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Government-Sponsored Enterprises as Federal Instrumentalities: Reconciling Private Management with Public Accountability

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A category of organization referred to as the "government-sponsored enterprise" (GSE) poses a critical financial and accountability challenge to American political institutions. The largest and perhaps best known GSEs are the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). GSEs have a legal status that deliberately straddles the public and private sectors. Although privately owned for profit, GSEs can expose the U.S. Treasury--and taxpayers--to massive financial liability. Federal oversight of GSEs is fragmented and generally ineffective, thereby leaving the public's interests subordinated to private interests. The authors argue that the first step toward imposing appropriate financial and political accountability is to enact a generic GSE management law which defines the attributes of GSEs, prescribes reporting and examination requirements, and imposes restrictions on financial risk taking. A new federal agency would be responsible for GSE regulatory oversight. This article reviews the problem of GSE financial accountability, and it suggests a solution that can reassert the distinctive legal and administrative characteristics of the public and private sectors.

Political priorities of the moment too often move the federal government to establish entities whose structure and operations depart from important principles of public law and private management. Similar programs and institutions are dispersed widely across the government and even beyond the margins of government. They are accountable, if at all, to a variety of federal agencies and congressional committees. As a consequence, the federal government generally, and the President and central managerial agencies in particular, have seen an erosion of their capacity to supervise these critical activities.[1]

The line between what is "public" and what is "private" has become indistinct.[2] Some scholars and practitioners approve of this blurring of public and private sectors as innovative and inevitable,[3] while others fear that sector blurring violates sound constitutional principles and ultimately threatens the ability of elected and appointed officials to maintain an orderly and responsible democratic system of government.[4]

Harold Seidman correctly concludes that the United States has entered an era of "quasi government" where functions of a public character are increasingly assigned to entities whose legal status has been designed to be deliberately ambiguous.[5] Ambiguity of legal status, however, is not a prerequisite for innovative management. Quite the contrary, ambiguity of legal status is an invitation to mismanagement and the commingling of public and private interests, generally to the disadvantage of both parties.

Government-Sponsored Enterprises

Misunderstanding of the roles and responsibilities of the public and private sectors is especially pronounced for a category of organization known as the "government-sponsored enterprise." The term, government-sponsored enterprise (GSE), has been variously defined and interpreted. Some apply the term broadly to include any entity enjoying a "non-government status and exemption from most, but not all, laws and regulations applicable to federal agencies, officers and employees."[6]

Others apply the term more narrowly. The U.S. Office of Management of Budget (OMB) presently defines government-sponsored enterprise to designate those "financial intermediaries directing capital to particular sectors of the economy."[7] The authors of this paper propose a more focused definition: a government-sponsored enterprise is a privately owned, federally chartered financial institution with nationwide scope and limited lending powers that benefits from an implicit federal guarantee to enhance its ability to borrow money.[8]

GSEs are chartered by act of Congress to accomplish public purposes. However, they are privately owned and

therefore are not considered to be agencies of the United States. Currently, seven such enterprises exist: the banks of the Farm Credit System (FCS), the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal Home Loan Banks (FHLB), the Student Loan Marketing Association (Sallie Mae), the Financing Corporation (FICO) of the Federal Home Loan Bank System, and the Federal Agricultural Mortgage Corporation (Farmer Mac). Additional GSEs are being formed or are under consideration.[9]

Nothing is modest about the size and scope of these GSEs. Today, the federal government implicitly guarantees over $700 billion of enterprise obligations and mortgage-backed securities, and the value of these obligations and securities is growing rapidly. Government-sponsored enterprises have fascinated and frustrated students of public administration for some years. On the one hand, GSEs share attributes with public institutions: they are established by Congress; they issue debt obligations with most of the characteristics of federal Treasury securities; they are governed by boards that include some or all governmentally appointed directors; they have lines of credit to the federal Treasury; their obligations are implicitly guaranteed by the federal government, creating potentially open-ended claims on federal funds; they are considered instrumentalities of the federal government with charters that preempt some state laws and taxes; and, because of their federal instrumentality status, they probably cannot go bankrupt under the federal bankruptcy code.

On the other hand, GSEs also possess many of the characteristics of the private sector: they are privately owned; they sell stock to private persons and institutions; their employees are exempt from federal civil service laws; they are free to make a profit; and their operations do not depend upon regular federal appropriations.

