

FREEMarket

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IT'S THE 1930s ALL OVER AGAIN

Llewellyn H. Rockwell, Jr.

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The world went bonkers for about ten years way back when. The stock market crashed in 1929, and with it fell the last remnants of the old liberal ideology that government should leave society and economy alone to flourish. After the Great Depression hit, there was a general air in the United States and Europe that freedom hadn't worked well. What we needed were strong leaders to manage and plan economies and societies.

And how they were worshiped—disgustingly so! There were Stalin and Hitler and Mussolini, but in the United States we weren't in very good shape either. Here we had FDR, who imagined himself capable of astonishing feats of price settings and economy boosting. Of course he used old-fashioned tricks: printing money and threatening people with guns. It was nothing but the old despotism brought back in pseudo-scientific guise. Things didn't really return to normal until after the war.

It's strange to go back and read opinion pieces from the times. It's as if everyone just assumed that we had to have either fascism or socialism, and that the one option that was ruled out was *laissez-faire*. People like Mises and Hayek had to fight tooth and nail to get a hearing. The Americans had some journalists who seemed to understand but they were few and far between.

So what was the excuse for such a shabby period in ideological history? Why did the world go crazy? It was the Great Depression, or so says the usual explanation. People were suffering and looking for answers. They turned to a Strongman to bail them out. There was a fashion for scientific planning, and the suffering economy (all caused by the government, by the way) seemed to bolster the rationale.

All of which brings me to a strange observation: when it comes to politics, we aren't that much better off today. It's true that we don't have people running for office in ridiculous military garb. They don't scream at us or give sappy fireside chats or purport to be the embodiment of the social mind.

But have you listened carefully to what the Democrats are proposing in the lead-up to the presidential election? It's just about as disgusting as anything heard in the ➞

1930s: endless government programs to solve all human ills. It's as if they can't think any other way, as if their whole worldview would collapse if they took notice of the fact that government can't do anything right.

But it also seems as though they are living on another planet. The stock market has a long way to fall before it reaches anything we could call low. Mortgage interest rates are creeping along at the lowest possible rates. Unemployment is close to 4 percent, which is lower than even Keynesians of old could imagine in their wildest dreams.

The private sector is creating a miracle a day, even as the stuff that government attempts is failing left and right. The bureaucracies are as wasteful and useless as they've ever been, spending is already insanely high, debt is skyrocketing, and there's no way that any American believes himself to be under-taxed.

The Democrats, meanwhile, go about their merry business as if the public schools were a model for all services in society. Oh, and let us not forget their brilliant idea of shutting down the industrial economy in order that government can plan the weather 100 years from now. We can only hope that there are enough serious people left to put a stop to this harebrained idea.

But before we get carried away talking about the Democrats, let's say a few words about the blood-thirsty Republicans, who think of war as not something to regret but rather the very moral life of the nation. For them, justice equals

Guantanamo Bay, and public policy means a new war every month. Sure, they pay lip service to free enterprise, but it's just a slogan to them, unleashed whenever they fear that they are losing support among the bourgeois merchant class.

So there we have it. Our times are good, and yet we face a choice between two forms of central planning. They are varieties of socialism and fascism, but not overtly: they disguise their ideological convictions so that we won't recognize that they and their ilk have certain predecessors in the history of political economy.

You see, the American economy may look good on the surface, but underneath the foundation is cracking. The debt is unsustainable. Savings are nearly nonexistent. Money supply creation is getting scary. The paper money economy can't last and last. One senses that the slightest change could bring about massive wreckage.

What would happen to us should the bottom fall out? Scary thought. We need ever more public spokesmen for our cause. In many ways, the Mises Institute bears a heavy burden as the world's leading voice for economic liberty. But we are working in every way possible to do what we can to make sure that the flame of liberty is not extinguished, even in the face of legions of charlatans and power-mongers. Even though the politics of our times are as dark as ever, there are many bright lights on the horizon. ■

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THE MENACE OF FANNIE MAE

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The shortcomings of Fannie Mae have been overlooked on the basis that Fannie plays a critical role in driving the housing sector, and thus the American economy. As Fannie goes, so goes the nation. Fannie means housing, and accordingly, Fannie is the conduit that takes one from “inequitable ownership” to the American Dream. For example, in 2001, Fannie Mae introduced its American Dream Commitment (ADC)—a promise to increase home ownership rates through minority ownership initiatives, to keep families from losing their homes, and to support housing for the chronically homeless.

