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Jonathan G.S. Koppell
Montclair State University, koppellj@mail.montclair.edu

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Author(s): Jonathan G. S. Koppell

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Hybrid Organizations and the Alignment of Interests: The Case of Fannie Mae and Freddie Mac

This article explores the political influence of government-sponsored enterprises (GSEs). Using Congress's overhaul of the regulatory infrastructure for Fannie Mae and Freddie Mac as a case study, the article presents two principal findings: (1) The characteristics that distinguish government-sponsored enterprises from traditional government agencies and private companies endow Fannie Mae and Freddie Mac with unique political resources; and (2) the alignment of interest groups around Fannie Mae and Freddie Mac is subject to strategic manipulation by the GSEs. A triangular model of this alignment is proposed and employed to analyze the legislative outcome. The case has implications for students of organizational theory as well as policy makers considering the use of GSEs or other hybrid organizations.

Although their names suggest Southern folksiness, Fannie Mae and Freddie Mac are recognized in Washington for their political clout, not their down-home cooking. Fannie Mae and Freddie Mac, known formally as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, respectively, are government-sponsored enterprises (GSEs)—stockholder-owned, profit-seeking corporations created by Congress to help address America's housing needs. GSEs are one type of hybrid organization that combines characteristics of public- and private-sector entities.

Although they are increasingly popular at the local, state, and national levels of government, hybrids receive relatively little attention. This article considers the political influence of GSEs through an examination of congressional crafting of legislation in 1992 to reshape the regulatory oversight of Fannie Mae and Freddie Mac. Specifically, this article has two objectives:

- *Provide better understanding of GSEs.* “While called ‘private,’” observes Harold Seidman, who coined the term government-sponsored enterprise, “these enterprises really function in a *terra incognita*, somewhere between the public and private sectors” (1988, 23). While some have suggested frameworks for considering the gamut of hybrid organizations (see Perry and Rainey 1988), this article takes the opposite tack: It is field re-

connaissance, an effort to understand the dynamics surrounding a particular type of hybrid.

- *Specify the interaction of organizational structure and political influence.* David Truman observes that “Although the effect of structural arrangements is not always what its designers intended, these formalities are rarely neutral” (1993, 322). It should not be surprising that the characteristics distinguishing government-sponsored enterprises from private corporations and government agencies should distinguish the nature of their political influence as well.

Federal regulators recently unveiled proposed regulations intended to ensure the financial safety and soundness of the two GSEs and to set levels of performance for low-income borrowers. Thus it is a timely moment to revisit legislation calling for the regulatory overhaul. The legislative history presented in this article was constructed from official records, trade magazines and newspapers, and

Jonathan G.S. Koppell is an assistant professor of politics, policy, and organization at the Yale School of Management. His research concerns the implications of delegating public policy responsibilities to different types of hybrid organizations including government-sponsored enterprises, government-backed venture capital funds, and government corporations. He was on the staff of the Office of Federal Housing Enterprise Oversight from 1993 to 1995. Professor Koppell's article was accepted in the fall of 1999. Consequently, it relies on sources and events prior to 2000. Email: jonathan.koppell@yale.edu.

extensive background interviews with participants from all sides including multiple executive agencies, Fannie Mae, Freddie Mac, interest groups, congressional staff, and other interested parties.¹

What Are Government-Sponsored Enterprises?

Government-sponsored enterprises (GSEs) are hybrids—part public, part private—that affect the lives of most Americans. Anyone who has borrowed money to purchase a home, farm, or pay for college, or invested in a mutual fund has likely been touched by government-sponsored enterprises.² Fannie Mae and Freddie Mac are *public* in several respects. Created by Congress to serve public purposes, they are exempt from state and local taxes, exempt from registration requirements of the Securities and Exchange Commission, and have a \$2.25 billion line of credit with the United States Treasury.³ They are *not*, however, subject to regulations that govern the activities of federal agencies. Their staffs are not considered government employees.

On the *private* side, Fannie Mae and Freddie Mac are profitable businesses owned by private shareholders. Their combined net income in 1998 was over \$5 billion (OFHEO 1997). In terms of assets, Fannie Mae and Freddie Mac rank third and sixth, respectively, among American corporations (Fortune 1999). Fannie Mae and Freddie Mac stock, traded on the New York Stock Exchange, consistently outperforms the S&P 500 average. Their executives earn multimillion-dollar salaries comparable to their Fortune 500 peers.

Although there is no direct cost to the federal government, GSEs do present financial risk. Despite explicit disclaimers to the contrary, investors believe that the federal government stands behind the GSEs' outstanding obligations. Because this perception has not been discouraged, Fannie Mae and Freddie Mac securities have the implicit backing of the U.S. government.

Fannie Mae and Freddie Mac: A Primer

When Congress created the Federal Housing Administration (FHA) in 1934 to insure lenders against borrower default, it was expected that private associations would purchase the mortgages as investments. No such associations ever materialized, so in 1938 an office was created within the Reconstruction Finance Corporation to fill the role (Fish 1979).⁴ This office, eventually named the Federal National Mortgage Association (later dubbed “Fannie Mae”), purchased FHA-insured loans from private lenders. Fannie Mae also purchased federally guaranteed loans to World War II veterans.⁵ The great suburban expansion of the 1950s was fueled by such loans (Jackson 1985).

Thus, the federal government not only assumed the default risk on these loans, it created a secondary mortgage market, a place for lenders to sell loans, thereby increasing the supply of money for more loans. Fannie Mae was gradually sold to private owners, and in 1968 it was chartered as a shareholder-owned corporation (R. Moe 1983), moving its expenditures “off budget.” At the same time, the Government National Mortgage Association (Ginnie Mae) was created as a government corporation to handle unprofitable subsidization programs.

In 1970, Congress created the Federal Home Loan Mortgage Corporation (Freddie Mac) to purchase loans made by institutions that were part of the Federal Home Loan Bank System (another Depression-era entity created to channel credit to home buyers). When the savings and loan (S&L) crisis precipitated the restructuring of the savings industry in 1989, Congress transformed Freddie Mac from a government corporation into a GSE modeled on Fannie Mae.

Fannie Mae and Freddie Mac are considerably further removed from the federal government than other federal housing entities. The Federal Home Loan Bank System is overseen by a board comprising five presidential appointees. The president of Ginnie Mae and the commissioner of the FHA are appointed by the president and answer to the secretary of the Department of Housing and Urban Development (HUD). The president and officers of both Fannie Mae and Freddie Mac, in contrast, are selected by the boards of directors. Their management answers to the board, not to the United States government. Although the president of the United States appoints five of 18 board members, these directors are not distinguished from the other members by an obligation to represent the president or the administration (Musolf 1983).

Fannie Mae and Freddie Mac do not lend money or insure individual mortgages, but they do act as conduits. They purchase loans originated by private institutions (banks, thrifts, and mortgage bankers), giving lenders money to make additional loans or investments. Fannie Mae or Freddie Mac keep the monthly payments made by the borrower, or they bundle many loans together and resell shares of the monthly payments as “mortgage-backed securities.”⁶ Securities sold by Fannie Mae and Freddie Mac are free of credit risk; that is, even if home buyers default on their loans, Fannie Mae or Freddie Mac will pay the holders of the mortgage securities all the money to which they are entitled (See figure 1).

