

Fannie Med? Another federal financial fraud on the public?

Written by Steven Horwitz

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Imagine an industry in which members of Congress and others believe that private markets can't supply the good at a price the public can afford. Imagine further that Congress believes that everyone has a "right" to this good. Imagine even further that the proposed remedy for this supposed "market failure" is to create a government program to supplement the private market and take care of those the market allegedly overlooks.

Of course, we don't have to imagine very hard, as this sounds much like the debate over the Obama administration's health-care program and its proposed government-run "public option" that would compete with private insurers. The argument made by Obama is that such a program would "force" private insurance companies to compete more intensely for underserved populations and also increase the quality of their service.

But wait. Haven't we heard the opening argument before? Indeed we have. It is taken from discussions over reform of a very different industry: housing. And the outcome of that debate in 1938 was Fannie Mae (Federal National Mortgage Association), followed 30 years later by Freddie Mac (Federal Home Loan Mortgage Corporation). These two "government-sponsored enterprises" (GSEs) were supposed to stabilize the housing market, yet we stand in the midst of a recession resulting from a housing bubble caused, to a significant degree, by Fannie and Freddie. Is this really a model we want to emulate for health-care reform?

Put aside for the moment whether the insurance companies are a significant cause of the problems with health care in the U.S., as opposed to being convenient scapegoats for decades of misguided government intervention in the industry. Instead, consider that an insurance GSE would exacerbate, rather than cure, the illnesses of the health-care industry, just as Fannie and Freddie did in the housing market.

Fannie Mae began as fully government-owned, as would the proposed insurance program. It later became privately owned (until the crisis last fall), but still had enormous government privileges and implicit taxpayer backing, as did Freddie Mac. The result was that both were responsible for driving up the cost of housing through their implicit subsidization of the housing market by buying up mortgages that others originated.

As they did so, it also increased the level of fraud and waste, as people trying to cash in on the housing bubble the GSEs, and the Fed, created began to say anything to get low down payment mortgages. This led to millions of Americans ending up in homes they couldn't afford and unsustainable financial "innovations" that cost us trillions of dollars, with the result that many people lost their homes. The GSEs created jobs for many in the financial and housing industry, but whether they really forwarded the goal of creating affordable housing for more Americans seems more than questionable after the last two years.

There is every reason to believe that creating a "Fannie Med" would have much the same effect

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on the health-care industry. A taxpayer-funded insurance program would only duplicate the waste, fraud, and bureaucracy of Medicare and Medicaid. Both programs have ended up costing billions more than anticipated, and Medicare is a major contributor to rising health-care costs through its various reimbursement processes. Of course, as Fannie Med attracted more people by underselling the private sector insurers, the bureaucracy, waste, fraud, abuse, and overall cost would multiply.

As those costs rose, the federal government would either ration care according to cost criteria (which the Obama plan already tacitly admits it will do), raise taxes substantially to cover that cost, or use inflation to do so if tax increases are too politically costly. Rationing by bureaucrats is an unpleasant option and so are tax increases that would destroy economic growth. Paying via inflation might well be the most likely outcome, but it would also be the most ironic as it would restart the very process that gave us the housing bubble and all of its human costs. Those costs would be even more intolerable if the service in question was health care.

In the current recession, the last thing we want to be doing is imitating the process that caused the housing boom and bust. Creating a Fannie Med might do just that, with the consequence that we will end up with no improvement in our health care, yet in need of it even more thanks to the resulting big kick in our economic fannies.

by Steven Horwitz

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