Adding to the confusion, Congress has been inconsistent in creating GSEs. The enterprises differ, for example, in the extent they reflect cooperative principles (as with the borrower control of Farm Credit System institutions), and the extent they are profit-oriented and responsive to investor-shareholders (such as the stockholders of Fannie Mae). To take another variation, securities of the newest GSE, Farmer Mac, are subject to Securities and Exchange Commission registration requirements, while securities of the other enterprises are not.[10] Each GSE is governed by a board of directors. All of the boards have a majority of private sector members, except for Freddie Mac whose board consists of the three federal officials constituting the Federal Home Loan Bank Board.[11]

Some contend that the solution to the problem of scrambled public and private characteristics is to eliminate government-sponsored enterprises altogether. This was the view of the Reagan Administration, for example, which argued that federally supported borrowing by GSEs (and other federal credit programs) distorted the allocation of financial resources and discouraged borrowers without access to federal subsidies. Others disagree and argue that GSEs are a legitimate means of encouraging the flow of credit to favored groups--such as farmers, home buyers, students, and thrift institutions--considered not quite capable of competing with other borrowers to attract credit on appropriate terms. Whatever the merits of the debate, the federal government has increased rather than decreased the number of GSEs, and it created two new ones--the Financing Corporation of the Federal Home Loan Bank System (FICO) and Farmer Mac--in 1987.[12]

The conceptual issues posed by GSEs involve serious consequences for the federal government. If they are private, GSEs should not be controlled through direct federal management spelled out in general management laws and implemented by federal officials. Nor are traditional management tools relevant, such as statutory salary limits for executives or federal budget limitations and OMB controls. On the other hand, if GSEs have access to public funds through their ability to pledge the government's implicit guarantee to back virtually any obligations they decide to incur, then they must be regulated or supervised if the federal government is to protect itself from potentially unlimited financial exposure.

Concern over the creditworthiness of the GSEs is not misplaced. In 1988, for example, the federal government authorized $4 billion of financial assistance for one insolvent GSE, the Farm Credit System.[13] Earlier in the decade, the largest of the GSEs, Fannie Mae, was in serious trouble. Borrowing short-term money to fund its portfolio of long-term mortgages, Fannie Mae's capitalization dropped until the corporation had a negative market value net worth in 1981 of about $11 billion. Only a combination of energetic management strategies, declining interest rates, and federal support brought Fannie Mae back from the brink.[14]

What these recent episodes suggest is that there is as much need for regulation of GSEs to limit financial exposure to the U.S. Treasury as there is for effective regulation of financial institutions with federally insured deposits. Ultimately, bringing fiscal soundness to the federal government requires a good deal more than simply balancing the national budget between income and expenditures.

How Enterprises Work

Given the considerable confusion engendered by the mix of public and private attributes of each GSE, the federal government must resolve conceptual ambiguities before it can effectively supervise these enterprises. It turns out that all GSEs have a common fundamental structure despite their conspicuous differences in size, lending activities, and financial soundness.

The single most distinctive characteristic shared by all GSEs is the implicit federal government backing of their obligations and guarantees. This implicit backing allows an enterprise to borrow large amounts of money and issue large volumes of guaranteed securities at favorable rates. It also permits the enterprise to enter, and perhaps to dominate, credit markets that would not be as rewarding to

independent private companies unsupported by the implicit federal backing. The scope of each enterprise's statutorily permitted activities creates an artificial segment within the general market place; its low cost of funds may enable a GSE to displace independent competitors in that market segment.

The direct obligations and some other securities issued by GSEs clearly state that they are not guaranteed by the United States, or by any agency or instrumentality of the United States other than the enterprise itself.[15] The Fannie Mae legislative charter, for example, provides that: "The corporation shall insert appropriate language in all of its obligations...clearly indicating that such obligations, together with the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the corporation."[16]

Despite such plain language, the financial markets perceive that the special relationship between the enterprises and the federal government is much closer than indicated by this disclaimer. The market believes that the obligations of the GSEs "presumably have *de facto* backing from the federal government."[17] Indeed, the disclaimer itself hints at a special federal relationship; completely private firms do not need to disclaim federal backing because no one believes such backing exists. The perceived relationship permits GSEs to sell their debt obligations and guaranteed securities at more favorable rates than can commercial companies without the perceived federal backing.

While the statutory characteristics vary somewhat among the enterprises, GSE securities benefit from many of the favorable attributes that are conferred by the federal government upon U.S. Treasury securities. Securities of most enterprises are exempt from registration by the Securities and Exchange Commission, their obligations are eligible to be purchased and held without limitation by national banks and other supervised institutions; their obligations are lawful investments for federal fiduciary, trust, and public funds (e.g., pension funds); their obligations can be issued and paid through the Federal Reserve System; their obligations are eligible collateral for Federal Reserve advances and discounts and are eligible to be bought and sold in Federal Reserve open-market transactions; and, for most GSEs, their obligations are exempt from state and local taxation.

Many of these benefits, such as favorable investment status for purchase by trust funds, banks, and thrifts, significantly expand the market for GSE securities. Moreover, the federal government makes a strong statement to investors by conferring upon these securities the same preferred investment status as U.S. Treasury obligations. The exemption from the usual Securities and Exchange Commission (SEC) registration laws removes investor protections considered necessary for all but the most secure federally-backed securities. Similarly, the exemption from investment restrictions on banks and thrift institutions is otherwise limited to federally-backed securities. Investors perceive that the federal government would not permit these exemptions from basic investor protection unless the securities were extremely safe.