The most significant business advantage that Fannie Mae and Freddie Mac enjoy (by virtue of their GSE status) is relatively low borrowing costs. Because of the implicit federal guarantee, the companies borrow at interest rates only slightly higher than those paid by the U.S. Treasury. Even companies rated as “AAA” by corporate rating firms pay

higher interest rates on debt securities than Fannie Mae or Freddie Mac (R. Moe 1983). The prices of their mortgage securities also reflect the safety of the investment. As a result, Fannie Mae and Freddie Mac enjoy an effective duopoly over the secondary market for home loans.⁷

The tremendous volume of loans handled by Fannie Mae and Freddie Mac results in significant financial obligations, at present approximately \$2.4 trillion (OFHEO 1997), a liability that largely went unnoticed before the savings and loan crisis in the 1980s. The S&L debacle served as a painful reminder that off-budget liability could become quite tangible. Congress included a provision in the 1989 bailout law calling for a study of the government's GSE liability.⁸ The subsequent budget reconciliation act called for additional reports and mandated congressional action on GSE regulatory reform, setting the stage for the struggle that is the focus of this article.⁹ Prior to the passage of the Federal Housing Enterprise Safety and Soundness Act of 1992, Fannie Mae and Freddie Mac had been overseen by a few HUD employees, none of whom were dedicated to the task full time.¹⁰ The act, signed by President George Bush, created a new quasi-independent regulatory agency and strengthened HUD's statutory authority.

Hybrid Characteristics and GSE Influence

On matters pertaining to housing and housing finance, Fannie Mae and Freddie Mac are influential participants in the legislative process. Freddie Mac and particularly Fannie Mae have been identified as influential political players in Washington (Bradsher 1992; Labaton 1991; Matlack 1990; Nitschke 1998). This surprises those who presume the two GSEs are "part of the government," not organized interests. In fact, that confusion helps to explain the two companies' political power. Fannie Mae and Freddie Mac are powerful because they possess resources that are generally associated with both private and public sector institutions.¹¹

No pejorative connotation should be inferred from this description of Fannie Mae and Freddie Mac. Although contemporary discourse frequently paints "political influence" in negative terms, it is not intended here to convey nefarious intentions or deeds. Fannie Mae and Freddie Mac have been successful in pursuing their legislative agendas; this article simply offers an explanation.

The Private Fannie Mae and Freddie Mac: GSEs as Interest Groups

The political activities of Fannie Mae and Freddie Mac are restricted in the same ways as any private company. Both companies lobby Congress, build relationships with individual politicians, and cultivate a network of other interest groups. This is a brief summary of the private-

sector characteristics that give Fannie Mae and Freddie Mac their influence.

Money. Like many large profitable corporations, Fannie Mae and Freddie Mac devote resources to political activities. Political expenditures can take many forms: personnel devoted to legislative or political liaison, development of educational materials, and advertising. Federal Election Commission records reveal that executives of both companies contributed heavily to the political campaigns of relevant committee members (including the years during which the Federal Housing Enterprise Safety and Soundness Act of 1992 was under consideration), and Fannie Mae and Freddie Mac appear on congressional honoraria reports for speaking engagements. Fannie Mae, for a time, ran a political action committee (Fannie PAC), which was disbanded after its existence generated criticism. Both companies frequently advertise in popular media and publications aimed at congressional members and staff.

Fannie Mae and Freddie Mac enjoy financial resources, not by chance, but as a function of their structure. They enjoy legally protected partial franchises and are profitable, at least in part, due to the implicit support of the federal government. Because every aspect of their operations can be affected by congressional action, Fannie Mae and Freddie Mac have powerful incentives to devote significant attention to Congress and to politics in general. Thus, one can conclude that GSEs *will* possess resources and motives to expend them for political advantage.

Electoral Connection. As purchasers of mortgages in every congressional district in the United States, Fannie Mae and Freddie Mac are of potential interest to every member of Congress. Their centrality in the American system of home finance makes issues related to Fannie Mae and Freddie Mac salient for representatives interested in the financial well-being of their constituents, an effective hook on which to hang lobbying efforts.

Understanding this, Fannie Mae and Freddie Mac employ strategies to reinforce their connection to member's districts. Fannie Mae, for instance, produces computer-generated maps that graphically display how much business the company is doing in each congressional district. The two companies also steer corporate attention to members. At announcements of new affordable-housing initiatives and other lending programs, elected officials are given the opportunity to bask in the positive attention generated by Fannie Mae or Freddie Mac.

Loyal Allies. Lenders, realtors, and other housing-related trade organizations that depend on Fannie Mae and Freddie Mac for their business can be mobilized to bolster the GSEs' political strength. Again, the structural dominance of Fannie Mae and Freddie Mac ensures the availability of this resource. The GSEs' status secures their hold

on a large share of the residential mortgage market. Thus, relationships with partners are asymmetric, and Fannie Mae and Freddie Mac have historically relied on consistent support from organizations with national memberships.

Critics have accused Fannie Mae of being heavy handed in its efforts to maintain solidarity. In 1986, Salomon Brothers opposed Fannie Mae's bid to amend its charter and expand its business. Not only did Salomon fail to stop Fannie Mae, it was cut off from the lucrative underwriting business that Fannie Mae had steered toward the Wall Street firm (Matlack 1990; Taub and Gold 1989). Fannie Mae withdrew advertising from *The Economist* after several articles—and editorial cartoons—portrayed Fannie Mae and Freddie Mac unfavorably (Matlack 1990). Fannie Mae has also been accused of using donations from its charitable foundations to coerce political support from dependent nonprofit organizations (Zuckman 1991a).

The 1999 formation of “FM Watch,” an interest group created by mortgage-industry businesses and trade associations, suggests that the landscape may be changing. FM Watch is a response to the feared expansion of Fannie Mae and Freddie Mac business into new areas of the mortgage market (Schroeder 1999).

Network Dominance. Former, current, and potential Fannie Mae and Freddie Mac employees constitute an extensive network in the housing finance community. The two GSEs offer the opportunity to work on housing-related issues with private-sector compensation and unparalleled levels of substantive engagement. As one former congressional aide (now working for a GSE) put it, “If you're interested in housing and finance in the United States, there is no better place to be working than at Fannie Mae or Freddie Mac.”

As a result, Fannie Mae and Freddie Mac personnel rosters boast numerous alumni of the executive and legislative branches, with both the Democratic and Republican parties well-represented. For example, current CEO Franklin Raines recently returned to Fannie Mae after a stint as head of the Office of Management and Budget; Newt Gingrich recently signed on as a consultant to Freddie Mac. The two companies thus gain expertise and connections to key players in the legislative process and the administration's policy formulation. Furthermore, there is an impressive history of GSE executives crossing back into government service, giving the company advantages in terms of access, and sympathy, at the highest levels.

The Public Fannie Mae and Freddie Mac: GSEs as Powerful Bureaucracies

The politics–administration dichotomy that is attributed to Woodrow Wilson exists as an ideal; such separation is feasible, even in Wilson's account, only with agreement on the ends of government (Wilson 1887). Barring such

consensus, bureaucracies (and the individuals who populate them) are part of the political process. Although numerous models have been offered to capture the place of bureaucracy in that process, all agree that public bureaucracies possess resources that can be utilized for political influence (Hill 1991). The public aspects of government-sponsored enterprises endow them with many of the resources attributed to public bureaucracies. This influence complements the private-side resources.

