Testimony of
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Mr. Chairman, members of the committee, thank you for the opportunity to testify today. In particular, I would like to thank you, Mr. Chairman, for your tenacity and commitment to protecting the interest of taxpayers with regard to the nation's housing government-sponsored enterprises (GSEs). My name is Leslie Paige. I am a vice-president of Citizens Against Government Waste (CAGW), a nonpartisan, nonprofit organization with more than one million members and supporters nationwide dedicated to eliminating waste, fraud and abuse in government.

CAGW is a member of the Homeowners Education Coalition (HomeEC), an ad hoc coalition of taxpayer groups, including National Taxpayer's Union, the Competitive Enterprise Institute, 60 Plus, the Free Congress Foundation, CapitolWatch, the Small Business Survival Committee, and the American Association of Small Property Owners. Collectively, the members of HomeEC represent millions of taxpayers and have decades of experience in advocating for taxpayers and seeking a smaller, more efficient government.

HomeEC's mission is to raise questions with our respective members, the media and the general public about the nation's largest housing GSEs, and to stimulate an ongoing, public review of their activities and the impact those activities have on taxpayers and the economy as a whole.

Mr. Chairman, today's hearing, like the hearings you convened last year and earlier this year, have provided our groups with the rare opportunity to have some input into the ongoing debate over what reforms, if any, Congress should enact with regard to the housing GSEs, particularly the two largest, Fannie Mae and Freddie Mac.

Recent newspaper stories in authoritative publications have reported that the nation's housing GSEs have once again conclusively beaten back any attempts to reform them. However, to paraphrase Mark Twain, we believe that reports of the demise of this important process have been greatly exaggerated.

Last year, during the GSE roundtable discussion you convened, Mr. Chairman, one of your panelists, Mr. Fred Khedouri, a financial manager at Bear Stearns stated that "the markets are in the business of gauging expectations and perception…so perception is the most central variable here." The only folks who benefit from the perception that the reform effort is dead are Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Maintaining the status quo qualifies as a win for the GSEs and a loss for taxpayers. We believe that Congress is actually at the very beginning of the process and we're proud to be part of it.

There are indeed voices in Congress, on Wall Street, in the media and in some sectors of the home mortgage market who say that the GSEs are extremely profitable, and supremely well-managed, that these hearings are much ado about nothing, that the GSEs should be left to their own devices, and that critics should just stop talking about them. CAGW and the members of HomeEC strongly disagree.

The time to address the concerns of taxpayers regarding the GSEs is not at some future date when they might be facing a financial crisis. Basically, been there, done that. We experienced exactly that type of scenario in the 1980s with the Savings & Loan debacle, which cost taxpayers hundreds of millions of dollars. In the "Origins and Causes of the S & L Debacle: A Blueprint for Reform," the Commission on Financial Institution Reform, Recovery, and Enforcement concluded that "Congress transformed the S & Ls into agents of national housing policy and that Government regulation sheltered the S & Ls from competition…." That sounds uncomfortably familiar to us.

In the final analysis, that bailout happened because the government created an oversubsidized environment and because politicians and policymakers were ill-prepared to deal with the unforeseen consequences of its actions.

We are seeing it now, as Congress rushes belatedly to address the financial plight of another mammoth quasi-government agency, the United States Postal Service.

Congress' fiduciary responsibility to taxpayers extends far beyond today's prosperity and the issue of whether a vigorous public debate will somehow impinge on the profitability of two quasi-government agencies. This public dialogue is laying the groundwork for the enactment of future reforms that will shield taxpayers from unwanted liabilities, without harming homeowners, the private sector, or the overall economy.

CAGW has had the issue of government-sponsored enterprises on its radar since the early 1980s. This organization was created 16 years ago after Peter Grace presented to President Ronald Reagan 2,478 findings and recommendations of the Grace Commission (formally known as the President's Private Sector Survey on Cost Control). These recommendations provided a blueprint for a more efficient, effective and smaller government.

The Grace Commission recognized the special advantages that Fannie Mae and Freddie Mac had and described the leverage these benefits conferred. The commission understood then, as many of you do today, that the GSEs' "agency" status assures them access to credit at a preferential rate. The commission concluded that the implication of federal support ensured that "even without full faith and credit, the government would rescue an agency in trouble. This appears to be important in increasing the credit limits of an agency, even though less creditworthy agencies pay interest rates above more creditworthy agencies."