Over time, the market can become even more confident about the government's likelihood of backing obligations of government-sponsored enterprises. As the value of outstanding GSE obligations increases so does the inability of the federal government to intimate that it would not stand behind this debt. The Comptroller of the Currency defended the federal protection of creditors of the Continental Illinois Bank by noting that, because of their size alone, the federal government simply cannot permit the failure of any of the nation's largest money-center banks.[18] This logic applies with even more force to government-sponsored enterprises; Fannie Mae, the Federal Home Loan Banks, and the Farm Credit System are significantly larger than many money-center banks.

Government-sponsored enterprises have another important common characteristic; by law they are confined to a narrow range of lending activities. Unlike completely private financial institutions that can grow by diversifying into a wide range of credit markets, GSEs are restricted to specific kinds of borrowers and often to particular kinds of loans. Fannie Mae and Freddie Mac are limited to providing a secondary market for residential mortgage loans below a specified size, currently $187,600. Farm Credit System institutions and the new Federal Agricultural Mortgage Corporation (Farmer Mac) are limited to specified kinds of agricultural lending; the Federal Home Loan Banks are limited to providing credit to thrift institutions; the Financing Corporation (FICO) is limited to purchasing FSLIC securities; and Sallie Mae is largely limited to education-related lending.

Because of their low borrowing costs and the benefits of their national charters, GSEs can grow quite rapidly. In 1987, Fannie Mae's lending expanded by $47 billion, to a total $243 billion by the end of the year. Sallie Mae, one of the smaller enterprises, grew 25 percent in size in 1987, from $18.2 billion to $22.9 billion in assets. Altogether, enterprise securities outstanding, including debt and mortgage-backed securities, rose from $9 billion in 1967 to $96 billion in 1977, to $661 billion in 1987. Outstanding GSE securities are increasing by an estimated $70 billion to $100 billion per year. Because of their access to inexpensive federally-supported credit, GSEs tend to grow quickly to dominate their statutorily permitted markets.

GSEs as Instrumentalities

The federal government's control over an institution differs significantly depending on whether that institution is an agency or instrumentality. The government manages an agency directly through the federal management hierarchy. As a general rule, an agency is subject to federal appointment of its senior officers, to civil service and federal procurement laws, and to the federal budget and other direct federal management controls. By contrast, an instrumentality is a privately owned institution that is supervised but not directly managed by the government.

What, precisely, are GSEs, and how do they relate to the larger organization of the executive branch? The answer to this question is that a GSE, as previously noted,

is an "instrumentality" of the United States, not an "agency." This distinction is critical and provides the basis for developing a regulatory structure for GSEs.

Under law, an "executive agency means an executive department, a government corporation, and an independent establishment."[19] As such it is the organizational term with the most encompassing definition. Conceptually, an entity is either an agency of the United States, or it is something else. For an entity properly to be considered an agency of the United States, it must have been created pursuant to law, be considered an arm of the sovereign power with authority to act with the force of law, and be subject to all the laws applying to "agencies" except where exempted in a general managerial statute or in its enabling statute. Once again, statutory variations exist designating institutions to be agencies for purposes of some laws but not others.

The concept of an "instrumentality," by contrast, generally lacks definition in federal statute, but it has content nonetheless. An instrumentality is a privately-owned institution that may be supervised but is not directly managed by the federal government. The federal government uses an instrumentality to carry out governmental purposes in addition to usual private purposes such as profit making for its private owners.

An instrumentality benefits from federal law that preempts state laws and taxes to the extent Congress prescribes. Unlike an agency, an instrumentality does not act with the power of the state. Rather, it is a private institution with authority to perform specified functions (e.g., providing credit to a designated economic sector) that are considered to embody public purposes. Significantly, a GSE typically is governed by a board of directors with a legal and fiduciary responsibility to the private stockholders and not to the federal government.

This clear distinction between "agency" and "instrumentality" is crucial although frequently violated in practice. The blurring of the proper boundaries between the public and private sectors arises from a variety of causes. Proponents of legislation establishing an instrumentality, for instance, may seek provisions providing some of the benefits of agency status, such as an exemption from antitrust laws. Conversely, Congress may seek to confer some of the benefits of instrumentality status upon executive agencies, such as exemptions from civil service personnel and salary restrictions.

The authors maintain that GSEs are a distinct kind of instrumentality amenable to a generic law governing important aspects of their organization, attributes, authority, and finances relating to the government's contingent liability from GSE operations.

Generic Laws as Tools of Administration

The underlying premise of this analysis is that in a democratic polity, all organizations assigned public benefits and public purposes by law should be accountable for their performance to elected leaders. Ideally, lines of accountability should be direct and unambiguous. Accountability of agencies of the United States is generally enforced by direct management command. For instrumentalities, however, accountability is indirect, and it is generally achieved through external regulation rather than direct federal management.