Unassailability. Fannie Mae and Freddie Mac are in a unique position to claim their successful performance as a matter of national importance. Chartered by Congress, the two GSEs represent a governmental effort to help Americans purchase their own homes. Housing is, in the words of one Fannie Mae executive, a “white hat issue.” Fannie Mae and Freddie Mac can strategically “wrap themselves in the flag” and make attacks politically costly.

Expertise. Experience, information, and technical expertise sometimes give bureaucracies the upper hand in negotiations (Rourke 1984). In the case of Fannie Mae and Freddie Mac, nonprofit organizations and congressional committees do not have the resources to conduct research and develop arguments with the breadth and depth of the GSEs. Even HUD can be outmatched.

This advantage was particularly evident during consideration of legislation pertaining to the capital stress tests, computer simulations that would determine capital requirements for each GSE. Individuals with sufficient technical proficiency to challenge the GSEs' claims were sprinkled throughout the administration and congressional staff. These individuals were, by their own accounts, outgunned. As a result, the GSEs dominated the crafting of legislation regarding these tests.

Insiders. Fannie Mae and Freddie Mac are historically and structurally linked to the federal government. Many home loans insured by the federal government are purchased by Fannie Mae and Freddie Mac. Both companies have worked with HUD on program evaluation and innovation. Like many housing organizations, HUD relies on the GSEs in such partnerships because they offer expertise and financial resources. Finally, the GSEs' long-term repeated interaction with members of Congress and their staffs has given them the opportunity to build strong relationships. Fannie Mae and Freddie Mac emphasize different strategies. One senior GSE officer noted that Freddie Mac has focused on maintaining strong relationships with the executive branch, while Fannie Mae has traditionally maintained strong ties on Capitol Hill.

The Best of Both Worlds: More Powerful than Agency or Private Company

Fannie Mae and Freddie Mac possess more resources as hybrids than they would as fully private or fully public enti-

ties. This point can be illustrated by considering two *fictitious* mortgage-purchasing entities. Consider the cases of the Federal Mortgage Agency, part of the executive branch, and Acme Mortgage Corporation, a private company.

The Federal Mortgage Agency would be subject to political control, run by a political appointee, and answerable to the president. It could not take retributive actions against businesses or interest groups that failed to endorse its legislative agenda. As a result, the Federal Mortgage Agency's behavior would be limited. It could not take positions independent of the administration. Without the latitude to punish clients and partners who do not act as allies in the political realm, it could not coerce surrogates. The Federal Mortgage Agency could not independently lobby Congress. It could not serve particular areas selectively and strategically. Moreover, the agency would be subject to a host of federal management laws and regulations governing everything from personnel to procurement.

Now consider another fictitious entity, the privately owned Acme Mortgage Corporation. Acme could spend large sums of money to cultivate political good will with impunity. It could enlist support from dependent institutions on key policy issues. However, as a private corporation, Acme would be restricted by federal financial laws. It would not have the implicit backing of the federal government or exemption from federal regulations and state or local taxes. Finally, Acme would not enjoy the imprimatur of public purpose and the mandate of the federal charter.

In short, neither the Federal Mortgage Agency nor Acme Mortgage Corporation would likely wield the same economic and political influence that Fannie Mae and Freddie Mac display. As government-sponsored enterprises, Fannie Mae and Freddie Mac have *all* the advantages of our fictitious entities and none of the disadvantages. It is not surprising that Fannie Mae and Freddie Mac resist calls for privatization, which could mean severing the remaining ties to the federal government. As one congressional staff member who has worked closely with the GSEs concluded, Fannie Mae and Freddie Mac are "more powerful than if they were private or if they were public."

The Alignment of Interests around GSEs

Terry Moe (1989) argues that interest groups can shape bureaucracies for their own advantage. Although this case study is consistent with Moe's hypothesis, this article is primarily concerned with an additional claim that is, in a sense, the converse of Moe's. The structure of institutions can shape the preferences of interest groups. In this case, the arrangement of interests around Fannie Mae and Freddie Mac reflect the organizational features of GSEs. Furthermore, this alignment of interests was pivotal in determining the outcome of the legislative process. The

following sections describe the alignment of interests around Fannie Mae and Freddie Mac and illustrate the significance of this arrangement with examples from the drafting of the Federal Housing Enterprise Safety and Soundness Act of 1992.

The Alignment of Interests Around Fannie Mae and Freddie Mac

Government-sponsored enterprises are governed by three objectives that could conflict with one another:

1. To fulfill programmatic policy purposes. In the case of Fannie Mae and Freddie Mac, this means providing greater access to mortgage credit markets.
2. To maintain a financially safe and sound operation that minimizes risk to the federal government.
3. To operate as a profitable private company that maintains a consistent return to shareholders.

Reckless pursuit of profits could undermine achievement of public purposes and expose the federal government to financial risk. Overly risk-averse regulation of financial safety and soundness could hinder the GSEs' abilities to meet programmatic goals or limit profitability. Overly ambitious programmatic goals could adversely affect the GSEs' profitability or even their financial safety and soundness.

This suggests a triangular arrangement of interests around the GSEs, each point potentially at odds with the other two (See figure 2). A brief description of the interest groups at each point of this triangle introduces the source of conflict between interests in the case of Fannie Mae and Freddie Mac.

Programmatic Considerations. Fannie Mae and Freddie Mac are regarded as part of the federal response to the public's housing needs. Although they were created to stabilize mortgage markets, eliminate regional disparities in credit availability, and facilitate home buying among middle- and working-class Americans, Fannie Mae and Freddie Mac should now, in the view of housing advocates, focus on providing credit opportunities for underserved markets and borrowers. Thus, proponents of housing for low- and moderate-income communities, generally nonprofit organizations, are pressing Fannie Mae and Freddie Mac to devote additional resources to housing for less-affluent Americans. The Department of Housing and Urban Development shares this interest in the GSEs' programmatic function.

Profitability. Fannie Mae and Freddie Mac are both profit-seeking companies, an orientation that is codified in the GSEs' charters. Even the clause pronouncing Fannie Mae's obligation to provide assistance to low- and moderate-income borrowers specifies that the company is entitled to a "reasonable economic return" on *all* programs (12 U.S. Code 1716).

Of course, the most interested parties in the profitability of Fannie Mae and Freddie Mac are their owners and managers. Stockholders' desire for the companies to maintain their market status creates a powerful incentive for executives. Like many corporate managers, executives at both companies are judged and compensated based, in large part, on stock performance. Thus, the corporate leadership is likely to resist legislation that would make it more difficult to maintain stock value.

The normative question of whether government-sponsored enterprises *should* be profit oriented is not relevant to this article. The fact that GSEs *are* profit-seeking entities is integral to explaining their behavior. The ownership of Fannie Mae and Freddie Mac, an "interest group" concerned with the profitability of their companies, brings a distinct set of interests before Congress.

