

HON. RON PAUL OF TEXAS IN THE HOUSE FINANCIAL SERVICES COMMITTEE

September 10, 2003

Fannie Mae and Freddie Mac Subsidies Distort the Housing Market Mr. Chairman, thank you for holding this hearing on the Treasury Department's views regarding government sponsored enterprises (GSEs). I would also like to thank Secretaries Snow and Martinez for taking time out of their busy schedules to appear before the committee.

I hope this committee spends some time examining the special privileges provided to GSEs by the federal government. According to the Congressional Budget Office, the housing-related GSEs received 13.6 billion worth of indirect federal subsidies in fiscal year 2000 alone. Today, I will introduce the Free Housing Market Enhancement Act, which removes government subsidies from the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the National Home Loan Bank Board.

One of the major government privileges granted to GSEs is a line of credit with the United States Treasury. According to some estimates, the line of credit may be worth over \$2 billion dollars. This explicit promise by the Treasury to bail out GSEs in times of economic difficulty helps the GSEs attract investors who are willing to settle for lower yields than they would demand in the absence of the subsidy. Thus, the line of credit distorts the allocation of capital. More importantly, the line of credit is a promise on behalf of the government to engage in a huge unconstitutional and immoral income transfer from working Americans to holders of GSE debt.

The Free Housing Market Enhancement Act also repeals the explicit grant of legal authority given to the Federal Reserve to purchase GSE debt. GSEs are the only institutions besides the United States Treasury granted explicit statutory authority to monetize their debt through the Federal Reserve. This provision gives the GSEs a source of liquidity unavailable to their competitors.

The connection between the GSEs and the government helps isolate the GSE management from market discipline. This isolation from market discipline is the root cause of the recent reports of mismanagement occurring at Fannie and Freddie. After all, if Fannie and Freddie were not underwritten by the federal government, investors would demand Fannie and Freddie

provide assurance that they follow accepted management and accounting practices.

Ironically, by transferring the risk of a widespread mortgage default, the government increases the likelihood of a painful crash in the housing market. This is because the special privileges granted to Fannie and Freddie have distorted the housing market by allowing them to attract capital they could not attract under pure market conditions. As a result, capital is diverted from its most productive use into housing. This reduces the efficacy of the entire market and thus reduces the standard of living of all Americans.

Despite the long-term damage to the economy inflicted by the government's interference in the housing market, the government's policy of diverting capital to other uses creates a short-term boom in housing. Like all artificially-created bubbles, the boom in housing prices cannot last forever. When housing prices fall, homeowners will experience difficulty as their equity is wiped out. Furthermore, the holders of the mortgage debt will also have a loss. These losses will be greater than they would have otherwise been had government policy not actively encouraged over-investment in housing.

Perhaps the Federal Reserve can stave off the day of reckoning by purchasing GSE debt and pumping liquidity into the housing market, but this cannot hold off the inevitable drop in the housing market forever. In fact, postponing the necessary, but painful market corrections will only deepen the inevitable fall. The more people invested in the market, the greater the effects across the economy when the bubble bursts.

No less an authority than Federal Reserve Chairman Alan Greenspan has expressed concern that government subsidies provided to GSEs make investors underestimate the risk of investing in Fannie Mae and Freddie Mac.

Mr. Chairman, I would like to once again thank the Financial Services Committee for holding this hearing. I would also like to thank Secretaries Snow and Martinez for their presence here today. I hope today's hearing sheds light on how special privileges granted to GSEs distort the housing market and endanger American taxpayers. Congress should act to remove taxpayer support from the housing GSEs before the bubble bursts and taxpayers are once again forced to bail out investors who were misled by foolish government interference in the market. I therefore hope this committee will soon stand up for American taxpayers and investors by acting on my Free Housing Market Enhancement Act.

