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Former CEA Chair N. Gregory Mankiw (2003 - 2005)

Looking back at my experience as CEA chair, I am struck by the broad range of questions the Council had to confront. Should corporate dividends be taxed at the same rate as ordinary income? What effect does Chinese exchange-rate policy have on the American economy? How should accountants treat executive stock options when computing a company's earnings? Why aren't U.S. utilities building new nuclear power plants? How should "means" be defined when means-testing a Medicare entitlement? What is the best way for policymakers to help speed the nascent recovery from the dot-com collapse?

For a professional economist, working at CEA is both demanding and exhilarating. Confronting such a large range of issues is inevitably a learning experience—and one done in short order and with high stakes. It is a great honor to play a small part in trying to steer public policy in a better direction and thereby improve the lives of our fellow citizens.

With the benefit of hindsight, one issue from my time at CEA is particularly notable: the oversight of Fannie Mae and Freddie Mac. CEA was part of a White House team that tried to reform these government-sponsored enterprises. We recognized that the GSEs were problematic. Their private goal of profit maximization did not mesh well with the implicit government guarantee of their debts.

In a speech I gave in November 2003 to a conference of bank supervisors, I described the situation as follows: "The enormous size of the mortgage-backed securities market means that any problems at the GSEs matter for the financial system as a whole. This risk is a systemic issue also because the debt obligations of the housing GSEs are widely held by other financial institutions. The importance of GSE debt in the portfolios of other financial entities means that even a small mistake in GSE risk management could have ripple effects throughout the financial system."

The administration sought legislation that would create and empower a more effective regulator. The regulator would have the authority to set both risk-based and minimum capital standards for GSEs; to review and, if appropriate, reject new GSE activities; and to wind down the affairs of a troubled GSE through receivership. We also wanted to make the GSEs less political. We recommended removing presidentially appointed directors from their boards and giving the regulator a permanent funding mechanism by allowing it to assess the GSEs rather than relying on the congressional appropriations process.

In the end, the administration failed in this effort, at least while I was there. Legislation to improve the oversight of Fannie and Freddie was enacted only in July 2008, well after the imbalances that led to the 2007-08 financial crisis had built up, making the problems apparent to everyone. In 2003 and 2004, with financial markets still placid, Fannie and Freddie had lots of friends in Congress (on both sides of the aisle) who blocked the White House's reform efforts. But we fought the good fight. And subsequent history shows, I believe, that we were on the right side of the issue.

Did CEA at the time foresee the housing boom and bust that unfolded over the next six years? No, of course not. But we did recognize the vulnerabilities of the GSEs, which were major players in the huge market for mortgage-backed securities. Would the proposed reforms have prevented the financial crisis? No, probably not. But they might have made it less severe and more manageable.

People often ask me whether it is frustrating to work in Washington, noting how hard it is to get anything done. Yes, in some ways, it is. This episode is only one example where our good policy (as my White House colleagues and I saw it) was subverted by an uncooperative legislature.

Yet, over time, I have come to appreciate that frustration for those in policy jobs is not a bug in the system but rather a feature. The founding fathers, in their great wisdom, built this tension into the system. In high school civics classes, it goes by the name “checks and balances.”

A common lament is that there is too much gridlock in Washington, and maybe there is. But imagine that your least favorite candidate wins the next presidential election. Might you be grateful when the new President and his or her CEA chair become frustrated while trying to implement their new ideas for economic policy?