

Paulson deserves praise for move

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Abstract (Abstract): Fannie and Freddie - hybrids that are privately owned but "government-sponsored" and that own or guarantee more than \$5,000bn (EUR3,500bn, pound(s)2,825bn) of mortgage-backed securities - had made themselves indispensable to the US housing market. Keeping them running was vital to the prospects of a housing recovery; without them there was no floor in sight for house prices, and little likelihood of a broader economic recovery.

The Treasury's promise to back the agencies supported their share prices for a time, but then confidence ebbed again. The agencies' cost of borrowing moved to a growing premium over the Treasury rate. Mr [Paulson]'s promise did not resolve the uncertainty owners and creditors faced about the soundness of their own investment. He had to move to resolve that uncertainty.

Full text: In July, explaining his contingency plan for emergency support of Fannie Mae and Freddie Mac, Hank Paulson, Treasury secretary, told the Senate banking committee: "If you have a bazooka in your pocket and people know it, you probably won't have to use it."

That is doubtless true, but once in a while you are obliged to prove you are not bluffing. So it proved with Fannie and Freddie.

July's announcement that the government was ready to lend without limit to keep the agencies going appeared to work at first. Certainly, the promise was credible. The Treasury knew, and the markets knew the Treasury knew, that the agencies could not be allowed to cease functioning.

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The Treasury's promise to back the agencies supported their share prices for a time, but then confidence ebbed again. The agencies' cost of borrowing moved to a growing premium over the Treasury rate. Mr Paulson's promise did not resolve the uncertainty owners and creditors faced about the soundness of their own investment. He had to move to resolve that uncertainty.

He deserves credit for doing so. It is not an easy thing for a Republican administration to nationalise two such colossal undertakings and take all of their assets and liabilities on to the public sector's balance sheet.

Under the new plan the Treasury itself will directly support the housing market by buying mortgage-backed securities. That too requires an ideological flexibility not usually associated with this administration.

Two months ago Mr Paulson stressed the importance of supporting Fannie and Freddie so that they could continue - as they must, he said - as privately owned entities. So much for that.

In the end, in spite of a cost to taxpayers in the tens of billions - and before this is over maybe hundreds of billions - yesterday's move was uncontroversial. Both presidential candidates back it, recognising the need to keep mortgage finance flowing. Differences are likely to arise over the terms of the nationalisation, however. Shareholders in the entities should get nothing: the agencies have failed through their own incompetence. Both boards should be dismissed, as the Treasury's plan is reported to require. The longer-term goal - for the next administration, at the earliest - should be to get the government as far as possible out of the housing market. That means breaking Fannie and Freddie into pieces small enough to fail, and privatising them. If the function they discharged - providing liquidity to the mortgage market - cannot be profitably undertaken without an implicit public subsidy, then it should not be undertaken at all.

Credit: By Clive Crook

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