Presciently, the Grace Commission stated then that the special advantages enjoyed by Fannie Mae and Freddie Mac would distort the market, an observation more recently made by Federal Reserve Chairman Alan Greenspan. The GSEs act as "a powerful disincentive for well-capitalized private sector entities to compete in the mortgage market." The commission also stated that there was no reason for Fannie Mae and Freddie Mac not to pay state and local taxes, and outlined a potential transition to a fully private status for all government sponsored enterprises, "without threatening their ability to perform their historic mission."

The Grace Commission further noted that the concern over what was then a substantial and burgeoning federal debt had not carried over to comparable increases in agency debt. That lack of concern was related to the fact that farming and home building, two "powerful constituencies," were primary beneficiaries of the GSEs, "making them a difficult target for any activity that gives the appearance of a reduction in Government support."

The Grace Commission summed up why it is important for Congress to convene hearings such as these and to continue oversight of the GSEs. "The Government does not control agency growth because it is private; but the agencies depend upon Federal sponsorship (i.e., being treated as part of the Government) for their growth. This contradiction has extremely important consequences, now and for the future."

There are numerous areas of concern with regard to the GSEs, but these concerns are all of a piece and they revolve around one central problem, in our opinion, and that is the special benefits the GSEs receive, the most important of these being the perception that the GSEs are backed by the taxpayers.

With the release of the CBO update, it is no longer tenable to argue that there are no federal subsidies and there is no implied government guarantee, yet the GSEs continue to try and the effort is tying them in rhetorical knots.

Last September, during the GSE Roundtable, a Freddie Mac representative emphatically stated that the GSEs receive no taxpayer subsidies. Later in the discussion, the same GSE spokesperson opined that the "non-existent" federal subsidy that his company does not receive was not "unique" and that the financial sector was replete with subsidies. Later still, a representative of Fannie Mae said that the "nonexistent" subsidy that his company did not receive was worth much less than the Congressional Budget Office claimed and furthermore, the benefits that Fannie Mae confers on homeowners far outweigh the value of this "nonexistent" subsidy.

It is an awkward situation to be in, reminiscent of the old fable about the Emperor and his nonexistent new clothes. In fact, there are subsidies and their value is measurable and substantial, whether you embrace the study done by Jim Miller and James Pearce, or the CBO analysis, as HomeEC does, it is worth multiple billions of dollars. Since 37 percent of their $10.6 billion annual subsidy is soaked up by the GSEs themselves, it is clear that they have converted their congressionally-conferred benefits into a highly-efficient profit-delivery system. In fact, private Wall Street ratings agencies, such as Standard & Poor's, calculate these government-conferred benefits when rating the GSEs. This year, S & P gave Fannie Mae and Freddie Mac AA- "risk to government" rating (we think it would be more accurate to call it "risk to taxpayers"), but this rating still assumes that the GSEs will have unlimited access to the debt markets during times of financial crisis, simply because they are government-sponsored enterprises, regardless of their true financial status.

There are good reasons for the investment community to believe that government would bail out the GSEs, in spite of official disclaimers to the contrary. Actions speak louder than words. The federal government has in fact stepped in to bail out another GSE in the recent past -- the Farm Credit system. Fannie Mae experienced serious financial instability in the 1980s. Congress can no longer simply accept the GSEs' reassurances that they are superior money managers and therefore their activities pose "zero" risk to taxpayers. Reality is finally sinking in…the GSEs have become "too big to fail," in a financial squeeze, the taxpayers would be on the hook and the risks are significant. As such, their financial activities merit serious scrutiny by Congress.

Aside from the very real issue of subsidies and implied taxpayer backing, if Congress needs more reasons to begin a reform process of the GSEs, members need only look at the newspapers every day because they are peppered with stories about the GSEs and their new financial activities every day.

There is the explosive debt issue. As of March 31st of 2001, Fannie Mae and Freddie Mac together either owned or guaranteed $2.4 trillion in mortgages and mortgage-backed securities. By 2003, these two entities will have more debt and guarantees outstanding than U.S. Treasury debt held by the public. Fannie Mae announced last year that it was prepared to begin issuing unlimited amounts of debt.