Whether the performance of a public function be by agency or instrumentality, public accountability is best promoted through a generic law. Today the federal code contains between 100 and 150 generic management laws depending on the definition employed. Many laws, such as the Anti-Deficiency Act or the Prompt Payment Act, fall within the responsibility of OMB.[20] Other agencies are also responsible for implementing generic management laws; for example, the U.S. Office of Personnel Management (OPM) administers the civil service laws, the U.S. General Services Administration (GSA) implements some federal procurement laws, and the U.S. Department of Labor administers the Federal Employee Compensation Act. The generic management laws, taken together, provide a framework within which Presidents can, if so disposed, shape the direction of management of the federal government, and--often to a lesser extent, depending on the relevant law--the direction of the "quasi government."

The President and Congress share responsibilities for overseeing the management of the Government and its agencies and instrumentalities. Management is more than simple control; it is also capacity building. Management laws, interpreted and administered with care, should permit the agency or instrumentality to perform its public responsibilities more effectively, not just more economically. Generic laws, properly written, provide a means to implement a comprehensive managerial strategy. In 1945, for example, Congress and the President enacted the Government Corporation Control Act to address the problem of managing the proliferation of government corporations resulting from the Depression and World War Two.[21] This important act reflected a theory of what a government corporation ought to be legally, structurally, and financially.[22] The act provided a framework for federal management, thereby focusing the oversight process on the need for questions whether a particular government corporation needed exemptions from general coverage because of special circumstances.

By framing the important issues in advance, a generic management law can greatly improve the quality of political discourse concerning federal supervision and oversight. Without a generic law, each institution and set of circumstances tends to be addressed on an ad hoc basis. In the absence of a framework of principles, a regulator or supervisor finds it difficult to impose accountability, especially if opposed by parties interested in lax oversight. A generic management law can help to shift the political debate to questions about whether exceptions to general rules are warranted. In a debate over exceptions, the advantage tends to shift to the agencies and the oversight committees in Congress which are most concerned with overall government management and away from more particular interest group constituencies.

The authors here contend that a generic law is especially important to promote accountability by instrumentali-

ties that are free from direct federal management controls. While a generic law is not a guaranteed means of assuring accountability, it is superior to efforts at imposing accountability through ad hoc legislation.

National Banks as Precedent

Hundreds of failed thrift institutions today testify that the mere fact of a generic law by itself cannot protect the government against mismanagement and financial exposure. The substance of that generic law is also essential. By contrast to the unfortunate Federal Home Loan Bank Board--statutorily required to promote the thrift institutions that it is supposed to regulate--the regulation of national banks provides a more promising precedent.

National banks are a major category of federal instrumentality. They are governed under a generic law known as the National Bank Act.[23] Under that act, the Office of the Comptroller of the Currency (OCC) in the Department of the Treasury charters national banks and supervises their financial safety and soundness. The experience of this regulator under the generic law provides a valuable model for regulating GSEs.

National banks and GSEs share important characteristics. Both are chartered by the federal government. Their federal enabling legislation preempts some state taxes and a number of state laws. Banks are expressly ineligible and GSEs are probably ineligible for bankruptcy under the federal bankruptcy code. Finally, and perhaps most importantly, the implicit federal guarantee of GSE borrowing resembles federal deposit insurance that permits national banks to obtain low-cost funds from depositors. As with the virtually unlimited federal risk exposure from the implicit guarantee of enterprise borrowing, the federal government also faces a multi-billion dollar financial exposure from its informal guarantee of the federal deposit insurance funds.

Both GSEs and national banks share common characteristics with the earliest federally chartered financial institution, the first Bank of the United States. That bank was authorized to serve the entire nation and to make virtually all kinds of loans.[24] Government-sponsored enterprises feature the former characteristic (nationwide scope) and national banks the latter (virtually unrestricted kinds of loans). Because of these common characteristics, GSEs and national banks share a common body of federal case law, descending from the earliest cases involving the first and second Banks of the United States.[25]

One major difference remains between the national banks and government-sponsored enterprises; the former are regulated under the authority of a generic law while the latter are not.

A Generic Law for Government-Sponsored Enterprises

The authors propose passage of a "Government-Sponsored Enterprises Financial Accountability Act" combining conceptual elements of the National Banking Act and the Government Corporation Control Act to provide the necessary guidelines for the organization and financial oversight of GSEs. This legislation would establish common financial controls and structural elements applicable to each GSE, and it would create the statutory framework for uniform federal supervision of enterprise safety and soundness.

This law would include a number of provisions designed to improve the accountability of GSEs to federal officials responsible for supervising enterprise safety and soundness. This accountability is important to help limit the government's financial exposure for GSE obligations. The law would structure each enterprise within an essentially uniform financial framework designed to protect against excessive federal risk exposure.

Second, the law would build upon lessons learned from the regulation of national banks (and from mistakes in the federal regulation of thrift institutions), and it would establish a central regulator to examine, supervise, and enforce requirements relating to financial safety and soundness. Third, because the GSEs differ significantly among themselves in the types of benefits they are designed to provide, and in recognition of the system of congressional committees with a stake in overseeing all federal credit programs within their political jurisdictions, the allocation of the benefits of GSE lending activities would not be covered by the generic law and would instead be left to congressional oversight and supervision.[26] Finally, the law would remove administrative anomalies, such as control of Freddie Mac by a board of directors consisting of federal officials and its other federal agency characteristics, and it would specify that GSEs are instrumentalities, not agencies of the United States.