In a nation where equality is everything, and where advantage need not be earned, but only redistributed, how can anything be more virtuous?

Fannie Mae (FNMA or Federal National Mortgage Association), a government-sponsored enterprise (GSE), finances one of every five home loans in the United States. In 1938 this GSE was founded by the federal government with a mission to increase home ownership across the United States. It is subject to congressional oversight via the Office of Federal Housing Enterprise Oversight (OFHEO). Fannie Mae stock (FNM) is actively traded on the New York Stock Exchange and is part of the Standard & Poor's 500 Composite Stock Price Index.

Fannie Mae may be one of the most ill-fated welfare creations, ever, on the part of the United States government. In the beginning, Fannie Mae's impact was negligible; however, from the outset

there were plans to swell Fannie's waistline by expanding her purchasing authority. At about the time the American soldiers were coming home from World War II, Fannie was enabled to purchase loans guaranteed by the Veterans Administration, in addition to the Federal Housing Administration-insured mortgages it was already purchasing. This creation and expansion of a secondary market for mortgages was a vital boost to the supply of lendable money in the United States.

The notion of a “right” to home ownership by means of government subsidies is so firmly entrenched in the American mindset that Fannie could only grow—and grow she did. In 1968, as a part of Lyndon Johnson's societal engineering agenda, Fannie was converted into a semi-private corporation and the ability to guarantee government-issued mortgages was switched from Fannie to the government's newest creation, Ginnie Mae (Government National Mortgage Association). This meant that Fannie would begin to operate with private capital on a self-sustaining basis. Fannie was growing up, and she was going on to bigger and better things.

In 1970, Richard Nixon authorized Fannie Mae to purchase conventional mortgages, launching a national secondary market for home mortgages. As Fannie's foray into the conventional mortgage market surged upward, in the 1980s it began to purchase second mortgages and adjustable-rate mortgages. It also commenced its mortgage-backed securities scheme.

Fannie Mae advertises itself as “a shareholder-owned company with a public purpose.” True to its words, in January of 2000 Fannie introduced its “Mortgage Consumer Bill of Rights” program. This rundown of entitlements promised the consumer the “right” to access credit and the “right” to qualify for the lowest-cost mortgage possible. No *de facto* private corporation can or will guarantee any consumers’ rights whatsoever—that is, unless it has the authority of government behind it to bolster its business model and guarantee its guarantees.

Between Fannie Mae and its “little brother” Freddie Mac (another GSE), you have the largest source of cash for home buying in the United States. They accounted for almost 50 percent of all mortgage bonds sold through April of 2007, according to *Insider Mortgage Finance*. Since the beginning of 2006, over 50 mortgage companies have discontinued operations, claimed bankruptcy, or are seeking a buyer. Yet Fannie Mae continues to flourish. Since the end of March 2007, Fannie Mae’s stock price has increased by almost 20 percent whereas the S&P 500 Index has risen only 8.1 percent.

Remember that corporations are generally *chartered by states*, and Fannie Mae was a New Deal innovation—created by and for the federal government. The sole purpose of this federally chartered, quasi-private entity was to intervene in the housing market while avoiding a more conspicuous regulatory apparatus governed by rules, thus allowing the government to advance and steer its progressive entitlement programs while in a semi-mute mode.

Fannie is a very willing lender with the power of prominence behind it. Its GSE status allows it to get away with not maintaining the necessary underlying capital, and enables Fannie to borrow on more favorable terms than its state-chartered competitors. It is also exempt from paying state or local income taxes and from filing with the Securities and Exchange Commission (SEC).

The perversion here is that the rating agencies, and the financial markets overall, have interpreted the GSE status to mean that there is an implied government backing, and thus their securities have been priced accordingly.

In 2004, Fannie was caught cooking the books. The Office of Federal Housing Enterprise Oversight alleged widespread accounting errors at Fannie Mae. James Lockhart, Director of the OFHEO, commented that “The image of Fannie Mae as one of the lowest-risk and ‘best in class’ institutions was a facade. Our examination found an environment where the ends justified the means. Senior management manipulated accounting, reaped maximum, undeserved bonuses, and prevented the rest of the world from knowing.”

The latest tally will have Fannie Mae restating its earnings to the tune of \$11 billion. Flagrant accounting errors go back to at least the 1990s, when the company was improperly deferring expenses in order to boost reported net income as it paid out huge bonuses to top executives.

