Government Influence and the Failure of Fannie Mae and Freddie Mac

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Abstract
In 2008 two government-sponsored enterprises, Fannie Mae and Freddie Mac, were placed into conservatorship due to insolvency. The financial bailout of the two publicly traded corporations came at the expense of the American tax payer. This study investigates the relationship between direct and indirect government influence and the increasing risk taking of Fannie Mae and Freddie Mac from the late 1990's through their conservatorship in 2008. As government-sponsored enterprises Fannie Mae and Freddie Mac have many special advantages that other publicly traded companies did not possess. These advantages allowed Fannie Mae and Freddie Mac to increase their profitability. Theoretical literature regarding Congress and the bureaucracy suggests that the actions of bureaucrats can be linked to the preferences of Congressional members because bureaucrats are responsive to potential threats or perceived threats from the legislature. This theory is applicable to Fannie Mae and Freddie Mac, and is used to explain why the government was able to directly and indirectly influence the government-sponsored enterprises. Overall this investigation has determined that the United States government pursued a clear mission that determined to increase the availability of housing to all Americans, specifically to low-income and under-served individuals, through the use of the government-sponsored enterprises. Despite this link there is no conclusive data to show that the pursuit of this housing mission led Fannie Mae and Freddie Mac to operate in riskier business segments. This study has also found that motivation regarding profit-seeking and compensation structure provide a more plausible explanation for why the government-sponsored enterprises began to engage in riskier business practices that led to their insolvency.

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Key words: Fannie Mae, Freddie Mac, housing finance, financial crisis, government intervention. The imposition of federal conservatorships on September 6, 2008, at the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation—commonly known as Fannie Mae and Freddie Mac—was one of the most dramatic events of the financial crisis. These two government-sponsored enterprises play a central role in the U.S. housing finance system, and at the start of their conservatorships held or guaranteed about $5.2 trillion of home mortgage debt.