Office of Comptroller of Government Enterprises

Today, where GSEs are regulated, the regulators generally lack sufficient resources to supervise the finances of these multi-billion dollar institutions; a GSE regulator such as the U.S. Department of Housing and Urban Development is neither oriented to nor staffed for proper supervision of the safety and soundness of a huge financial institution such as Fannie Mae. Also, their regulatory mandate is vague, and this has led several regulators to slight safety and soundness in favor of other policy goals. This state of affairs is inadequate to protect the federal government and taxpayers from undue financial exposure. The proposed GSE Financial Accountability Act would address these problems by providing that GSEs be supervised in a manner similar to current federal oversight of national banks.

One important feature of enterprise regulation would be the delegation to a single administrative agency headed by a single administrator the authority to regulate, examine, and enforce compliance through appropriate measures to assure safety and soundness. The GSE regulator might be, and should be, located within the Treasury Department because of that Department's expertise in financial mat-

ters; it is within the Treasury Department that the regulator of the national banks, the Comptroller of the Currency, is housed.[27]

Operating in much the same manner as the Office of the Comptroller of the Currency (OCC), the centralized GSE regulator might be called the Office of the Comptroller of Government Enterprises (OCGE). It would develop long-term expertise in assessing and regulating the financial soundness of GSEs. Especially important, the OCGE could apply lessons learned from supervising one GSE to another and, in so doing, could provide guidance to Congress about structuring proposed new enterprises. Statutorily, each GSE would no longer be treated *sui generis*. Indiscriminate blurring of public and private characteristics would be discouraged if not prevented. Recognition that GSEs can be supervised as a category of organization rather than attempting to develop regulatory structure and processes for GSEs individually is the necessary first step toward public accountability in this crucial field of public policy.

A Theory of Enterprise Safety and Soundness

Because the federal government's guarantee removes much of the usual market discipline, effective government regulation is essential to help contain enterprise risk taking and to help assure its long-term viability.[28]

Regulation is not an assured solution for problems caused when the government's implicit guarantee distorts normal market incentives. Failure of the Continental Illinois Bank provides a recent example of the fact that regulation is not complete protection against risk exposure of the federal government. Nevertheless, absent untried substitutes such as risk-related federal insurance premiums, a strong case exists for regulation of GSEs as a partial substitute for insufficient market discipline.

What are the elements of effective GSE regulation? To begin with, it is essential that the regulatory agency be capable of overseeing safety and soundness and that the regulator not have conflicting motivations that could impede effective regulation to this end. Given a capable and properly motivated regulator, the form of safety and soundness regulation follows logically from the federal government's role as implicit guarantor. Efficient government regulation should resemble the measures adopted by a private guarantor imposing controls on a firm whose obligations it guarantees or by a private lender overseeing the credit worthiness of a borrower.[29]

Reporting and Examining Risk Exposure

Effective federal supervision of GSE safety and soundness should include prompt and accurate financial reporting by each GSE, periodic detailed financial examination by the regulatory agency and a variety of statutory limitations and regulatory controls on financial risk-taking.

Each enterprise should be required to provide an annual report of condition to the OCGE, much as is provided by national banks to the Comptroller of the Currency. Such reports should include assessment of the risks, e.g., credit risk, interest rate risk, and business risk, relating to purchased loans as well as GSE contingent liabilities.

GSE reports should be supplemented by periodic examination of enterprise operations by the OCGE. Examination permits the regulator to investigate the policies and procedures used by the enterprises to assure financial soundness. Examination can address management practices relating to asset quality, interest rate exposure, management information and control, and other aspects of enterprise risk taking. Examination should be conducted within a framework of OCGE regulations and policy statements defining some of the important standards of safety and soundness to be met by each GSE. In addition, examiners would be empowered to monitor and require correction of any other GSE activities and conditions involving unnecessary risk exposure.

Statutory and Regulatory Controls on GSE Risk Taking

The 1980s have provided the federal government with significant lessons on the need for effective control on financial risk taking by federal instrumentalities. The most important lessons can be summarized as follows. First, institutions must maintain sufficient capital so that the private owners have their own money at stake and are not merely taking risks at the taxpayers' expense. Capital requirements should be imposed on a risk related basis; as an institution increases its credit risks or interest-rate risks or operating risks, the private owners should meet increasingly higher capital requirements. These capital-adequacy requirements must apply to financial activities whether or not they appear on the institution's balance sheet. For a GSE, for example, risk-based capital requirements would attach to the volume of business and risks involved in issuing its guaranteed mortgage-backed securities as well as holding loans in its portfolio.

Second, if net worth drops below prescribed standards, the OCGE should be empowered to impose appropriate controls on the institution's activities. An array of regulatory prior approval requirements, adapted from the Fannie Mae charter act, could be used for this purpose. These controls would include the authority to deny payments of dividends to shareholders, to prohibit growth of lines of business that the regulator considers risky, and to require reduced risk from ongoing activities. If net worth declined below a specified level, the regulator could also be empowered to remove directors and officers of the GSE, as the OCC is currently authorized to do with respect to national banks.

