What to Do about the GSEs?

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Fannie Mae and Freddie Mac—the two large “Government-Sponsored Enterprises” (GSEs) that are at the center of U.S. residential mortgage finance—remain the “elephants in the room” that are being ignored as part of broad-brush financial sector reform. Neither the Dodd-Frank Act nor the proposed Financial CHOICE Act has addressed the reform of the GSEs’ structures—even though the GSEs were placed in government conservatorships in early September 2008 and have remained in that state ever since.

In this essay, we take an in-depth look at the GSEs: what they do, the impact of the conservatorship, why they were ignored in Dodd-Frank and are ignored in the CHOICE Act, and what should be done. Reform—which is essential for a more efficient housing finance system—revolves around two central issues: first, the immediate issue of what should be done with/about the GSEs; and second, the larger issues of how residential mortgages should be financed and how U.S. public policy toward housing finance and toward housing, more generally, should be structured.

The goal of reforming housing finance should be to ensure an efficient mortgage market, both in primary (origination), as well as in secondary mortgage markets. Keeping the GSEs in conservatorships is surely not an element of any sensible reform. We believe that it is critical to move the system of financing residential housing in the direction of greater efficiency and greater equity. U.S. housing finance should be moved toward a private system, with any government guarantees priced by the market. Since the CHOICE Act is still at the stage of proposed legislation, there is plenty of time for its drafters to address the GSEs and develop a blueprint for a better financial system for residential housing.