Upon being hit by the scandal in 2004, Fannie Mae stopped filing its financial statements with the SEC. It is interesting to note that past and present board members of Fannie Mae—some of whom are appointed by the president—have been highly representative of the Beltway elite: a former Reagan chief of staff, lobbyists, a former aide to Nixon, a Reagan Secretary of Labor, a US trade representative, and a top economic advisor to President Bush. The company plans to hold its shareholder meeting in December of this year, for the first time in three years.

So here we have a company surrounded with much misconception in the financial markets and accused of deceit by its own government overseers. It has chunked away nearly 40 percent of its profits via restatements of its fraudulent financial statements for recent years.

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News from the Institute

Mises University

The Mises University this year was a vibrant occasion of intense learning, and also fun. It was the 21st year of this intensive course that has taught economics to so many. Nothing on a conventional campus anywhere in the world compares. It is not only a source of encouragement and enlightenment for the students. For our staff and faculty, it provides a huge boost. There is nothing quite like observing the education of a new generation in the ideas of the Austrian School. It's a reminder that all our efforts are not in vain. Thank you for all that you have done to support this cause. ■

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25th Anniversary Celebration

We surely hope to see you in New York in October (12–13) for our 25th anniversary celebration. We'll hear some amazing talks, meet fascinating people, enjoy some great music, toast the appearance of the wonderful biography of Mises, and generally celebrate all that the Mises Institute does. Please join us! For more information see mises.org/events. ■



Scholars Conference

The Austrian Scholars Conference, March 13–15, 2008, is accepting papers submissions. There are several themes this year: the lost literature of the Austrian School, the Continental tradition of thoughts, questions about intellectual property, and global warming and the environment. Austrians have unique contributions to make in all these areas, and 2008 is the year to add your voice. To suggest papers and sessions, write Joseph Salerno at jsale@earthlink.net. ■

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Certainly, then, we can predict the collapse of this mortgage giant due to (1) a lack of audited financials and thus no conveyance of reliable information to the public, (2) an accounting scandal that produced achievements which the OFHEO described as “illusions deliberately and systematically created by the Enterprise’s senior management with the aid of inappropriate accounting and improper earnings management,” and (3) a collapsing business model in light of a bursting housing bubble, along with an imploding sub-prime mortgage market.

Wait. Not so fast.

Instead we witness a publicly traded company with four high-profile attributes:

1. Fannie Mae’s financial condition serves as a proxy for Congress’s oversight;
2. Fannie Mae’s “health” serves as a proxy for the health of the housing market;
3. Fannie Mae’s stock price has an influence on one of the world’s most closely watched stock market indexes;
4. Leading up to the 2004 presidential election, President Bush had an aggressive housing agenda to “dismantle the barriers to home

ownership” with Fannie Mae playing a significant role in “financing” this agenda—and perhaps garnering more than a few votes for Bush and those congressmen who hung on to the coattails of this agenda.

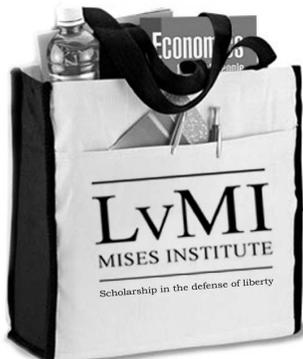
With mortgage defaults on the rise, a financial meltdown at Fannie Mae would certainly demonstrate that foreign policy wasn’t President Bush’s only major weakness, and it could prove embarrassing for members of Congress aspiring to move into the White House.

Considering the four aforementioned attributes, and the fact that this GSE is deeply mired in scandal, Fannie Mae is no doubt being closely monitored by the Working Group on Financial Markets (a.k.a. the Plunge Protection Team—which reports directly to the president of the United States).

Fannie Mae is not a free-market entity, nor is it a private body that must compete on the same playing field as its competitors. Fannie Mae is representative of all that’s wrong with central planning institutions: it is a government-created conduit for carefully crafted financial and market socialism that the bureaucrats uphold for the purpose of propping up their fantasies for pandemic social engineering.

There’s nothing “American” about this dream. In the eyes of the Republic’s visionaries, this particular dream has turned into a nightmare. ■

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TEN GREAT ECONOMIC ERRORS
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- AUSTRIAN SCHOLARS CONFERENCE
March 13–15, 2008 • Auburn, Alabama
- MISES UNIVERSITY
July 27–August 2, 2008 • Auburn, Alabama



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