The profitability of other companies may also be at stake when Congress considers government-sponsored enterprises. Primary market lenders (banks, thrifts, mortgage bankers) depend on Fannie Mae and Freddie Mac. Without the stream of capital the GSEs guarantee, many lenders could not function. Home builders, realtors, mortgage insurers, contractors, landscapers, and other housing-related industries recognize the critical role of Fannie Mae and Freddie Mac; more loans means more business. Similarly, Wall Street firms that handle the multimillion-dollar issuances of Fannie Mae and Freddie Mac securities have a strong interest in the two companies. The more business the GSEs are doing, the more income such firms earn by underwriting the sale of debt and mortgage securities to investors.

Of course, there can be serious disagreements among these groups. For example, some financial institutions that depend on Fannie Mae and Freddie Mac complain they cannot compete with the GSEs because of their preferential status. One should not assume that all mortgage-related businesses would naturally endorse proposals beneficial to Fannie Mae or Freddie Mac.

Financial Safety and Soundness. The combined outstanding debt of Fannie Mae and Freddie Mac exceeds \$740 billion (OFHEO 1997). Fannie Mae and Freddie Mac guarantees cover more than \$1.1 trillion in outstanding mortgage securities (OFHEO 1997). To give some perspective, the housing GSEs' \$2.4 trillion combined liability is greater than the actual or projected total outlays of the U.S. federal government in any single year.

Although such large numbers may seem abstract, the risk is quite real. The financial conditions of Fannie Mae and Freddie Mac, for example, are very sensitive to interest rate movements. Unforeseen shifts in the market can have catastrophic consequences. Fannie Mae absorbed "substantial losses" in the early 1980s when interest rates rose and the companies' borrowing costs greatly exceed

its revenues (*BNA Banking Report* 1990). Freddie Mac has written off millions of dollars in losses on poorly managed programs (*Economist* 1989). If, for example, even one GSE were unable to meet its current outstanding obligations, the federal government would be stuck with a bill for hundreds of billions of dollars.

Interest groups concerned with the financial safety and soundness of Fannie Mae and Freddie Mac are not readily visible. If Fannie Mae can produce a higher rate of return for its stockholders by maintaining a small cushion of reserve capital, the stockholders benefit. The increased risk is borne by the federal government, and the stockholder can bail out if the company's fortunes deteriorate. Wall Street investment banks are equally unconcerned with financial safety and soundness: As long as investors are confident that the federal government guarantees Fannie Mae and Freddie Mac securities, their business is not affected.

At stake, then, is the creditworthiness of the federal government. Unfortunately, the public good of "creditworthiness" is diffuse and indivisible, difficult to organize an interest group around. This is a logical extension of the observations that Stanley Surrey offers on the politics of tax breaks; the cost of tax loopholes is so diffuse as to be nonexistent (Surrey 1976). The costs to taxpayers presented by GSEs is even more diffuse. In fact, there is only a *risk* of cost. By analogy, then, legislative resistance to GSE risk should be lower than it is for tax breaks.

The strongest institutional advocate for fiscal prudence is the Treasury Department, which took the lead in drafting the safety and soundness legislation. A handful of "public interest" groups and members of Congress raised the risk presented by government-sponsored enterprises. It is telling, however, that perhaps the single most effective advocate for safety and soundness regulation has been a private individual, Washington attorney Thomas Stanton, a former Fannie Mae associate general counsel and self-appointed activist for financial safety and soundness. Stanton's 1991 book, *State of Risk*, and his personal lobbying were influential in the legislative process (Matlack 1990; Rauch 1991).

Alignment in Action: Redesigning a Regulatory Framework

The Federal Housing Enterprises Financial Safety and Soundness Act of 1992 took shape over three years. Fannie Mae and Freddie Mac worked with the administration to develop the initial proposal and later negotiated with congressional staff. This gave the GSEs, as a former Office of Management and Budget official described it, "two bites at the apple." The alignment of interests, combined with the resources available to the GSEs, allowed Fannie Mae and Freddie Mac to shift the debate from disadvantageous issues to more favorable ground. Yet the history of the legislation shows that opponents recognized this strategy and,

to some extent, counteracted it successfully. This section considers three key elements of the act: regulatory structure, capital standards, and affordable-housing goals.

Regulatory Structure. The act divided regulatory authority over Fannie Mae and Freddie Mac between a new, quasi-independent agency, the Office of Federal Housing Enterprise Oversight (OFHEO), and HUD. OFHEO is responsible for safety and soundness regulation, while HUD is responsible for programmatic regulation. This outcome resulted from a combination of congressional politics, fear of regulatory capture, and the GSEs' desire to maintain Congress's role in the oversight process.

The fear of regulatory capture came from all points of the interest group triangle. Safety and soundness advocates worried that a small, independent regulatory agency could be influenced by Fannie Mae and Freddie Mac and that HUD would subordinate safety and soundness to programmatic goals. Affordable-housing advocates were wary of Treasury regulation because safety and soundness might dominate programmatic considerations. The GSEs were leery of any regulator that might hinder their ability to function successfully.

The May 1991 General Accounting Office report to Congress recommended the creation of a federal enterprise regulatory board to oversee all government-sponsored enterprises. Such a regulator would have "the visibility and capability to act promptly and effectively if a government-sponsored enterprise experiences severe difficulties" (GAO 1991, 46). The "super-regulator" idea, however, was doomed from the outset. The proposed super-regulator would have overseen agricultural, educational, and housing GSEs. Thus, the agriculture and education committees would likely have lost jurisdiction over *their* GSEs to the banking committee. Such changes are not generally welcomed enthusiastically (see Fenno 1973). Furthermore, existing regulators resisted efforts to strip away their authority and, in some cases, their reason for existence.

The critical issue was whether HUD should retain regulatory authority or whether a new regulatory agency should be created to oversee Fannie Mae and Freddie Mac. The GSEs took different positions regarding the optimal regulatory structure. Fannie Mae argued that HUD should continue in its role as regulator. A politically insulated independent regulator might diminish the value of relationships with HUD and Congress that Fannie Mae had long cultivated. Freddie Mac, on the other hand, favored the independent-regulator proposal. One independent regulator with safety and soundness as well as programmatic authority over the two housing GSEs, Freddie Mac argued, would produce more coherent regulation.¹²

The Treasury Department favored the creation of a single, independent regulator, while HUD was loathe to surrender its regulatory authority. The Bush

administration's desire to maintain a united front forced a compromise: separation of safety and soundness from programmatic regulation *within* HUD. The Treasury was satisfied that the OFHEO director was sufficiently insulated from the HUD secretary. According to the statute, "The Director is authorized, without the review or approval of the Secretary, to make such determinations, take such actions, and perform such functions as the Director determines necessary" to set capital standards, issue and enforce regulations, and examine Fannie Mae and Freddie Mac (12 U.S. Code 4513).

Still, the HUD secretary retains the right of approval over any OFHEO actions that are not directly required by the legislation. OFHEO submits its appropriations requests and clears drafts of proposed regulations through the Office of Management and Budget. The OFHEO director is appointed by the president, with Senate confirmation, to a five-year term. Fears that the safety and soundness regulators would dominate programmatic interests were allayed because the secretary retained direct authority over programmatic oversight (see figure 3).