The CBO report addresses an even more important issue, aside from their calculation of the value of the GSEs' subsidies. What the CBO is pointing out, and what taxpayers need to more clearly understand, is that these mortgage giants now control 71 percent of the conventional conforming mortgage market. This dominance, were it occurring among two purely private corporations, would certainly raise eyebrows at the U.S. Department of Justice's Anti-Trust Division.

According to a recent analysis by Peter Wallison and Bert Ely for the American Enterprise Institute (which I have attached to my testimony), Fannie Mae and Freddie Mac will own or guarantee 91 percent of the conventional conforming mortgage market within three years at their current growth rate. Federal Reserve Chairman Alan Greenspan has worried aloud about the market distortions this growth is already causing. At what point do we wake up and realize that our entire home mortgage system has been nationalized and that because we failed to restrain GSE growth, curtail their non-mortgage related activities, and protect taxpayers when we had the chance, we have shifted enormous risks onto them, risks that should really be borne by the private sector?

In addition to the sheer volume of the debt the GSEs are accruing, there is the composition of that debt. The GSEs are repurchasing more and more of their own mortgage-backed securities. Today 34 percent of all Fannie Mae-guaranteed MBS are held by Fannie Mae and the comparable percentage for Freddie Mac is 31 percent. This growth in the repurchase of MBS far surpasses the percentages in the private sector. This practice defeats the original purpose of the secondary mortgage market, which is to allow the free market to distribute mortgage risk among many private investors. Barbara Miles of the Congressional Research Service described the repurchasing of MBS as the "repatriation of debt," and failed to see any mission-related purpose for the practice. The repurchase of

MBS is driven by the GSEs' true agenda, the quest for excessive profits derived from their government subsidies.

The repurchase of MBS is not the only change in the nature of the GSEs' business enterprises. In order to realize the sort of massive profits they have become accustomed to, and to make good on their promises to investors to maintain the double-digit growth in earnings, Fannie Mae and Freddie Mac are marauding into areas which are outside their charters, which are unrelated to helping lower and middle income people achieve homeownership, and which are already served by a highly competitive and vibrant market.

For example, the GSEs are purchasing home equity loans, insisting that it is well within their charter to help homeowners extract value from their single most valuable asset. However, 70 percent of all home equity loans are used for consumer purchases or debt consolidation and there are thousands of financial institutions, large and small, ready to provide that service. It is a huge stretch to contend that this practice puts people into homes.

There have been recent revelations that Fannie Mae and Freddie Mac have begun peddling securities at the retail level to individual investors with as little as $1,000 to invest. These investments are packaged to mimic callable certificates of deposit, an activity is in direct competition with small regional banks. To quote the vice chairman of the Community Bankers Association of New York, this move is "an overt example of mission creep that creates a more difficult entity for the government to control…Not only are they building a customer base to sell future products to, they are creating a population of political constituents."

Earlier this year, Freddie Mac invested several million dollars in LendingTree.com, an e-commerce mortgage brokerage startup which was in financial trouble and needed help. Why LendingTree.com and not some other similar company? As we understand it, The Department of Housing and Urban Development has not made a ruling on the permissibility of this sort of investment and is waiting for more information from Freddie Mac. The larger point is that picking winners and losers in the volatile world of e-commerce is not the role of a federally-chartered GSE, armed with the implied backing of the taxpayer.

Fannie Mae has agreed to purchase loans from the home improvement giant Home Depot, loans which will used for remodeling or consumer purchases. Congress should be demanding an explanation of how this kind of financial activity gets low-income people into affordable housing.

There are serious indications that Fannie Mae and Freddie Mac may seek an increase in their conforming loan limits, which, at $275,000, already constitute an entitlement for upper middle income homebuyers. This would put them directly into the jumbo mortgage market and in direct competition with private commercial lenders who already serve that niche. Congress should block any legislation or amendment which would raise the conforming loan limit.

In fact, CAGW and the other members of HomeEC believe that it is unconscionable for the GSEs to be buying consumer loans, trying to move into the jumbo home mortgage market and the sub-prime market, getting into retail investment banking, or dabbling in e-commerce at a time when several official and independent analyses show that they are lagging in their congressionally-chartered mission of catering to low and middle-income people trying to purchase a first home.

