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Implications of the New Fannie Mae and Freddie Mac Risk-based Capital Standard

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The paper concludes that the probability of default by the GSEs is extremely small. Given this, the expected monetary costs of exposure to GSE insolvency are relatively small — even given very large levels of outstanding GSE debt and even assuming that the government would bear the cost of all GSE debt in the case of insolvency. For example, if the probability of the stress test conditions occurring is less than one in 500,000, and if the GSEs hold sufficient capital to withstand the stress test, the implication is that the expected cost to the government of providing an explicit government guarantee on \$1 trillion in GSE debt is less than \$2 million. To be sure, it is difficult to analyze extremely low-probability events, such as the one embodied in the stress test. Even if the analysis is off by an order of magnitude, however, the expected cost to the government is still very modest.