Several senators and their staffs disliked the compromise. Expressing their sentiments, Senator Carl Levin (D-MI) commented that "the better course of action would have been to place the regulator of housing enterprises outside of HUD" (*Cong. Rec.* 1992, S8652). But the Senate gave the House the structure it wanted in exchange for concessions in the areas of capital standards and affordable-housing goals. Congressional staff note that Fannie Mae lobbied heavily with more sympathetic House members to maintain HUD's authority. The compromise, it was concluded, was the best available deal. "They could have been stronger," said Levin, "but at least the regulator does not report to the Secretary when it comes to safety and soundness" (*Cong. Rec.* 1992, S8652).

As a final bit of protection, Fannie Mae fought to keep channels of congressional review in place as an insurance policy. Significant examples of this strategy include the requirements that OFHEO clear all proposed regulations through oversight committees and go through the yearly appropriations review (a requirement that bank regulators are not subject to). Critics of the final law note that because the independent safety and soundness regulator was subject to the congressional appropriations process, the GSEs would have "a chance to exercise influence over the regulator by lobbying the Appropriations committees" (Taylor 1992). Administrative and congressional staff explain that they understood why Fannie Mae wanted the appropriations clause inserted and that it could cause difficulties for OFHEO in the future. Nevertheless, the clause was accepted to get the bill passed.

Although there is some substantive justification for the division of regulatory responsibility, this case study supports

Moe's glum conclusion that, given the objectives and influence of interest groups, the democratic process is unlikely "to promote effective organization (T. Moe 1989, 329).

Setting Capital Standards. The three congressionally mandated reports on the regulation of government-sponsored enterprises recognized the need for meaningful capital requirements to ensure the GSEs have enough money to cover losses. With each loan purchased, Fannie Mae and Freddie Mac assume credit risk (the borrower may not repay the loan) and interest rate risk (Fannie Mae or Freddie Mac may have to pay higher interest rates on debt than they receive from borrowers.) Although maintaining reasonable capital is prudent, holding excess capital is inefficient; reserve capital does not maximize return. Thus, there is tension between the need for capital reserves and the desire to utilize capital profitably.

The general approach suggested by the reports and agreed to by the administration and the GSEs was a two-part capital standard: a minimum capital standard, a baseline ratio of retained capital to liabilities, and a risk-based capital standard, a more complex requirement derived from projected losses under computer-simulated economic scenarios. The initial question was how much latitude Congress should grant OFHEO to translate the law into precise regulations.

The GSEs disagreed on the desirability of regulatory discretion to specify the capital standards. Freddie Mac favored regulatory discretion, but Fannie Mae sought to have Congress define as much of the risk-based capital standard as possible to constrain any future regulatory agency. The Treasury Department wanted OFHEO to have complete discretion in setting capital standards.

Fannie Mae invoked programmatic concerns in its arguments against discretion. A company spokesman suggested that a regulator with discretion could impose "such a high capital standard that the corporation would be unable to fulfill its housing mission" (Zuckman 1991b), an argument endorsed by corporate supporters (HDR 1992). The final legislation spelled out most of the minimum capital requirement and a great deal of the risk-based capital requirement. Keeping the determination of capital standards in the legislative domain was consistent with Fannie Mae's strategy throughout the legislative process: capitalize on the good congressional relationships that had been cultivated and maintained over several years.

Although Fannie Mae and Freddie Mac expressed different views on several specific questions, the two GSEs both argued against legislation that would raise capital levels. Once the capital standards battle was kept in Congress, the GSEs focused on shaping the regulations. Leland Brendsel, chairman and chief executive officer of Freddie Mac, and James Johnson, chairman and chief executive officer of Fannie Mae, both testified before Congress that overly de-

manding capital standards would threaten the GSEs' ability to perform their programmatic functions (U.S. Senate 1991, 197; U.S. House 1991b, 36). By invoking the housing functions of their companies, as they did in arguing against regulatory discretion, the two executives portrayed the capital standards debate as a conflict between programmatic goals and fiscal safety. This deflected attention from profitability.

Other interest groups interested in profitability joined this chorus. Stephen Ashley, president of the Mortgage Bankers Association, warned that "excessive capital requirements are not necessary and, in fact, would limit credit availability and raise interest rates for homebuyers" (U.S. House 1991b, 72). Not coincidentally, that would mean a loss of business for the members of Ashley's organization. The California Association of Realtors argued that "Any increase in required capital for the FNMA and FHLMC will reduce the supply of lendable funds in the primary mortgage market and raise mortgage interest rates" and dismissed the prospects of a taxpayer bailout as "extremely remote" (U.S. Senate 1991, 380).

More tellingly, interest groups clustered around the *programmatic* node rallied against stringent safety and soundness regulations. In their testimony before Congress, affordable-housing advocates argued against higher capital standards. Paul Grogan, president of the Local Initiatives Support Corporation, a national nonprofit development organization, raised the danger that safety and soundness regulation would adversely affect affordable-housing programs: "A regulator focusing only on safety and soundness will not take into account the impact of its actions on low-income housing and communities" (U.S. House 1991b, 412). Such statements were not uncommon among affordable-housing advocates (HDR 1991).

The mobilization of interest groups suggests the consequences of the alignment of interests. In a conflict between profitability and safety and soundness, the programmatic node was a swing faction. Fannie Mae and Freddie Mac used their resources to recruit groups clustered around this node. The Treasury Department, the only institutional advocate of safety and soundness, had no such ability.

In advocating more stringent capital standards for the GSEs, Treasury representatives sought to distinguish the points of opposition. A central theme of Undersecretary Robert Glauber's testimony before Congress was that higher capital requirements do not necessitate reductions in affordable-housing support or increases in interest rates or fees charged to American home buyers. "It should be possible for these institutions to raise significant amounts of capital and do so without raising their prices," explained Glauber. "What it would mean would be somewhat of a reduction in the rate of return that they make (U.S. House 1991b, 24)." Under questioning from Senator Jake Garn on the impact of increased capital requirements on mort-

gage interest rates, Glauber reiterated, "If anybody bore the burden, it would be the shareholders and not homebuyers" (U.S. House 1991b, 23).

The problem with Glauber's claim lay in the structural independence of Fannie Mae and Freddie Mac. Given the absence of direct governmental control over the two companies, there was no guarantee that increased capital standards *would not* adversely affect housing programs. While the companies *could* lower their rates of return, they could just as easily raise the fees charged to borrowers. Both the General Accounting Office and Congressional Budget Office recognized this possibility and even calculated adjustments in rates paid by borrowers required to help GSEs meet higher capital requirements. A 1996 Congressional Budget Office report on the GSEs made the point more starkly, noting that Fannie Mae and Freddie Mac effectively decide how much of the federal subsidy that is implicit in the advantages they receive is passed on to borrowers.

