

# Perspectives

## Social Security and Mortgage Lending: Two Hot Potatoes for Greenspan



The friendless Alan Greenspan has done it again. This time, the Federal Reserve Chairman has managed to gravely offend Republicans and Democrats, as well as a third of the nation. What heresies did he preach? Actually, Greenspan said nothing we don't all know to be true. It's the topics he picked that got everyone upset...intensely political topics, at election time.

Greenspan talked about social security benefits. If unchanged, his wispy voice suggested, long-term economic growth may be threatened. The country can't afford them.

How so? The Chairman patiently explained how politicians vying for the vote of the elderly are keeping in place a regime that won't be able to pay for itself. Once the baby boomers join the ranks of claimants, there'll be a profound shortage of money. To make up the shortfall, the government will have to heavily borrow, which will drive up interest rates and that, we all know, can hurt seniors dependent on social security benefits more than anyone. And so, Alan Greenspan opined, it's time to look at remedies. One is to cut back the benefits, the other to up the eligibility age. Voilà!

Within hours, political figures of every stripe vied for air time, so that they could publicly distance themselves from the Fed Chairman.

### **Dangerous Policies at Government Sponsored Lenders**

Some of you will have seen Greenspan in congressional testimony. He speaks slowly and for a long time. Little surprise then that the Fed Chair exhausted the social security topic half-way through his presentation. That's when he turned to the other political hot potato: mortgage lending. Government sponsored lenders like Freddie Mac and Fannie Mae, he said, are at risk and their activities should be curbed. Anyone who understands something about the two institutions' multi-trillion loan exposure would readily agree.

Why are Freddie Mac and Fannie Mae a threat to stability? Mainly because they've become large enough to monopolize the single-family mortgage market. At the same time, that market has considerably changed, and some new features, like prepayment privileges of loans by borrowers, have the potential to de-stabilize it. An even bigger threat is the ability of countless borrowers who hold variable-rate mortgages floating rate mortgages to cope when interest rates start to rise. But what poses the main risk to US taxpayers is that Fannie Mae and Freddie Mac, unlike other lenders, are not required to keep loan loss reserves, despite their unprecedented debt.

Is there any reason we shouldn't be worried about these two mega-lenders? They're now so large that even a modest crisis could prove very expensive for the government. Greenspan, by the way, is not the first to caution of the potential cost of a bailout; both the Congressional Accounting Office and the Congressional Budget Office have sounded similar warnings. But Greenspan offers a solution: he wants to cap the size of the two government-sponsored entities, so that private industry can more freely compete. That has the building and real estate industries up in arms. The reason: Fannie Mae and Freddie Mac can borrow, and consequently lend, at lower rates than other competitors, because the market perceives that the government stands behind them.

### **Perceived To Be Guaranteed**

All in all, Fannie Mae and Freddie Mac are parade examples of what happens when government gets involved in the free market. The two entities are managed without the procedural safeguards mandated for private industry and are less accountable. Yet, despite that, they have the effect of crowding out free market operators, because their activities are perceived to be guaranteed. If the experiment goes wrong, the public pays considerably more for the damage than it ever benefited from the intended advantages.

Both on the subject of social security and government sponsored lending, Mr. Greenspan was wise to speak up. He may have fewer friends left on Capitol Hill than Michael Jackson, but this time he did the right thing. □

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