The regulator would also have the other enforcement powers available to the OCC, such as authority to issue cease and desist orders, and authority to impose civil penalties on enterprises and their directors and management.[30] Finally, the regulator would be empowered to appoint a conservator or receiver for a financially troubled enterprise under authority patterned on the authority of the OCC to deal with troubled national banks.

Directors of Government-Sponsored Enterprises

Although GSEs are instrumentalities of the United States, they are privately owned and therefore require a board of directors accountable to their private owners. From the time of the second Bank of the United States, however, the federal government has appointed some members to the boards of a variety of instrumentalities.

When the government appoints directors of a private company, this can engender considerable confusion as to their proper role and legal obligations. Even when the President appoints such government directors, they are not considered to be officers of the United States.[31] Should they represent the views of the Administration that appointed them, the "public interest," even if in conflict with Administration policy, or the financial interests of the corporation and its private owners?[32]

On balance, the legal and political ambiguity inherent in the role of a governmentally appointed member of a board of a privately-owned corporation makes such an appointment of dubious value. Indeed, such appointees may give the impression of governmental participation and approval of corporate decisions that is unlikely to be the case in fact.[33] "Of all the means available to exert government influence and safeguard the public interest," Harold Seidman observes, "presidential appointment of directors is probably the least effective."[34]

The GSE Financial Accountability Act proposed here would provide that all GSE directors be elected by the shareholders. The Comptroller of Government Enterprises would be empowered to remove those GSE directors under statutory authority similar to that available to the Comptroller of the Currency.

Additional OCGE Authorities

As privately-owned instrumentalities, GSEs are entitled to create subsidiaries, to merge all or part of their organization with another organization, and to dissolve their corporation unless prohibited from doing so by their enabling legislation. The Comptroller of Government Enterprises should develop rules and regulations governing such actions by GSEs to insure that the federal government's financial interests are protected in such cases.

The GSE Financial Accountability Act, again taking its cue from the Fannie Mae charter, should provide the OCGE with general regulatory authority. The Fannie Mae legislation provides that the regulator, the U.S. Department of Housing and Urban Development (HUD), "shall have general regulatory power over the Federal National Mortgage Association and shall make such rules and regulations as shall be necessary and proper to assure that the purposes of this title are accomplished."[35]

This general regulatory authority is important to empower the regulator to fill in gaps in the otherwise sparse language characteristic of most federal charters. It is also important, along with the other regulatory powers, to enable the regulator to exert subtle leverage on GSEs (which may be very large financial institutions), without having to rely upon more draconian measures that could disrupt the financial markets. Such leverage is important in the relationship of federal regulators to national banks, and the similarities here appear persuasive.[36]

No doubt a fine line exists between too little and too much federal regulatory intervention in the activities of GSEs. The GSE Financial Accountability Act should include legislative guidance clarifying that the OCGE should not become involved in day-to-day managerial or operational decisions of a GSE except as these relate to the institution's safety and soundness and its compliance with the law. As a GSE drops in net worth or increases risk exposure, the degree of OCGE involvement in GSE management decisions would increase. Again, the relationship between the Comptroller of the Currency to the national banks provides an appropriate legislative and practical model.

Conclusion

Government-sponsored enterprises have become not only a financial challenge to political leaders but also a management and accountability challenge. Today, they function in the twilight zone between the public and private sectors with little systematic oversight by either the executive or the legislative branches. Efforts to impose upon GSEs the appropriate degree of accountability to federal agencies and to Congress have so far failed, partly because there is no generally accepted theory of how best to regulate these federal instrumentalities to promote the public interest.

The President must be considered at least partially responsible for the policies and operations of GSEs. While GSEs may not have their financial dealings directly reflected in the budget, the contingent liabilities incurred by these instrumentalities cannot help but influence the health of the economy generally and, as in the case of the recent bailout of the Farm Credit System, sometimes directly affect the federal budget itself. Yet the President and the executive branch have little legal authority or institutional capacity to affect the policies of GSEs. The authors contend that the first step toward resolving this discrepancy between political responsibility and institutional capacity is to enact a generic law providing for comprehensive regulation of GSEs and clarifying their status as instrumentalities rather than agencies of the United States.

The premier tool for managing the public sector and the "quasi government" is public law. Depending on its content, public law can help to solve or exacerbate a problem. The proposed GSE Financial Accountability Act would rest on basic principles of constitutional and public management theory. The distinctive legal character of the public and private sectors would be maintained and protected. The relationship and responsibilities of the two sectors would be spelled out with as much precision as possible, and provisions would be applied as a generic law to the various GSEs.