Negotiations between Senate staff and representatives of Fannie Mae and Freddie Mac resulted in the risk-based capital requirement (more stringent than the House version) that was included in the final bill. The conference committee adopted the Senate's capital standards and parameters for a risk-based capital stress test. When the GSEs faced an unpalatable component of the capital standard in Congress, they argued for regulatory discretion, hoping to fight the battle another more advantageous day.¹³ Suffice it to say, the compromise left ample room for dispute between the new regulator and the GSEs.¹⁴

The legislative history of the capital standards confirms the influence of Fannie Mae and Freddie Mac. Not only were the GSEs able to employ their considerable political power, the organization of interests around government-sponsored enterprises allowed Fannie Mae and Freddie Mac to enlist groups with programmatic interests for their battle against stringent capital standards. Furthermore, the triangular arrangement of interests dictated the strategic behavior of the Treasury Department. In practice, this meant driving a wedge between the programmatic and profitability nodes by arguing that the GSEs could cut profits to meet stricter capital requirements rather than paring affordable-housing programs. Given the resources at the GSEs' disposal, this strategy proved unworkable.

Housing Goals. There is tension between the programmatic mission of the GSEs and both profitability and safety and soundness. Although the programmatic goals are publicly unassailable, there *is* resistance on the part of the GSEs to the additional burden of programmatic regulation. While fighting higher capital standards, programmatic goals were invoked by Fannie Mae, Freddie Mac, and allies to dull the impact of safety and soundness regulations. In the case of affordable-housing goals, Fannie Mae and Freddie Mac

attempted to enlist groups clustered at the safety and soundness and profitability nodes to thwart the efforts of housing proponents at the programmatic node.

With Congress overhauling the regulation of Fannie Mae and Freddie Mac, interest groups that had been pressing the GSEs to contribute more to the development of low-income and affordable housing saw an opportunity. The affordable-housing aspect of the legislation was introduced when House Banking Committee chairman Henry Gonzalez inserted a provision requiring the GSEs to allot an amount equal to 20 percent of the previous year's dividend payments to the Federal Home Loan Banks' "Affordable Housing Program," which subsidizes rental units for low-income families. Fannie Mae and Freddie Mac were animated in their opposition to Gonzalez's subsidization provision (U.S. House 1991b). Their testimony on the subject was vehement, they marshaled significant resistance from their allies, and the subsidization program was eventually removed from the bill (with the blessing of many members of Congress who had argued the provision was a corruption of the GSEs' mission).

The battle saw a parade of Fannie Mae and Freddie Mac allies rising to the GSEs' defense. The comments submitted by a host of Wall Street investment firms indicated that profitability was as significant in the resistance to the affordable-housing goals as was safety and soundness. Jonathan Gray, for example, an analyst specializing in GSEs, asked members of the House subcommittee, "[H]ow would you feel, placing your money at risk, in a venture whose profits accrue to you only after a third party has extracted an interest, the amount of which interest is subject to change at any time?" (U.S. House 1991b, 406). Many financial-sector participants that depend on Fannie Mae and Freddie Mac to provide a large, lucrative share of their business urged members to recognize the importance of profitability, which, they suggested, was crucial to the success of government-sponsored enterprises. Unlike Fannie Mae and Freddie Mac, which (as GSEs) risked offending the public with overt emphasis of profitability, these firms were politically safe to argue profitability and understood that it was in their business interest to support Fannie Mae and Freddie Mac.

The backlash prompted Gonzalez to scrap his proposal and order the GSEs and housing groups to reach a compromise, a move that proved controversial. In an episode recounted differently by all participants, representatives of the affordable-housing groups met with representatives of the GSEs and negotiated language that was inserted into the first House bill. The two paragraphs created a weak requirement "that a reasonable portion of the corporation's mortgage purchases be related to the national goal of providing adequate housing for low- and moderate-income families, but with reasonable economic return to the corporation" (U.S. Congress 1991, 20, emphasis added).

Some observers, including Rep. James Leach (R-IA), cried foul and argued that Fannie Mae had bought off the affordable-housing groups with donations from its Fannie Mae Foundation. Housing groups that were dependent on the money, it was alleged, were forced to choose between supporting Fannie Mae and sacrificing funds (Zuckman 1991a).¹⁵ According to a former committee staffer, members of the committee chose not to fight for tougher regulations when the affordable-housing groups signed off.

The situation was different on the Senate side. A bipartisan group of senators of varying ideological backgrounds called for greater dedication to programmatic goals. Chairman Donald Riegle (D-MI) and ranking minority member Jake Garn (R-OH) both supported more ambitious affordable-housing goals. Riegle introduced the Senate bill on the floor, noting that “[HUD regulations] have been too weak and often have not been enforced. So the bill creates better standards with specific enforcement tools that will require the GSE’s to increase their efforts to provide financing for those who need it most” (*Cong. Rec.* 1992, S8607). Others, such as Senator Alan Dixon (D-IL), were more strident: “Congress must send a strong message to the GSE’s that they have important public purposes which must be fulfilled. Their responsibilities are not just to their shareholders who have benefited handsomely from the GSE’s unique relationship to the Federal Government. Their responsibilities are also to the public: To maintain their financial safety, but also to assure that our housing finance markets work for the benefit of all Americans—not just the affluent” (*Cong. Rec.* 1992, S8651). The affordable-housing provisions of the bill were solidified and specified, effectively adding enforcement provisions and force of law to existing HUD housing goals.

Fannie Mae and Freddie Mac were reluctant to express opposition to housing goals in principle and, in fact, endorsed the Senate legislation after extensive negotiation. Groups sympathetic to the GSEs resisted the housing goals, testifying they were unnecessary and potentially damaging to the enterprises.¹⁶ For example, Fannie Mae, Freddie Mac, the National Association of Realtors, the Mortgage Bankers Association, and the National Association of Home Builders visited members *en masse* and warned against the dangers of stretching the GSEs. Overly ambitious housing goals, they claimed, could jeopardize their safety and soundness and cost taxpayers billions.

On this issue, the advocates of safety and soundness were in the swing position. Initially, the Treasury resisted the goals, fearing they might pose a threat to safety and soundness, though this position was never taken publicly. Treasury officials recognized that without the support of housing interests that demanded the affordable-housing goals and, more importantly, the Senators who agreed with them, the bill would never pass and safety and soundness would die with

it. Although the Treasury Department’s reports on GSE regulation and testimony before Congress made it clear that safety should be the paramount regulatory concern, the housing goals could be approved with confidence that safety and soundness would not be jeopardized.

Fannie Mae and Freddie Mac argued the programmatic goals were poorly defined and difficult to meet, yet they could not attack them on principle. Thus, the only mechanism available was to enlist the third node: safety and soundness. The Treasury’s unwillingness to endorse the argument that safety and soundness would be threatened by the affordable-housing goals diluted the strength of this approach. The GSEs argued they were already working to expand lending to low- and moderate-income families, but without the support of the safety and soundness node the GSEs could not eliminate the goals.

The inclusion of affordable housing goals was not an overwhelming defeat of Fannie Mae and Freddie Mac. The deletion of the rent-subsidization program demonstrated that Fannie Mae and Freddie Mac *could* influence the crafting of the goals and avoid their most disliked designs when alliances among interests were not formed. The GSEs’ political muscle was used effectively to mobilize sympathetic interest groups in the housing and financial sectors. As the testimony on the Affordable Housing Program subsidy indicates, a range of groups lobbied against the requirement. Most importantly, the Treasury’s antipathy toward this provision was never in doubt. It was dropped from the conference version of the bill.