Mission creep by the GSEs is inevitable for several reasons. With the nation's home mortgage market maturing, the GSEs must diversify in order to maintain their 15 percent annual profit growth commitment to Wall Street investors. It will continue to be a nagging problem as long as there is no effective, authoritative regulatory structure in place to draw a bright line and enforce it. Mission creep must not be dismissed as the carping of a few self-interested industry groups. The encroachment of a government-sponsored entity into a competitive sector of the economy will cause the otherwise healthy players to leave the market and result in fewer choices for consumers and more risk for taxpayers.

In the opinion of CAGW and the other members of HomeEC, the Department of Housing and Urban Development is simply not up to supervising these two financial behemoths, with mortgage portfolios in the multi-trillions and whose activities have a systemic impact on the entire economy and banking system. HUD has a relatively small cadre of staffers to define and enforce mission-related goals and the Office of Federal Housing Enterprise Oversight is charged with ensuring the safety and soundness of their financial activities. Both of these regulatory offices are financially outgunned and lack enforcement tools.

There are no clearly defined parameters on what is or is not a secondary mortgage market activity, what sort of investments the GSEs should be permitted to engage in. They have been permitted to interpret their charters as an infinitely malleable set of loose guidelines where anything that makes a hefty profit is construed as furthering homeownership. The affordable housing mission has become nothing more than a politically-convenient fig leaf.

As long as the GSEs continue to enjoy $10.6 billion annually in government benefits; continue to absorb 37 percent of that windfall; continue to leverage their implied taxpayer guarantee to expand unimpeded into businesses beyond the scope of their charters, then Citizens Against Government Waste favors the imposition of a strong, independent, adequately-financed regulator with expertise in addressing systemic risk and armed with meaningful enforcement mechanisms to take action if necessary.

Having said that, Mr. Chairman, I must add that the groups in HomeEC are free market advocates. The optimum long-term reform we favor is the full privatization of all of the GSEs.

Fannie Mae and Freddie Mac have had great success securitizing home mortgages. Today, securitization is a firmly established financial practice. The activities of Fannie Mae and Freddie Mac do not exist in a vacuum. Their duty to stockholders, which dictates that they maximize profits, has run head on into their mission. The quest for profits is winning, at taxpayer expense. Thousands of private entities are standing by with sophisticated techniques to securitize a range of things. It is no longer necessary, nor advisable, to continue subsidizing a business, engaging in normal business practices, which could achieve success on its own.

The CBO study raises still more questions. HomeEC would respectfully like to suggest that CBO be asked to receive data from the GSEs in order to analyze several more relevant questions, on behalf of taxpayers, such as: what are the risks to taxpayers associated with the GSEs' decision to repurchase vast quantities of their own MBS?; what are the risks to the taxpayer of having two GSEs holding on their balance sheets more mortgage-related assets than the entire 1,600 member thrift industry; to what extent are the subsidies given to Fannie Mae and Freddie Mac capitalized into housing prices and therefore benefit sellers and home builders, rather than home buyers; to what extent are the GSE subsidies that do get passed on to consumers going to home buyers/sellers with high incomes, rather than those on the "cusp" of ownership; how exactly do Fannie Mae and Freddie Mac increase the rate of home ownership by purchasing refinanced mortgages and home equity loans; to what extent do factors other than the existence of Fannie Mae and Freddie Mac (such as changes in the tax laws) account for the relatively modest increase in the home ownership rate from 63.9 percent in 1985 to 66.8 percent in 1999; what exactly is the value of the GSEs' exemption from Title V (privacy) of the Gramm-Leach-Bliley Act?

Mr. Chairman, the groups in HomeEC are philosophically opposed to subsidy programs, whether they be implicit or explicit. History shows that subsidy programs breed inefficiency, waste and abuse and they often hang on long after their original mission has been accomplished, putting taxpayers at increased risk.

Even if you agree with the notion that homeownership is a greater societal good and that the federal government has an appropriate role in promoting it, the real question before this committee and the Congress is "Is this the most efficient way to help low income families get into their first homes?" The fact is, the GSEs subsidize is mortgage debt and, increasingly, consumer debt. They are the least efficient, least transparent, least accountable subsidy delivery system. And they have now become so ascendant in the financial markets that their activities have far-reaching effects throughout the entire national financial system and therefore into the pocketbooks of ordinary citizens. Increased oversight by Congress is absolutely obligatory.

On behalf of our one million members and supporters, we thank the committee for the opportunity to speak to you today and are available to answer any questions you might have.