Generic laws are not appropriate for all public management problems. They are most effective when a specific management problem cuts across a number of agencies or instrumentalities. The choice is either to approach each agency or instrumentality on an individual basis, inserting in the enabling legislation the desired language, or to write a general set of rules and assign their implementation to a central management agency. This latter approach is favored when the regulation is based on common principles that can be implemented without detracting from the intended, unique qualities of each regulated instrumentality. The regulation of financial soundness of GSEs meets this test.

The Government-Sponsored Enterprises Financial Accountability Act, properly drafted, would serve several critical public purposes. First, it would provide for a degree of regulatory accountability by GSEs in their practices that result in federal financial exposure. Second, it would recognize and define the role of federal instrumentalities as agents to carry out statutorily defined public purposes. And third, it would provide for the President and the designated federal regulatory agency the legal authority and institutional capacity to help assure that the privately-owned GSEs are regulated in a manner consistent with public administration principles and sound financial management practices.

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Notes

1. Ronald C. Moe, "Liabilities of the Quasi Government," *Government Executive,* vol. 20 (November 1988), pp. 47-50.
2. Lloyd Musolf and Harold Seidman, "The Blurred Lines of Public Administration," *Public Administration Review,* vol. 40 (March/April 1980), pp. 124-130.
3. See, for example: Barry Bozeman, *All Organizations Are Public: Bridging Public and Private Organizational Theories* (San Francisco: Jossey-Bass Publications, 1987). Mark A. Emmert and Michael M. Crow, "Public, Private and Hybrid Organizations: An Empirical Examination of the Role of Publicness," *Administration and Society,* vol. 20 (August 1988), pp. 216-244.
4. See, for example: Ronald C. Moe, "Exploring the Limits of Privatization," *Public Administration Review,* vol. 47 (November/December 1987), pp. 453-460. Harold J. Sullivan, "Privatization of Public Services: A Growing Threat to Constitutional Rights," *Public Administration Review,* vol. 47 (November/December 1987), pp. 461-467.
5. Harold Seidman, "The Quasi World of the Federal Government," *The Brookings Review,* vol. 6 (Summer 1988), pp. 23-27.
6. Ibid., p. 25.
7. U.S. Office of Management and Budget, *Special Analyses: Budget of the United States Government, Fiscal Year 1990* (Washington: U.S. Government Printing Office, 1988), p. F-21.
8. Thomas H. Stanton, *Government Sponsored Enterprises: Their Benefits and Costs as Instruments of Federal Policy* (Washington: Association of Reserve City Bankers, 1988), p. iv. This definition excludes a variety of institutions that share some characteristics with GSEs. For example, the College Construction Loan Insurance Corporation (Connie Lee) is not a GSE because it is partly government owned; the Farm Credit System Financial Assistance Corporation is not a GSE because its securities are expressly, and not merely implicitly, guaranteed by the federal government.
9. For example, in 1986 the House of Representatives passed legislation to create a new GSE called the Corporation for Small Business Investment (COSBI) to fund small business investment companies. See Thomas H. Stanton, "Pending Legislation Would End Impasse Over SBA Program," *Legal Times* (October 6, 1986), p. 24. On February 6, 1989, the Bush Administration proposed creating a new GSE, the Resolution Funding Corporation, to provide an off-budget conduit for funding the insolvent Federal Savings and Loan Insurance Corporation.
10. Compare 12 U.S.C. 2279aa-12(a) of the Farmer Mac charter act with 20 U.S.C. 1087-2(d) of the Sallie Mae charter act, for example.
11. 12 U.S.C. 1452 specifies that Freddie Mac's Board of Directors consist of the three members of the Federal Home Loan Bank Board. The three members of the Bank Board are the Chairman and two members, each appointed by the President and confirmed by the Senate. 5 U.S.C. App. 1, Reorg. Plan No. 3 of 1947, Sec. 2 Conceptually and legally, this direct federal control probably makes Freddie Mac an agency of the United States, not an instrumentality. The Freddie Mac charter also includes other characteristics that are normally associated with agency status such as the provision that "the corporation shall be entitled to all immunities and priorities...to which it would be entitled if it were the United States or if it were an unincorporated agency of the United States." Yet, other provisions of the charter legislation exempt the enterprise from civil service and procurement and other requirements normally applicable to an agency.
12. For an informed discussion of the role of both "market failure theory" (private sector) and "non-market failure theory" (public sector) as catalysts to public policy decisions, consult Charles Wolf, Jr., *Markets or Governments: Choosing Between Imperfect Alternatives* (Cambridge: MIT Press, 1988).
13. U.S. Office of Management and Budget, *Special Analyses: 1990,* pp. F-23 to F-26.
14. See, e.g., U.S. Department of Housing and Urban Development, "1986 Report to Congress on the Federal National Mortgage Association" (Washington: U.S. Government Printing Office, 1987), pp. 87-112.
15. By contrast, the federal government expressly pledges its full faith and credit to back securities guaranteed by the Government National Mortgage Association (Ginnie Mae). 12 U.S.C. 1721(g)(1). Ginnie Mae is a wholly-owned government corporation within the Department of Housing and Urban Development and thus is an agency rather than an instrumentality of the United States.
16. 12 U.S.C. 1719(b).
17. Marcia Stigum, *The Money Market,* rev. ed. (Homewood, IL: Dow Jones-Irwin, 1983), p. 212.