Furthermore, critics point out that the goals did not force the GSEs to finance significantly higher levels of affordable housing than Fannie Mae was funding at the time of the bill’s passage. Also the enforcement mechanisms are extremely weak. HUD can do little more than admonish the GSEs if they do not meet goals. Finally, HUD may be reluctant to damage the productive working relationships it has established with Fannie Mae and Freddie Mac.

Epilogue. It is still too early to pass judgment on the efficacy of the new regulatory regime. OFHEO has finalized and applied the minimum capital standards (both companies have complied) and recently published its proposed risk-based capital regulation, beginning what is sure to be a contentious period of negotiation and gamesmanship with the GSEs, Congress, and the administration (Connor 1999; OFHEO 1997). Under the proposed rule Freddie Mac would meet the capital standards, while Fannie Mae would not.

The housing goals passed by Congress had a three-part requirement with interim goals in low-income, central cities, and special affordable categories. Although there has been some controversy regarding HUD’s interpretation of the law, both Fannie Mae and Freddie Mac met most of the interim targets (failing in the central cities category).

HUD just recently proposed its final regulation, which would raise the target for loans to low- and moderate-income families from 42 percent to 50 percent by the end of the year 2001 (Day 1999). Fannie Mae, but not Freddie Mac, has expressed its acceptance of the new goals.

Arguments against the new capital rules and housing goals have conformed to the patterns described in this article. In both cases, the third node—programmatically concerns in the first case, financial safety in the second—has been invoked to tilt the scales toward profitability.

Implications

From the case of Fannie Mae and Freddie Mac, implications can be inferred regarding the ramifications of organizational structure for GSEs and other hybrid institutions.

Organizational Structure as a Feedback Loop

As Terry Moe contends, interest group influence in the legislative process partially explains the creation of a regulatory infrastructure for Fannie Mae and Freddie Mac that is saddled with contradictions and ambiguities. In each component of the Federal Housing Enterprise Safety and Soundness Act of 1992, the GSEs were able to dilute or obfuscate the objectives. However, this account glosses over Fannie Mae and Freddie Mac's ability to shape and manipulate interest group preferences. This suggests the need for refinement of Moe's argument.

The previous section illustrated that the triangular arrangement of interests rewarded actors who maintained alliances between interest group nodes. Fannie Mae and Freddie Mac were able, in the view of first-hand observers, to design their regulation. They did so with the assistance of allies, many of whom had little self-interest in helping the GSEs. Models of interest group participation in institution building should account for organizations with the ability to manipulate preferences of other groups for their own self-interest.

In this case, the politics of structure could be represented as a feedback loop. By exerting influence on the crafting of the 1992 legislation, Fannie Mae and Freddie Mac effectively influenced their own regulatory structure. This, in turn, guaranteed their influence in the future. The limits of this loop are unclear. Fannie Mae and Freddie Mac, for example, have agitated for congressional charter amendments to broaden the scope of potential activities, engendering serious opposition from formidable opponents including the organization of FM Watch as a political counterweight. Fannie Mae and Freddie Mac will likely counter any efforts by FM Watch to diminish their influence in aggressive fashion. Thus a new test of the GSEs' influence may come soon.

With a single case, it is difficult to specify when such "feedback loops" might arise. Certainly, some government agencies influence the political actors that ostensibly are

overseeing them. However, the structure of government-sponsored enterprises is a key factor in explaining the distinguishing influence of Fannie Mae and Freddie Mac. It endows the GSE with resources for political influence and results in an arrangement of interest groups that allows and rewards strategic manipulation. Although greater specification is required, the point is noteworthy. Like genetic mutations, some hybrid organizations may continue to change—sometimes in ways that are neither foreseen nor desired by their creators.

Hybrid Institutions: Out of Control or Self-Control?

Lloyd Musolf and Harold Seidman (1980) warn that government-sponsored enterprises are governmental institutions beyond the control of government. This proposition offends the ideals of popular sovereignty and government accountability. While it does not appear that any governmental entity "controls" Fannie Mae and Freddie Mac, this study suggests a more complicated truth: The infrastructure to "control" them may exist, but GSEs have the resources, ability, and position to control their own controllers.¹⁷

This conclusion is offered while sidestepping the sizeable literature devoted to the problematic concept of control. That is possible because the point is straightforward. If government-sponsored enterprises can, by nature, exert great influence over those responsible for controlling them, it is difficult to imagine a definition of control that would be satisfied.

Concrete conclusions are inappropriate. Not only is it too early to judge the success or failure of the Federal Housing Enterprise Safety and Soundness Act of 1992, alternative proposals for regulating Fannie Mae and Freddie Mac might provide more stringent oversight. For example, a proposed super-regulator for all government-sponsored enterprises might be more independent and less prone to capture than a single-purpose, quasi-independent office of HUD. Still, this case should serve as a warning to those seeking to employ a hybrid organization. Designers of future hybrids must be aware of the political potential of the organizations they are creating. Few would have anticipated that Fannie Mae and Freddie Mac would grow into political heavyweights.

Government-sponsored enterprises are an intriguing alternative form of government. Their ability to address public needs at no direct expense to the taxpayer makes them appealing, particularly when paring the cost of government is a concern. This article introduces some nonbudgetary ramifications of this approach. As proposals for additional GSEs are considered, it would be wise to consider the consequences of creating independent political actors with potential influence greater than most institutions, public or private.

