times larger than the amount they have in capital reserves. As a result, timing is posing the greatest challenge to the FHFA’s efforts to get Fannie and Freddie out of conservatorship, Calabria said. If either of the housing or equity markets softens in the near future, that would make it much harder for Fannie and Freddie to raise capital. “We’re not forecasting a downturn, but if we do have a downturn in the next couple years, they will fail,” Calabria said. “They will become insolvent, and they will run out of capital.”

Impact: Turn the AFF harms. Federal government will have to bail them out again, just like ’08 because they’ll go under

Kimberly Amadeo 2019 (2 0 years of senior-level corporate experience in economic analysis and business strategy; master's degree in management from the Sloan School of Business at MIT ) “What Was the Fannie Mae and Freddie Mac Bailout?” <https://www.thebalance.com/what-was-the-fannie-mae-and-freddie-mac-bailout-3305658>

The continued rising of rates forced Paulson to nationalize Fannie and Freddie. Nationalization meant the Treasury would take over the GSE's entirely, essentially wiping out stockholders' wealth. As Fannie and Freddie's stock prices were declining due to fears of nationalization, it only made it harder for the GSE's to raise capital, thus creating a self-fulfilling prophecy. The other option would be for the Treasury to start injecting large sums of cash to an essentially private company. That would make stockholders happy but continue the precedent set by the Federal Reserve's bailout of Bear Stearns.

3. Privatization = Crash

Private segment of the housing market caused the ’08 housing crash, and removing government from mortgage finance would crash it again

John Griffith 2012 (*Policy Analyst with the Housing team at the Center for American Progress*) 7 Things You Need to Know About Fannie Mae and Freddie Mac 6 Sept 2012 <https://www.americanprogress.org/issues/economy/reports/2012/09/06/36736/7-things-you-need-to-know-about-fannie-mae-and-freddie-mac/>

Many conservative analysts and politicians—resorting to heated rhetoric and mistruths about the origins of the crisis—argue that we need a fully private mortgage market run by Wall Street. It was the fully private segment of the market, however, that caused millions of foreclosures and brought down the entire financial system. If we draw the wrong lesson from the financial crisis and abruptly withdraw the government from mortgage finance, it will lead to a sharp reduction in the availability of home loans, cutting off access to mortgage finance for the middle class.

4. Higher federal deficits

Link: Fannie & Freddie paid back more than their bailout and are turning a profit now, reducing the federal deficit, since profits go back to the Treasury

CNBC 2018. (journalist Diana Olick) 5 Sept 2018 “Decade after housing crash, Fannie Mae and Freddie Mac are Uncle Sam’s cash cows” <https://www.cnbc.com/2018/09/05/fannie-mae-freddie-mac-are-uncle-sams-cash-cows-a-decade-after-crash.html>

So far, Fannie Mae has paid $167.3 billion and Freddie Mac has paid $112.4 billion. Add it up, and the two drew $191.4 billion but paid $279.7 billion, a net profit of $88.3 billion — and they continue to pay. “The taxpayers were the ultimate vulture investors here. We bought low when nobody else would come in, and as a result the taxpayers are reaping the reward,” said Seiberg. “So this has been a great deal for taxpayers.” The money goes into the general Treasury funds reducing the amount the government has to borrow each year. This, some argue, is why Congress has been slow to reform the mortgage market and take the two out of conservatorship.

Impact: Every increase in the federal deficit hurts the economy

Dr William Gale and Benjamin Harris 2010.  (Gale - PhD in economics, Stanford Univ.; senior fellow at the Brookings Institution and co-director of the Urban-Brookings Tax Policy Center; former assistant professor in the Department of Economics at UCLA, and a senior economist for the Council of Economic Advisers under President George H.W. Bush;  Harris -   master’s degree in economics from Cornell University and a master’s degree in quantitative methods from Columbia University; senior research associate with the Economics Studies Program at the Brookings Institution)  “A VAT for the United States: Part of the Solution”  https://www.brookings.edu/wp-content/uploads/2016/06/0721\_vat\_for\_us\_gale.pdf

But even in the absence of a crisis, sustained deficits have deleterious effects, as they translate into lower national savings, higher interest rates, and increased indebtedness to foreign investors, all of which serve to reduce future national income. Gale and Orszag (2004a) estimate that a 1 percent of GDP increase in the deficit will raise interest rates by 25 to 35 basis points and reduce national saving by 0.5 to 0.8 percentage points of GDP.

5. Negative economic impacts to privatization

Privatizing Fannie & Freddie would raise home buying costs and harm minorities and the poor

NBC News 2019 (journalist Ben Popken) 6 Sept 2019 “Could Trump's plan to privatize Fannie Mae kill the 30-year mortgage?” <https://www.nbcnews.com/business/business-news/could-trump-s-plan-privatize-fannie-mae-kill-30-year-n1050641>

But returning Fannie and Freddie to private ownership could have a negative effect on home buyers, especially first-time, lower-income, minority, and rural borrowers, said Adam Levitin, a professor at Georgetown University Law Center who studies bankruptcy and consumer finance. "The Administration’s proposal will increase the cost of mortgages for all borrowers, especially families of color, low- to moderate-income families, and rural families whose income growth has been surpassed by housing costs for homes as well as rental markets across the country," a civil rights coalition [said in a joint statement](https://www.responsiblelending.org/media/dont-disrupt-lending-or-increase-cost-housing-civil-rights-coalition-warns-against-wh-plan) Thursday.