18. Irvine H. Sprague, *Bailout: An Insider's Account of Bank Failures and Rescues* (New York: Basic Books, 1986), p. 259.
19. 5 U.S.C. 105.
20. For an overview of the generic management laws administered by the U.S. Office of Management and Budget, consult U.S., Congress, Senate, Committee on Governmental Affairs, Office of Management and Budget: Evolving Roles and Future Issues. Prepared by the Congressional Research Service, S. Print 99-134. 99th Cong., 2d sess. (Washington: U.S. Government Printing Office, 1986), pp. 395-675.
21. 31 U.S.C. 9101-9.
22. Sidney D. Goldberg and Harold Seidman, *The Government Corporation: Elements of a Model Charter* (Chicago: Public Administration Service, 1953). National Academy of Public Administration, *Report on Government Corporations*, 2 vols. (Washington: National Academy of Public Administration, 1981).
23. 12 U.S.C. 1 et seq.
24. "An Act to incorporate subscribers to the Bank of the United States," approved February 25, 1791, 1 Statutes at large, 191. See also Bray Hammond, *Banks and Politics* (Princeton: Princeton University Press, 1957).
25. The case law for both kinds of institutions stems from two major U.S. Supreme Court decisions: *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819) and *Osborn* v. *Bank of the United States*, 22 U.S. (9 Wheat.) 738 (1824).
26. Issues involving the allocation of benefits appear to be difficult for GSE regulators to handle. In one well publicized instance, the Secretary of the Department of Housing and Urban Development tried but failed to intervene in Fannie Mae lending policies and decisions. The Secretary wanted to alter Fannie Mae's policies so as to increase its lending to central city and low-income home buyers. See U.S. Department of Housing and Urban Development, "1986 Report to Congress on the Federal National Mortgage Association," pp. 162-166.

    With respect to the scope of GSE lending authority, the financial regulator proposed here should be limited to assuring that the enterprise complies with the laws and does not engage in ultra vires acts.
27. Note that it would not be appropriate to centralize financial regulation of GSEs within the U.S. Office of Management and Budget because OMB's authority relates to federal management and the federal budget rather than oversight of privately-owned, off-budget institutions such as government-sponsored enterprises.
28. Extensive literature exists on this point concerning a variety of financial institutions with borrowing implicitly backed by the federal government. See Mark J. Flannery, "Deposit Insurance Creates a Need for Bank Regulation," *Business Review* (Federal Reserve Bank of Philadelphia, January/February 1982), pp. 17-27. Fischer Black, Merton H. Miller, and Richard Posner, "An Approach to the Regulation of Bank Holding Companies," *Journal of Business*, vol. 51 (1978), pp. 379-412. Sherman J. Maisel, ed., *Risk and Capital Adequacy in Commercial Banks* (Chicago: University of Chicago Press, 1981), chapter 6.
29. Black, Miller, and Posner, "An Approach to the Regulation of Bank Holding Companies," p. 382.
30. See 12 U.S.C. 1818(e). This section provides a variety of grounds for the regulator to remove directors and officers of a national bank.
31. See memorandum of U.S. Attorney General Robert Kennedy, "Memorandum Re Constitutionality of Senate Confirmation of Persons Nominated by the President as Incorporators and Directors of the Communications Satellite Corporation," *Congressional Record*, vol. 109, pt. 5 (88th Cong., 1st sess., 1963), pp. 6977-6978.
32. A study of an instance when Congress provided for governmental directors on the board of a private corporation, the Communications Satellite Corporation, led Herman Schwartz to conclude:

    > Both the practicalities of life and the lessons of history lead to the conclusion that the appointment of government directors to a private board cannot protect the public interest against private abuse. Moreover, such directors may even be instruments of harm to other aspects of the public interest. Their presence may reinforce the belief that the Government assures the profitability of the corporation....

    Herman Schwartz, "Governmentally Appointed Directors in a Private Corporation: The Communications Satellite Act of 1962," *Harvard Law Review*, vol. 79 (December 1965), p. 363.
33. GSEs may actually work to increase the identification of their public directors with the interests of the stockholders rather than the public. Fannie Mae, for intance, has a generous stock plan available for presidentially appointed directors. The plan provides, simply described, for $30,000 in stock to be given to "non-employee members" of the Board over a five-year period. The intent of this generosity is to "reinforce the mutuality of interest between such directors and the company's stockholders." Fannie Mae, "Proxy Statement Dated March 27, 1987," Appendix C, page C-1. As reported in Stanton, *Government Sponsored Enterprises*, p. 26.
34. Harold Seidman, *Politics, Position and Power*, 3d rev. ed. (New York: Oxford University Press, 1980), p. 293.
35. 12 U.S.C. 1723(h).
36. Carter H. Golembe and David S. Holland, *Federal Regulation of Banking* (Washington: Colembe Associates, Inc., 1986), pp. 231-232.