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Thousands of unemployed workers seek aid in Washington in this January 1932 file photo. The economic disaster of the 1930s propelled the government from emergency measures to keep owners from losing their homes and farms to active promotion of homeownership as a national goal.

Do we want Fannie public or private?

By ALICE M. RIVLIN | 07/18/2008 04:49 AM EDT

Treasury and Federal Reserve efforts this week to shore up Fannie Mae and Freddie Mac reveal how deeply ambivalent Americans are about whether they want these housing finance giants to be private corporations making money for their shareholders or public utilities responsible for keeping housing credit flowing and stabilizing the economy.

Recent history suggests that we want the mortgage giants to be private when they are making breathtaking profits for their investors and executives. But when the going gets tough, we need Fannie Mae and Freddie Mac to keep the credit flowing to homeowners even if it means putting taxpayer resources on the line. Willem Buiter at the London School of Economics has called this ambivalence “the most deceitful socialism I know.” And he may have a point.

When the current crisis passes — and it will — we should consider whether the government should own part or all of these firms and put public members on their boards both to restrain their exuberance in over-hot housing markets and to make sure that taxpayers share in the profits as well as the losses.

Ambivalence about public responsibilities has pervaded housing policy at least since the Great Depression. The economic disaster of the 1930s propelled the government from emergency measures to keep owners from losing their homes and farms to active promotion of homeownership as a national goal. A myriad of public and quasi-public entities financed, insured and guaranteed mortgages, and regulations proliferated, often belatedly as the subprime crisis revealed, to prevent discrimination and predatory practices by private lenders.

Over the past three-quarters of a century, these public efforts proved hugely successful in expanding homeownership — none more so than the creation of a secondary market for home mortgages by the Federal National Mortgage Association, immediately dubbed Fannie Mae. Fannie Mae attracted so much capital into the home mortgage market by bundling mortgages and selling its mortgage backed bonds that in 1968 it was turned into a private corporation. Well, sort of — it still had a (never used) line of credit with the Treasury, plus some special tax breaks, and benefited from the widespread perception that the government would not let Fannie Mae fail.

The implicit government guarantee allowed Fannie and its younger cousin Freddie Mac to borrow money cheaper than their private competitors and considerably enhanced their profitability. For decades, no one knew whether the implicit guarantee was real or a figment of lenders' imaginations, but now we know. We learned this week that the government will not let Fannie Mae and Freddie Mac fail, nor should it. It will do what is necessary to keep these giants of the secondary mortgage market afloat, and it will even use them to fill the gap created by private retrenchment and keep housing credit flowing until confidence returns. Private lenders, in turn, will continue to buy their debt on favorable terms.

If all goes well, this government gesture will cost taxpayers nothing and ease the credit crunch. But if housing prices continue to fall and investor confidence weakens further, taxpayers could take a hit — maybe a big one. In any case, we taxpayers will have put our credit on the line and taken the risk of losing. So shouldn't we share in the gains, too, if markets stabilize, the excess housing created by the bubble is absorbed, and Fannie and Freddie again make money?

Don't tell us there is no government guarantee and that the connection to the Treasury is not enhancing the profits of Fannie and Freddie's investors. We won't believe that again. Just let us share in the gains and appoint a few members of their boards to think about how Fannie and Freddie can lean against the winds that inflate the next housing bubble. If that sounds like socialism, at least it is open and not deceitful socialism. No one can deny that our society has a collective interest in strong, stable housing markets.

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