1. Interviews were conducted in the spring of 1996 and the summer of 1997. Interview subjects included representatives of organizations that participated in the development of the legislation, including Fannie Mae, Freddie Mac, the Treasury Department, the Department of Housing and Urban Development, the Office of Management and Budget, nonprofit and industry interest groups, and committee staff from the relevant committees and subcommittees on both the House and Senate sides of Congress. Interviews were conducted on background and subjects declined to be cited by name.
2. Home loans are frequently financed with the assistance of Fannie Mae, Freddie Mac, or institutions that rely upon the Federal Home Loan Bank System. Farm purchases are often financed through Farm Credit Banks, Banks for Cooperatives, or the Federal Agriculture Mortgage Corporation (Farmer Mac). Student loans are frequently purchased by the Student Loan Marketing Association (Sallie Mae), recently “privatized,” and college facilities construction can be financed with the assistance of the College Construction Loan Corporation (Connie Lee). Securities issued by these GSEs are present in the portfolios of most investment funds and savings institutions. In addition to these federal institutions, there are numerous similarly structured state and local entities involved in housing, transportation, environmental protection, utility provision, and other public functions.
3. Fannie Mae and Freddie Mac securities are also considered governmental with respect to restrictions on investment of public funds.
4. The Reconstruction Finance Corporation was created in 1932 to lend money at 3 percent interest in an effort to revive the economy. Congress appropriated \$300 million to the agency. It also issued debt and bonds to raise money (Fish 1979, 195).
5. In this article, loans described as FHA-insured also include loans insured by the Department of Veterans Affairs.
6. Fannie Mae and Freddie Mac sometimes purchase their own securities and retain them in their own portfolios.
7. Not all home loans are eligible for purchase by Fannie Mae and Freddie Mac. There is a ceiling on the dollar value of loans they can purchase, plus standards which all loans must meet for purchase. Loans that meet these requirements are called conforming loans. There is a significant secondary market for nonconforming loans, that is loans that cannot be purchased by Fannie Mae and Freddie Mac.
8. Section 1004 of FIRREA, the 1989 law that overhauled regulation of the savings and loan industry, required the comptroller general of the United States to prepare a study of government-sponsored enterprises, including Fannie Mae and Freddie Mac, to determine the financial soundness and stability of the government-sponsored enterprises; the need to minimize any potential financial exposure of the federal government; and the need to minimize any potential impact on borrowing of the federal government.
9. The Omnibus Budget Reconciliation Act of 1990 required the Treasury Department and the Congressional Budget Office to prepare additional reports on GSE regulation and required congressional consideration of GSE legislation by September 1991. Failure to consider legislation would result in a mandatory vote on a proposal to be presented by the Treasury Department.
10. HUD’s limited regulatory authority over Fannie Mae and Freddie Mac had rarely been utilized due to chronic lack of resources, expertise, and political leverage. In 1989, the FIRREA legislation added oversight of Freddie Mac to HUD’s responsibilities and required the issuance of new regulations for the GSEs. By the time that regulation of Fannie Mae and Freddie Mac was being restructured, no final regulations had been issued.
11. While using the term repeatedly, this paper does not take on the vexing issues of “power” described by March (1966), Dahl (1957), and others. A simplistic definition—the ability to get what one wants—is utilized for the analysis of this case. Further specification is clearly required.
12. The disagreement revealed differences between the two companies. At the time the FHEFSSA was under consideration, Freddie Mac had been a private company for only two years. Prior to the introduction of stock ownership and creation of a board of directors, Freddie Mac, in the words of an administration official, functioned “like an agency not a private corporation.” The leadership at Freddie Mac did not have the political experience or perspicacity that Fannie Mae strategists displayed. The contrast between Leland Brendsel, Freddie Mac’s CEO, and Jim Johnson, Fannie Mae’s leader, is telling. Brendsel is a Ph.D. economist. Johnson was a top aide to Vice President Mondale and a successful Wall Street investment banker.

With the transformation from government agency to private corporation, Freddie Mac moved to the profitability node of the triangle—but had not yet adapted. As a congressional aide put it, “Freddie Mac was operating under an organizational culture reflecting past interests.” Fannie Mae, on the other hand, recognized the virtue of keeping authority within HUD, a government agency that, like many interest groups called upon to support the GSEs’ positions, relied on partnerships with Fannie Mae.
13. Fannie Mae and Freddie Mac had strategic reasons to press for ambiguous language in the FHEFSSA. For example, one version of the risk-based capital rules required the regulator to identify the worst historical interest rate shocks for use in the stress test. The GSEs resisted this clear requirement and insisted that the final bill require only that the interest rate portion of the stress test be “reasonably related” to the worst historical experience. This left the door open for future dispute (and negotiation) with OFHEO. The frequent appearances of the phrase “reasonably related” suggests the appeal of this solution for the GSEs. Fannie Mae was able to

- extract such concessions because the Bush administration and several senators were eager to pass the law and feared the ability of the GSEs to, at the very least, delay its passage. By creating mechanisms to exert pressure on their regulators through Congress, the GSEs maintained the value of their good relations on Capitol Hill.
14. The unanswered questions of the capital standards affect millions of dollars for each GSE. Even seemingly simple issues can be vexing. For example, the risk-based capital standard required by Congress calls for a stress test. A computer simulation is utilized to determine how much capital the GSEs require to withstand a horrendous economic scenario as bad as the worst 10-year period experienced in any region of the United States. This simplified clause gives some sense of the difficulty of the task. What is a region? The legislation says only that a region is 10 contiguous states. Which 10 states? This question is critically important; it defines how bad the worst-case scenario is for the GSEs. Development of the capital standards requires the regulator to resolve scores of such difficult questions.
 15. In his dissenting views on H.R. 2900, reported out of the House Committee on Banking, Finance and Urban Affairs, Rep. Jim Leach expressed his dismay over this phenomenon: "The committee's judgment on the housing provisions of the bill unfortunately was clouded by the endorsement of the approach favored by Fannie and Freddie by a variety of activist consumer groups which without notification to Congress became recipients of substantial contributions from the two GSEs" (U.S. House 1991a, 112).
 16. As one Treasury staffer who worked on the legislation recalled, "Fannie would make a phone call and all of a sudden fifty letters would arrive on the Hill. And the letters all pretty much looked the same because Fannie would draft it and send it out."
 17. In a remarkable letter to their colleagues, Representatives J.J. Pickle and Willis Gradison, who had begun the drive toward FHEFSSA by inserting the report requirement into the savings and loan bill, urged that Fannie Mae's influence be resisted: "We believe that Fannie Mae should not possess a veto over the form of its own supervision. The primary concern of Congress in drafting this legislation should be to protect the taxpayer by requiring all GSEs to be capitalized adequately. Public policy on such a serious issue should not be stalled, perhaps permanently, by lobbying efforts that put the private interest of a single enterprise above the broader public interest" (Pickle and Gradison 1992). They concluded emphatically that "The time has come to protect the public purse not Fannie Mae's profits" (Pickle and Gradison 1992).

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Figure 1 How Fannie Mae and Freddie Mac Work

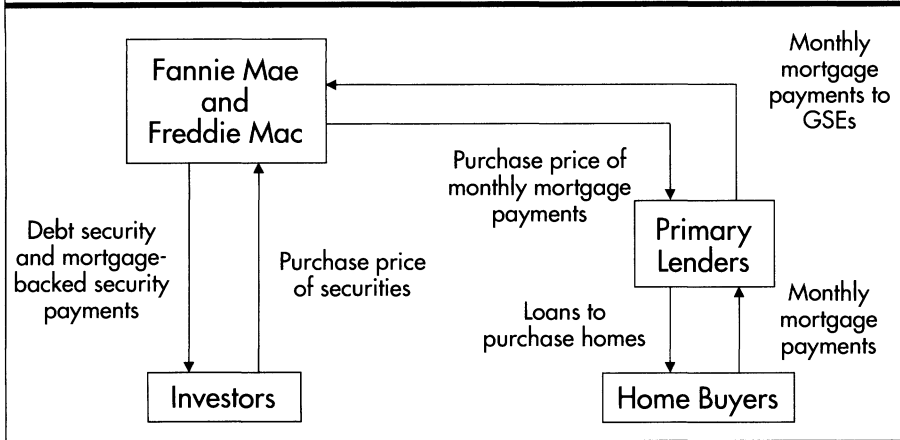


Figure 2 Alignment of Interests

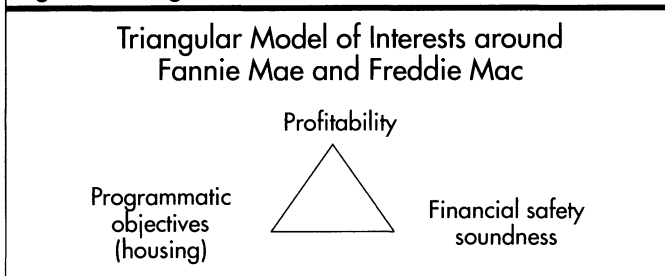


Figure 3 New Regulatory Structure for Fannie Mae and Freddie Mac

